360° Business Model Innovation

Towards an Integrated View of Business Model Innovation

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bios below

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Overview: Business model innovation has arguably become a critical way to innovate, but its success factors are poorly understood. A lack of tools allowing the examination of business models in their entirety combined with the complex relationship between business model changes and market outcomes makes this especially difficult. This article introduces a comprehensive framework that addresses these two issues, by providing an integrated, value-based view of all of the critical components of the business model. Comparing this framework with Osterwalder's Business Model Canvas highlights its benefits in considering business model innovation. Finally, the framework is applied to two well-known cases—Netflix and Spotify—to demonstrate how the tool can be used to highlight the critical differences in business models that may at first seem very similar and show how the framework enables managers to envisage the dynamics of business model innovation.

Keywords: Business model innovation; Value-based perspective; Value capture; Netflix; Spotify

Long gone are the days when breakthrough technological innovation was considered the primary driver of competitiveness. Increasingly, innovative business models—the mechanisms for capturing value from technological innovation—are allowing less technologically advanced firms to displace powerful incumbents. In particular, increasing digitization across many industries has rendered old pricing and revenue models obsolete and demanded entirely new ways of capturing value. As a result, even the most traditional industries have experienced disruption as a result of business model innovation.

While it only seemed logical that industries relying heavily on digital technologies (such as the telecom, video game, music, and movie industries) would be highly disrupted and struggle to find a new sustainable business model, many were surprised to see traditional industries, such as hotels or taxis, radically reshuffled by the advent of new business models. In most cases, these disruptive business model innovations did not come from companies already operating in the market, but from outsiders, such as Apple (music), Netflix (movies), Rovio (video games), Airbnb (hotels), and Uber (taxis). The prevalence of these kinds of disruptions have convinced most companies of the need for business model innovation, not only to stay ahead of existing competitors but also to anticipate the emergence of new ones.

However, this kind of business model innovation, necessary as it is to maintain competitive advantage, remains difficult in practice. Many companies simply do not know where to start. The complexity of business model innovation is exacerbated by a lack of common language—there are many representations of what a business model actually is, each with its own elements and definitions—and a lack of universally applicable tools. Widely adopted frameworks, such as Osterwalder and Pigneur's Business Model Canvas, while generally adequate to represent potential business models, may not be the best tool to support business model innovation.

We seek to address this gap by presenting a 360° business model framework, one that represents all aspects of a business model from a value perspective. Such a framework can offer a comprehensive view that can help direct attention to where business model innovation might have the most impact. In conjunction with other well-known tools, it can also help direct the execution of business model innovation.

Business Model or Business Models?

Given the increasing interest in business model innovation, it is not surprising that the concept has become ubiquitous over the past decade. It is used by both academics and practitioners, and it would be hard to find a startup that has not made a "revolutionary" (or "disruptive") business model the crux of its elevator pitch. However, in spite of the growing consensus around the critical importance of understanding business models and business model innovation, there is little agreement about what a business model actually is, or how it might be innovated (Baden-Fuller and Haefliger 2013).

A number of frameworks and tools are available, each relying on its own underlying notion of what a business model is. Osterwalder's Business Model Canvas (Osterwalder and Pigneur 2010) has been widely adopted by practitioners, who value its clear and

concise presentation. Osterwalder's Canvas consists of 9 key elements that address the value proposition as well as the activities and relationships required to support it. These elements are presented in a single-page graphical format, which makes it easy to survey and practical to complete. However, although the Canvas is a good general-purpose tool for describing business models, it does not address some key drivers of business model innovation associated with value creation, capture, and delivery.

Academic researchers, on the other hand, face a more complex landscape. Partly because each study has a different focus, researchers often consider only some aspects of business models (typically value creation and value capture), while leaving out others that are not relevant to their work but are nonetheless essential. There is also a lack of consensus in academic literature around the primary components of a business model; for instance, in some studies, value networks are considered a primary component of the business model alongside value creation and value capture (Koen, Bertels and Elsum 2011), while others regard them as a part of value creation (Abdelkafi, Makhotin, and Posselt 2013). Finally, there is occasionally some confusion over some of the components; for instance, as discussed in Makadok and Coff (2002), the term "value creation" is sometimes used to describe aspects of business models that are in fact related to value capture, such as the revenue models.

The lack of consensus around the specific components constituting a business model, and the consequent lack of a precise representation of an archetypal business model, underlays a lack of common understanding of what business model innovation precisely is (Teece 2010). This gap is widened by the complex nature of business models and business model innovation, and their interaction with markets. Sometimes, a small change in a particular business model component can create competitive advantage and positive market outcomes, or lead to failure. Elsewhere, a combination of barely perceptible changes across the business model will make a company stand out from the competition.

This complexity gives urgency to the need for a framework that encompasses all the components of a business model and gives a comprehensive view of the possible business model innovations and their likely outcomes. Such a 360° view is intended to provide an effective tool to reflect upon, plan, and implement business model innovation.

Towards a 360° Business Model Framework

Although there is little consensus on the various elements that constitute a business model, some key components are mentioned more often than not:

- Value creation,
- Value proposition,
- Value capture,
- Value delivery, and
- Value communication.

Value creation—the mechanism by which goods and services acquire value that can then be captured and shared—is one of the most important elements of a business model (Zott and Amit 2002; Chesbrough 2007; Abdelkafi, Makhotin, and Posselt 2013). Value creation derives from core competencies, key resources, governance, complementary assets, and value networks. Firms create value by combining core competencies with key resources (preferably in new ways). Governance—how resources and competencies are managed—can also greatly affect value creation (for instance, by improving productivity). Complementary assets, such as complementary products and services, business alliances and partnerships, customer base and reputation, are critical elements in the success of a firm, as Teece (1986) notes; the lack of such assets has led to the failure of many firms, despite technological advantages. Consequently, complementary assets are a critical driver of value creation. Value networks, which consist of upstream (suppliers) and downstream (distributors, end users) relationships, are just as critical and arguably increasingly so. In recent years, firms have turned to co-creation and crowdsourcing to widen their value networks; collaborative arrangements and engagement with customers can increase access to complementary assets.

The **value proposition**—the mechanism through which the value created is offered to the market—is another central element of the business model (Chesbrough 2010; Teece 2010, 2011). The value proposition specifies what is offered (the product or service) and at what price (the pricing model). It must be both sustainable for the firm and suitable to the market. Business model innovation often proceeds through changes in the value proposition, for instance by introducing a "freemium" pricing model or moving from product to service offerings through servitization.

Value delivery describes how the value created is delivered to customers (target market segments) through distribution channels (Osterwalder, Pigneur, and Tucci 2005; Abdelkafi, Makhotin, and Posselt 2013; Holm, Günzel, and Ulhøi 2013). These elements offer ample opportunity for business model innovation, by addressing the needs of a neglected market segment (for instance, low-cost airlines that target budget travelers) or by introducing a new way to deliver products or services (for instance, moving to Internet delivery or 3D printing).

Value capture refers to the ability of a firm to benefit from the value created (Chesbrough 2007; Holm, Günzel, and Ulhøi 2013). Thus, it includes the revenue model used to generate cash flow as well as the cost structure. Value capture also includes profit allocation across the value chain. Profit allocation has become increasingly important as firms seldom produce value on their own, but rather rely on co-innovation and other mechanisms to increase their reach and gain access to complementary assets and competencies. Value capture is also a key vector of business model innovation. In fact, at times, changing markets force firms to innovate in this area of the business model, as in newspaper publishing, where the balance between subscriptions and advertising revenues is evolving. Innovation may also allow a firm to gain market leadership through cost restructuring, as in the case of low-cost airlines. As Apple has demonstrated with its 30/70 revenue split on iTunes and the App Store, profit allocation can be a very effective area for lucrative business model innovation. Of course, Apple's story also illustrates how fleeting such gains can be. When Apple first offered artists and developers 70

percent of revenues, that cut was significantly higher than what other online platforms offered, and it powered a rapid adoption of the iOS platforms. However, as the revenues Apple takes in from app sales have grown, this revenue split has been heavily criticized, and Apple's 30 percent cut is now often referred to as the "Apple tax" (Bradshaw and Bond 2015).

Value communication—how companies communicate with customers and partners about their products and the value they create (Bieger and Reinhold 2011; Abdelkafi, Makhotin, and Posselt 2013)—is the last key component of an effective business model. Value communication comprises both the story the firm tells and the ethos it communicates as well as the communication channels used to tell that story. Beyond simply describing the products and services they offer, ethos and story enable companies to set themselves apart from the competition and encourage customers to build an emotional identification with the company. Communication channels are constantly evolving, most recently with the increased importance of social media—itself an innovation—in communicating a company's values and offerings.

These five elements together provide a solid basis for a comprehensive business model framework (Figure 1). Unlike other available tools, this framework presents all the value aspects related to business models (creation, proposition, delivery, capture, and communication), as well as their subcomponents, thereby enabling an exhaustive overview of various the levers of business model innovation. This is particularly important because disruption sometimes emerges from changes to just one subcomponent of the business model. For instance, online platforms for taxi booking have long existed. What made Uber disruptive is that it changed value networks so that anyone, and not just professional taxi drivers, could respond to a customer's need.

---Figure 1 near here---

While this framework is, to our knowledge, the first to offer an integrated view of all the value-based components of a business models, other tools also provide an integrated view of business models, although from different perspectives. This is the case, for instance, with Osterwalder's Business Model Canvas, which is stakeholder focused—intended to define who does what in a given business model. That focus makes it valuable for designing and building business models, as the required actions become intuitively clear. However, it does not focus on value explicitly, and therefore leaves out some of the elements of value that may be critical levers of business model innovation. For instance, changes in governance can be key levers of business model innovation (as demonstrated by the success of Starbucks—one of the key aspect of its business model innovation was to treat employees like partners and not just labor force), and digitization often implies reconfigurations in the value chain that require rethinking profit allocation, but neither of these elements are mentioned in the Canvas. Thus, the 360º framework offers an important complement to existing tools.

The focus on value makes the 360º Business Model Framework a robust tool for visualizing business model innovation and for distinguishing the role of the various elements of a business model in creating and capturing value. Its comprehensiveness

allows distinction between very small elements of the business model, so that apparently similar business model innovations can be identified and analyzed. Two case studies—Spotify and Netflix—help illustrate this use.

Case Study: Spotify vs. Netflix

Spotify and Netflix, both of which have emerged as media powerhouses in the last decade, seem at first glance to have very similar business models. Both offer, for a flat monthly fee, unlimited consumption of streamed content (music in the case of Spotify, films and television shows in the case of Netflix). Both offer several pricing tiers, and both have disrupted well-established market structures. Spotify and Netflix appear so similar in fact, that both are generally cited (together or interchangeably) as epitomes of the streaming business model (Keating 2012; Anastasia et al. 2014; Mulligan 2015; Westbrooks 2015).

However, analyzing the two business models using the 360º Framework reveals a very different picture. Spotify's business model innovation modified individual subelements of value creation (complementary assets), value proposition (the pricing model), value delivery (distribution channels), and value capture (the revenue model) to create a service that disrupted the market in spite of the existence of successful predecessors (Figure 2). Netflix's business model, on the other hand, modified nearly all of the elements of value creation and value proposition, as well as single elements of value delivery (distribution channels) and value capture (the revenue model) in creating its DVD-by-mail and later its streaming video services (Figure 3).

---Figure 2 near here---

---Figure 3 near here---

It is striking how few components of the industry standard business model Spotify changed. Although very few consumers had experienced music streaming before Spotify launched in 2008, similar services with comparable business models had existed since at least the early 2000s (Rayna 2006). The very first such service, Rhapsody, was launched in late 2001, followed by a newly legitimized Napster in 2003. Both had the same features that Spotify adopted seven years later: a flat monthly fee for unlimited access to streamed music, personalized playlists, and tailored recommendation engines. Indeed, at the time of Spotify's launch, Rhapsody's catalogue was far wider than Spotify's, powered by distribution agreements with all five major music labels.

But Rhapsody and Spotify's other forerunners lacked a critical complementary asset: ubiquitous consumer access to smartphones and other mobile Internet-enabled devices. To take their music on the go, Rhapsody's customers had to use a specially equipped audio player that was compatible with Rhapsody's digital rights management technology. The choice of such players was abysmally small and, of course, did not include the iPod, the audio player of choice for 80 percent of consumers at the time (Rayna 2006). When Rhapsody reverse-engineered Apple's DRM system in order to make its music available on iPod, Apple reacted by releasing new firmware that blocked Rhapsody music on iPod.

Spotify, by contrast, launched at the very moment when that critical complementary asset became available. By that time the Apple iPhone and countless Android smartphones were available, and both mobile operating systems had become open platforms. Spotify's customers had only to download an app to have access to their music wherever they went. Developing apps for iOS and then Android gave Spotify instant access to this new mobile distribution channel.

Spotify's only other business model innovation was the creation of a free pricing tier that offered users the option to listen to advertisements in place of paying subscription fees, creating a new revenue model previous entrants had not accessed. However, this element was not entirely new; it had been used by television streaming services since the early 2000s and Last.fm, the Internet streaming radio service, had introduced a similar model just months before Spotify's launch.

Thus, the novel aspects of Spotify's business model relate, on the one hand, to complementary assets (mobile phones and Internet-enabled mobile devices, as well as their operating systems) and distribution channels (mobile Internet networks), and on the other hand to pricing models (introduction of a free tier) and revenue models (use of advertising to fund the free tier).

Netflix, which launched in 1997 as a traditional pay-per-rental DVD rental service that offered delivery by mail, became truly disruptive only when it innovated the business model more thoroughly. In 1999, the company switched to a subscription model, in which customers paid a monthly fee for "all you can watch" mail-order DVD rentals. This model, which innovated both on distribution channels (mail delivery) and pricing model (monthly fees versus per-DVD fixed-period fees plus late fees collected when customers failed to return DVDs within the rental period) was highly disruptive, displacing the leading video rental chains (most notably Blockbuster). The company's next innovation was the launch of a subscription-based streaming service in early 2007. Interestingly, this move was disruptive not only for Netflix's competitors, but also for the company's own business model—Netflix itself predicted that streaming would eventually displace DVD rentals altogether. Netflix was the first company to launch such a service, making it an innovator in terms of product offering and service offering, as well as pricing model and distribution channel.

However, Netflix's business model innovation reaches beyond these pricing and channel elements. A critical aspect of the company's business model relates to its very effective recommendation system, which offers suggestions for what users may enjoy based on their past consumption.[1] While recommendation systems were not intrinsically new—nearly all online music vendors had one—Netflix was the first to use one for films and television shows. Beyond that, Netflix invested far more than previous companies had in developing its recommendation system as an asset, creating a highly powerful data mining system that, rather than relying only on a customer's past consumption to create recommendations, would also cross-reference usage patterns across all users to offer unique recommendations. The company even launched an open competition in 2006, the Netflix Prize, offering a prize of $1 million to anyone who could improve the results of the algorithm by more than 10 percent.[2] With this recommendation system, Netflix

improved both the value proposition (as the recommendation system is a service bundled with Netflix's subscription offer) and value creation—its core competencies (the algorithm), key resources (the data collected) and value networks (ratings supplied by users).

The recommendation engine eventually provided the data to power Netflix's most recent business model innovation: the creation of original content to be distributed exclusively through the company's streaming channel. Analytics using data provided by the recommendation algorithm ensured the success of this latest venture by enabling the company to tailor scenarios and scripts to match the interests and desires of the potential audience.

Netflix's focus on its recommendation system has enabled the company to develop essential core competencies, such as a very fine understanding of consumption patterns and success factors for film and television, that the company has put to good use in driving further business model innovations, most notably its foray into original content. Netflix has also developed key resources, such as the recommendation algorithm itself and its vast database of user consumption patterns and user tagging, commenting, and review behaviors. In fact, this database constitutes one of the company's most valued assets; even if competitors were to gain access to the algorithm itself (or develop one just as accurate), their recommendations would not be as effective because they would not have access to the vast pool of data Netflix has collected. Furthermore, Netflix has developed innovative ways to expand its value networks, through customer ratings and crowdsourcing (primarily in the form of the Netflix Prize).

Netflix completely redefined the value proposition for the industry, offering unlimited access rather than disk-by-disk rentals. The addition of original content represented a new product offering, and the recommendation engine is a new service offering for this market. The flat "all-you-can-watch" monthly fee was also a significant departure from the usual pay-per-view or pay-per-rental structures that prevailed at the time.

Netflix's success has also been driven by its access to complementary assets that provide alternative distribution channels, such as mobile devices, game consoles, and connected TVs. Finally, Netflix has innovated in terms of value capture, by diversifying its revenue model. Unlike Spotify (and many others), Netflix has found a new revenue channel that does not rely on advertisements—the company generates revenues by selling its most successful original content to television broadcasters worldwide (Anastasia et al. 2014).

Although Spotify and Netflix are generally seen as interchangeable examples of the streaming business model, it is striking how much more innovative Netflix's business model is than Spotify's. Whereas Spotify's business model innovation mainly relies on significant changes to a handful of subcomponents (four overall), Netflix's ongoing business model innovation has entailed changes in many more subcomponents (nine overall), leading to two of the five top-level components (value creation and value proposition) being completely redefined (Table 1). Thus, the 360º Framework shows that Spotify's business model innovation is fairly incremental (few components changed to a

limited extent), while Netflix has innovated more radically, with more components changed and to a greater extent.

---Table 1 near here---

As noted in Keeley et al. (2013), businesses that innovate by changing more dimensions of their business models tend to be more disruptive in the long run. Our comparison of Spotify and Netflix via the 360º Framework supports this assertion. While Spotify was undoubtedly disruptive at its launch, maintaining its competitive advantage is likely to require further innovation. As a matter of fact, the company has not sustained its early success, as competitors, notably Napster and Rhapsody, have rapidly copied its business model innovations and new competitors have entered the market. Two recent entrants, Apple and Amazon, represent a serious threat to Spotify because, besides their financial firepower, both companies have, like Netflix, invested significantly in developing very effective recommendation systems that they can deploy rapidly to support their music offerings. Indeed, both companies already have tremendous amounts of music-related consumer data to work with, Amazon from customer purchase data and Apple through its Genius feature, which generates playlists based on consumers' playing habits, as well as from consumers' purchases, feedback, and ratings.

Netflix's position, by contrast appears safer (at least for now), supported by its extensive (and continuing) business model innovations. Competitors have entered the market, but many of them still rely on the old, advertising-driven television business model. For instance, on Hulu, ads interrupt viewing every 20 minutes, even for paying subscribers; content is highlighted mainly as a result of editorial and business choices rather than via a strong recommendation algorithm. More serious contenders, such as Amazon, which has recently begun offering original content in addition to its Prime Video service, may present a stiffer challenge, but Netflix's core competencies, key resources, and value networks continue to provide a valuable competitive advantage.

Netflix's business model innovation may well become even more disruptive in coming years. The company's recent forays into content production and distribution, the ubiquity of mobile networks, and the growing obsolescence of curated content offerings (like the line-ups offered by traditional television channels) may well lead to the birth of an entirely new industry, led by streaming giants like Amazon and Netflix, that offer consumers the content they want when and where they want it. As history has shown, Netflix has never been afraid to make dramatic changes to its business model and introduce new ones, even when that meant cannibalizing its current offering.

Conclusion

Business model innovation has arguably become the critical way to innovate, sometimes even trumping technological innovation as a key source of competitive advantage. Yet, until now, business model innovation and its success factors have remained poorly understood, with the available tools not providing the level of detail and systematic understanding required to execute business model innovation. Our 360º Business Model Framework offers a detailed view of a business model, with a clear focus on all of the value dimensions that make up the foundation of every business model. Further, by

highlighting where, exactly, a business model is innovative, the framework can help illuminate the long-term competitiveness of the innovation.

The 360º Framework does have some limits. In particular, while all of the value-based components (and subcomponents) of business model innovation are captured by the framework, the tool does not allow for components to be weighted for their likely disruptiveness. Weighting of particular components is likely to vary from industry to industry and from firm to firm—for some markets and firms, value creation innovations will be more important; in others, value capture or value proposition innovations will lead to more significant competitive advantage. This means, of course, that while the framework is useful for identifying possible paths of business model innovation, the actual choice of a particular path will require a deeper analysis.

Understanding business models and business model innovation has become increasingly important for companies' success, and even sometimes for their survival. The 360º Business Model Framework provides practitioners with a useful tool for reflecting on and implementing business model innovation.

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Notes

1. Very effective, indeed. According to Netflix, 75 percent of viewer activity is driven by recommendation (Vanderbilt 2013).

2. See http://www.netflixprize.com/. The competition ran until 2010, when it was discontinued because of privacy concerns.

Table 1.—Comparison of business model innovation components—Spotify vs. Netflix

	Spotify	**Netflix**
Value creation		
Core competencies	—	Data mining, content production
Key resources	—	User data, original content
Complementary assets	Mobile Internet access	Internet-enabled PCs and devices
Value networks	—	Users, crowd
Value proposition		
Product offering	—	Video streaming, original content
Service offering	—	Recommendations
Pricing model	Free tier	"All you can watch"
Value delivery		
Distribution channels	Mobile Internet	Internet, mobile Internet, alternate devices (game consoles, television)
Value capture		
Revenue model	Advertisement	Subscription, content syndication

Note: Only components changed by one or both companies are shown.

Figure captions

Figure 1.—360° Business Model Framework

Figure 2.—Components affected by Spotify's business model innovation

Figure 3.—Components affected by Netflix's business model innovation