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Agile Business Model Innovation

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By Adam J. Bock and Gerry George

Business model innovation (BMI) is risky, but when companies do it with agility, they thrive. This article looks at how Return Path, the global leader in email marketing, met the challenge of applying BMI successfully. The authors interviewed up to 700 CEOs to better understand BMI drivers.

Business model innovators have emerged as high growth firms in the most competitive markets.¹ While technological innovations fuel new customer applications, innovative business models are the engines of industry evolution. But business model innovation (BMI) is risky. After leading the revolution to digital music distribution, Apple went on to disrupt the mobile phone and portable computing industries while Napster was effectively sued out of existence.

Business model innovators do far more than adjust strategic positioning; they exploit non-intuitive entrepreneurial opportunities that become obvious only in hindsight. BMI is a leap of faith based on limited, unknowable information. Firms that bet on BMI must be flexible enough to adapt as information changes. Successfully balancing BMI with agility can launch the firm to industry dominance. Return Path, the global leader in email marketing, is an excellent example of agile, radical business model innovation. Return Path has captured 70% of the global email whitelist market, and is the recognized leader in email deliverability. Agile business model innovators like Return Path meet the challenge of implementing BMI in turbulent, unpredictable global industries.

Business Model Innovation is Different and Risky

Business model innovation is the development of novel configurations of resources and transactions to create new markets or serve markets in new ways.² Unlike product and process innovation, business model innovation must be both opportunity-centric and disruptive. BMI requires a fundamental change in how the firm generates and captures value to reconfigure industries.^{3,4}

Studies of business model innovators show that outperforming firms emphasize business model innovation at twice the rate of underperformers.⁵ Success derives in part from truly novel approaches to value creation and implementation of drastic changes in organizational processes, resources, and systems. These commitments are a gamble that may lock the firm into hard-to-change projects, assets, and capabilities. BMI is like jumping off a mountain; agility is the hang glider that helps the firm choose where to fly and land.

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Agile firms are ambidextrous, shifting between exploration and exploitation of new opportunities rapidly and effectively. Nokia created modular structures to rapidly innovate products and adjust to changing market needs through reduced coordination costs.⁶ IBM unlocked formal structures to empower local change and facilitate process innovation. These strategies are powerful tools for enabling agility during product or process innovation.⁷ Unfortunately, modular structures and local empowerment are not effective during business model innovation. So how does a firm get both?

Stage 1: Fostering business model innovation

We analyzed interviews with more than 700 global CEOs to better understand BMI drivers and the role of agility.⁸ It's helpful to first identify the factors that don't drive BMI. Business model innovation is not significantly driven by geography, firm type, or firm size. There are slightly more business model innovators in the Americas than Europe, but otherwise the differences are negligible. Further, BMI is not associated with prior innovation success. BMI may not be a dynamic capability that accumulates as a learned skill. If BMI fundamentally changes firm-level value creation activities, then getting it right once does not predict getting it right again.

So what does drive BMI? First, business model innovators explore distant horizons. They are attuned to globalization and changing geopolitical and environmental contexts rather than industry or economy-specific problems. Second, business model innovators actively seek discontinuous and disruptive innovations, de-emphasizing investment in incremental product innovation. Third, they rely on strong central leadership, usually from the CEO. While other types of innovation benefit from bottom-up participation, BMI requires top-down leadership of radical change.

Stage 2: Becoming an agile business model innovator

Agility during BMI challenges traditional theories of flexibility and innovation. The four agile business model innovation rules are difficult to implement because they contradict accepted tenets for strategic growth. Agile business model innovators simplify structures, partner for control, instill creativity at the firm boundaries, and foster self-reliance for innovation. Let's explore each rule and then consider how Return Path implemented BMI without sacrificing agility.

Rule 1: Simplify structures. Most large firms, especially global organizations, exist in a state of continuous structural change. Management teams utilize cross-functional and matrix-managed structures to fine-tune processes and evolve activities towards changing goals. During business model innovation, however, managerial attention is at a premium; reconfiguring processes through re-engineering simply doesn't help. To remain agile, business model innovators must simplify internal structures by delegating lower-priority activities to trusted partners.

Rule 2: Partner for knowledge. It might seem obvious that focusing the firm down to core capabilities and processes would maximize managerial potential to absorb and utilize new knowledge and skills.⁹ In fact, when business model innovators completely divest non-essential activities, they lose agility. The key factor is access to knowledge. BMI requires the firm to invest in unfamiliar, uncertain directions.

When agile business model innovators contract for non-core functions, they retain access to knowledge in related fields. When business model innovators divest non-core functions, they may become too isolated to adapt to macro-level trends that generate novel opportunities. Agile business model innovators partner to retain control of knowledge sources while reducing the attention burden of non-core functions on key managers.

Rule 3: Foster self-reliance for innovation. There is a subtle but critical distinction between delegating non-core functions to trusted partners and depending on those or other partners for innovation outcomes. Collaboration requires directed attention to coordinate distant opportunity exploration. Partners engaged in business model innovation will perceive opportunity landscapes very differently. Disparate capability sets, investment profiles, cultures, and innovation goals generate different perceptions of value creation, leading to high coordination costs.¹⁰ Partnering for innovation during BMI runs a dual risk: locking the firm into low value opportunities or turning a collaborator into a competitor. In either case, agility will be compromised. The agile business model innovator is self-reliant for innovations.

Rule 4: Instill creativity at firm boundaries. BMI requires exploring unfamiliar markets and value creation activities. Creativity throughout the organization is essential to the firm's agile development of new processes and capabilities. While some firms may rely primarily on the ingenuity of key employees, agile business model innovators take a lesson from The Lean Startup¹¹ by encouraging rapid, low-cost experiments at the interface with customers and markets. Creativity at the market interface generates information about new trends and facilitates the testing of new value creation mechanisms. Flexible thinking by market-facing personnel, encouraged and rewarded by management, encourages novel approaches to value creation. This is a vital source of agility in identifying and addressing the needs of potential or previously untargeted customers.

Figure 1 shows how the agile BMI rules build on the drivers of business model innovation.

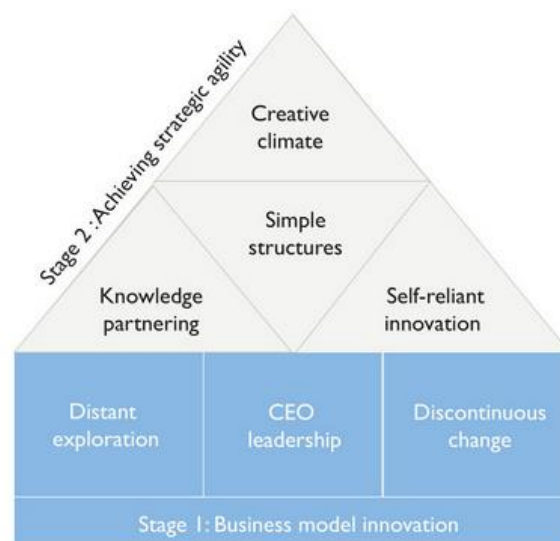


Figure 1: The Agile Business Model Innovator

Iterative, Agile BMI at Return Path

The power of agile BMI can be seen at Return Path, the global leader in email deliverability. Return Path is revolutionizing spam management by certifying safe email from reliable senders based on a scoring system similar to consumer credit scores. To accomplish this, the firm synergistically combines two business models. On the email recipient side, Return Path links internet service provider (ISP) email delivery statistics to email marketing standards, enabling a “whitelist” of certified safe senders. On the email marketing side, Return Path provides a spectrum of services to improve email marketing outcomes. Founder and CEO Matt Blumberg described how the innovative combination of value creation systems emerged from a failed experiment to build a cooperative network of email deliverability data sources. “We changed the business model from being a purely co-operative network among businesses which had proved to be an all or nothing proposition... to having two distinct sides to it: a consumer side and a corporate side... Let’s focus on both of them but focus on them a little differently, try to get as much data from consumers directly as we can and then build a sales channel for that into the corporate data. So, you know, sort of leveraging one market as a way of getting into the other one.”

To become the global leader, Return Path addressed all four agile BMI rules. First, Return Path simplified structures. Blumberg described the awkward evolution of the firm’s structure: “It was the world’s smallest conglomerate, right, even at \$30M, it’s like a pretty small business. The businesses were so different that it was just mind bending for the executives that were working on all of them.... we had two businesses that were succeeding: one was the research business and one was the deliverability business, so essentially our strategic decision was ‘let’s let those things flourish and clear the distractions.’”

When executive management decided to focus on the “good sender” model for email deliverability, it simplified structures by consolidating complementary businesses and jettisoned non-core technologies. Blumberg described the process: “Let’s put Authentic Response over here, let’s put it with Postmaster Direct which is its supplier and vertically integrate those two things, and completely separate it legally and financially. Then let’s just get rid of [the email change-of-address business], let’s either shut it down or sell it and then the consulting thing... had sort of become part of the deliverability business at that point, so let’s just fold that into the deliverability business.” Rather than excising all non-core functions, Return Path retained partnerships for knowledge. The company kept part ownership of Authentic Response, the spinout most closely linked to the firm’s SafeSender™ model. To this day, the firms’ headquarters are in adjacent offices. The overlap helps Return Path’s executive team identify and assess emerging opportunities in related online security domains.

The firm has built extensive partnerships with global ISPs, but relies on internal creativity for innovation. To update the firm’s business model to incorporate emerging opportunities in email security, management turned to employees. During “Business Model 4.0,” every employee at the firm participated on teams that generated a portfolio of long-term opportunities, including solutions to serve the “long-tail” of SMEs, domain protection tools, and new email analytics tools, including a single-pixel

email tracker. Blumberg credits this process with nearly all of the firm's new product and service innovations.

To update the firm's business model to incorporate emerging opportunities in email security, management turned to employees.

The firm's creativity at the market interface and overall agility has been repeatedly tested. In 2010, company policy certifying certain types of customer emails as "safe" came into conflict with downstream stakeholders. Many of Return Path's customers benefited from the indirect certification of third-party emails, enabled by transparent but sometimes non-obvious email marketing practices. Relatively few internet users read the fine print when signing up for online loyalty programs. Return Path's certification program labeled third-party emails generated through such sign-ups as "safe." The company faced a very specific challenge at the market interface, as Blumberg describes: "A couple of our larger ISP partners came to us and said 'You know, we don't like some of the mail that you're certifying and we recognize that it meets the thresholds that we've all agreed to, but it is essentially the legal form of spam.' We have complaint rate thresholds above which we won't certify your mail, below which we will, and the ratio actually gets tougher as you get bigger. But the problem is that in terms of third party email marketing, the numbers are so big that even the tightest thresholds still result in a million people complaining about something, yet our agreed standards make it seem okay."

Decertifying this type of email would put nearly 5% of the firm's total revenue base at risk and expose the firm to less scrupulous competitors. Return Path is a venture-funded company, and venture capitalists are not traditionally enthusiastic about decisions with clear negative revenue potential. In addition, Return Path was growing nearly 100% per year, and lost revenue would directly impact working capital availability.

Firms that aspire to change the dominant competitive paradigm incur high risks at every level of the organization. The question for businesses like Apple, Groupon, and Return Path is whether BMI is a dynamic capability that can be a renewing source of strategic rejuvenation.

Despite these concerns, the executive team believed that the firm was agile enough to address the challenge. They turned once again to the full employee base. A summary of the situation was circulated around the company. Feedback and commentary were integrated into a "community statement" about the problem. Employees overwhelmingly supported preserving the integrity of the business model. They empathized with non-paying downstream stakeholders, the ISPs that provided the email deliverability data to Return Path as part of the "receiver" model. The needs of paying customers were important, but would need to be addressed in a more flexible way. Blumberg describes how the firm's commitment to BMI led to a difficult decision: "We contacted the firms that were the source of the bad emails. [We] wouldn't fire them as clients, we would continue to work with them on our software products, we'd continue to work with them on our consulting product, we would try to help them convert their third party marketing mail into sponsored newsletters or things that were certifiable – and we flipped the switch on it. We braced ourselves; we could lose \$1.5M in revenue tomorrow."

Return Path did not lose a single client, a testament to the strength of the firm's business model, its high-integrity leadership in email deliverability standards, and its agile approach to customer relationships. The company's proprietary database now covers more than 2 billion of the world's 3 billion valid email inboxes. Return Path has captured a 70% share of the global email marketing and

sender whitelisting market. The firm manages more than 65% of public complaint feedback loop services around the world. In 2012, the company was named one of the best companies to work for by Fortune Magazine.

Becoming an agile business model innovator is neither simple nor easy. Firms that aspire to change the dominant competitive paradigm incur high risks at every level of the organization. The question for businesses like Apple, Groupon, and Return Path is whether BMI is a dynamic capability that can be a renewing source of strategic rejuvenation. Our research revealed no link between BMI and prior change success. Achieving agile BMI requires investing in the intangibles: creativity, employee commitment, and knowledge creation. Only agile business model innovators repeatedly rewrite the rules of value creation to their own advantage.

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