The St. Gallen Business Model Navigator

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1. New Products are not enough

There are many companies with excellent technological products. Especially in Europe, many firms continuously introduce innovations to their products and processes. Yet, many companies will not survive in the long term despite their product innovation capabilities. Why do prominent firms, which have been known for their innovative products for years, suddenly lose their competitive advantage? Strong players such as *AEG*, *Grundig*, *Nixdorf Computers*, *Triumph, Brockhaus, Agfa, Kodak, Quelle, Otto*, and *Schlecker* are vanishing from the business landscape one after the other. They have lost their capabilities of marketing their former innovative strengths. The answer is simple and painful: these companies have failed to adapt their business models to the changing environment. In future, competition will take place between business models, and not just between products and technologies.

New business models are often based on early weak signals: Trendsetters signal new customer requirements; regulations are discussed broadly before they are eventually approved. New entrants to the industry discuss new alliances at great length; disruptive technology developments are results of many years of research. The insolvency of *Kodak* in 2012 has also a long history. The first patents for digital cameras had already been published by *Texas Instruments* in 1972. *Kodak* realized the potential of the new technology and in the 90s initiated an alliance on digital imaging with *Microsoft* in order to conquer this new field. But – as can be observed frequently – the disruptive move was faint-hearted. When the first digital cameras entered the market in 1999, *Kodak* forecasted that ten years later digital cameras would account for only 5 % of the market, with analog cameras remaining strong at 95 %. In 2009, the reality was different: Only 5 % of the market remained analog. This misjudgment was so grave and powerful that it was too late when *Kodak* physically blew up its chemical R&D center in Rochester in order to change the corporate-dominant logic of analog imaging. Between 1988 and 2008, *Kodak* reduced the number of its employees by more than 80 %, in 2012 *Kodak* filed for bankruptcy protection.

It is often said that existing business models ‘don’t work anymore’. Still, the typical answers provided by R&D engineers are new products based on new technologies and more functionality. By contrast, the underlying business logic is rarely addressed despite the fact that business model innovators have been found to be more profitable by an average of 6 % compared to pure product or process innovators (BCG 2008). As a consequence, managers consider business model innovation to be more important for achieving competitive advantage than product or service innovation, and over 90 % of the CEOs surveyed in a study by IBM (2012) plan to innovate their company’s business model over the next three years. But a plan is not enough.

When it comes to making the phenomenon tangible, people struggle. Very few managers are able to explain their company’s business model ad-hoc, and even fewer can define what a business model actually is in general. The number of companies, which have established dedicated business model innovation units and processes is even lower. Given the importance of the topic, this lack of corporate institutionalization is surprising – however, considering the complexity and fuzziness of the topic, it is to be expected.

Before discussing how to innovate a business model, it is important to understand what it is that is to be innovated. Historically, the business model has its roots in the late 1990s when it emerged as a buzzword in the popular press. Ever since, it has raised significant attention from both practitioners and scholars and nowadays forms a distinct feature in multiple research streams. In general, the business model can be defined as a unit of analysis to describe how the business of a firm works. More specifically, the business model is often depicted as an overarching concept that takes notice of the different components a business is constituted of and puts them together as a whole (Demil and Lecocq 2010; Osterwalder and Pigneur, 2010). In other words, business models describe how the magic of a business works based on its individual bits and pieces.

Business model literature has not yet reached a common opinion as to which components exactly make up a business model. To describe the business models throughout our study, we employ a conceptualization that consists of four central dimensions: the Who, the What, the How, and the Value. Due to the reduction to four dimensions the concept is easy to use, but, at the same time, exhaustive enough to provide a clear picture of the business model architecture:

Who: Every business model serves a certain customer group (Chesbrough and Rosenbloom 2002; Hamel 2000). Thus, it should answer the question ´Who is the customer?´ (Magretta 2002). Drawing on the argument from Morris et al. (2005, p. 730) that the ´failure to adequately define the market is a key factor associated with venture failure´, we identify the definition of the target customer as one central dimension in designing a new business model.

What: The second dimension describes what is offered to the target customer, or, put differently, what the customer values. This notion is commonly referred to as the customer value proposition (Johnson et al. 2008), or, more simply, the value proposition (Teece 2010). It can be defined as a holistic view of a company's bundle of products and services that are of value to the customer (Osterwalder 2004).

How: To build and distribute the value proposition, a firm has to master several processes and activities. These processes and activities, along with the involved resources (Hedman and Kalling 2003) and capabilities (Morris et al. 2005), plus their orchestration in the focal firm's internal value chain form the third dimension within the design of a new business model.

Why: The fourth dimension explains why the business model is financially viable, thus it relates to the revenue model. In essence, it unifies aspects such as, for example, the cost structure and the applied revenue mechanisms, and points to the elementary question of any firm, namely how to make money in the business.

By answering the four associated questions and explicating (1) the target customer, (2) the value proposition towards the customer, (3) the value chain behind the creation of this value, and (4) the revenue model that captures the value, the business model of a company becomes tangible and a common ground for its re-thinking is achieved. A central virtue of the business model is that it allows for a holistic picture of the business by combining factors located inside and outside the firm (Teece 2010; Zott et al. 2011). For this reason, it is often referred to as a boundary-spanning concept that explains how the focal firm is embedded in, and interacts

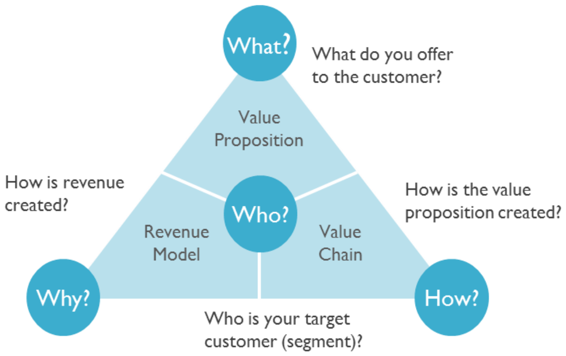


Fig. 1 Business model definition – the magic triangle

with, its surrounding ecosystem (Shafer et al. 2005; Zott and Amit 2008). The task most commonly attributed to the business model is that of explaining how the focal firm creates and captures value for itself and its various stakeholders within this ecosystem.

Considering the vast scope that is subsumed under the business model umbrella, it becomes clear that, in the real world, a firm's business model is a complex system full of interdependencies and side effects. Changing – or innovating – the business model can hence be assumed to be a major undertaking that can quickly become very challenging.

Generations of managers have been trained within Porter's five forces of industry analysis. Michael Porter taught us to analyze the industry and try to gain comparative competitive advantage due to better positioning. Kim and Mauborgne (2005) paved the way out of Porter's box. 'Beat your competitor without trying to beat your competitor' is the credo that obliges companies to leave their highly competitive own industry and create new uncontested markets in which they can prosper. It is a mantra for business innovators as we have seen in our own research and coaching of companies during the last decade. *IKEA* revolutionized the furniture business, Apple successfully re-defined industry boundaries, and *Zara* reinvented the European fashion industry with high-speed cycles. Many others revolutionized their industries in a very radical way: *Mobility car sharing*, *Car2go*, *TomTom, Wikipedia, Microinsurance, Better Place, Verizon*, and *Bombardier Flexjet* are only a few examples of companies which escaped the traditional industry logic and therefore redefined their respective industries.

So, why do not more companies just come up with a new business model and move into a 'blue ocean'? It is because thinking outside the box is hard to do – mental barriers block the road towards innovative ideas. Managers struggle to turn around the predominant logic of 'their' industry, which they have spent their entire careers understanding. First, many managers do not see why they should leave the comfort zone as long as they are still making profits. Second, it is common knowledge that the harder you try to get away from something, the closer you get to it. Bringing in outside ideas might seem promising in this case – however, the ´not invented here´ (NIH) syndrome is well known and will soon quash any outside idea before it can take off in a company.

According to surveys of Harvard colleague Markides (2000) companies fail to develop a breakthrough strategy due to several factors:

- Cultural inertia and unwillingness to change a 'winning formula'
- Contentment and complacency
- Processes and structures that become rigid and unyielding
- Strong and unquestioned beliefs and corporate sacred cows
- Conservatism and fear of losing the current profit stream
- Strong vested interests and politicking
- Managerial overconfidence or arrogance
- Unyielding habits and company norms
- Overreliance on what has worked in the past

- Passive and uncritical thinking and quick dismissal of information that conflicts with current view
- Stubborness and a passionate but unreflective reliance on past processes, habits, and values.

In view of these barriers, a successful approach that leads to innovative business model ideas must master the balancing act of bringing in stimuli external to an industry to achieve novelty while, at the same time, enabling those within an industry to develop their own innovative business model ideas.

Research methodology

As business innovation research is still a young phenomenon, we used a two-step approach to analyze the basic patterns of business models.

In phase 1 we analyzed 250 business models that had been applied in different industries within the last 25 years. As a result we identified 55 patterns of business models which served as the base for new business models in the past. More than five years of research and practice in the area of business model innovation have culminated in a methodology that helps firms structure and navigate the process: the *Business Model Innovation Map*, which guides the innovator through the many opportunities a company faces (see also Gassmann et al. 2013).

In phase 2 we used that knowledge and, together with selected companies, developed a construction methodology which is based on two basic principles: First, 90 % of all new business models have recombined already existing ideas, concepts and technologies as we found in our research group. Consequently this fact has to be used for developing new business models. Second, we applied the iterative process of design thinking, which was developed at the Institute of Design at Stanford University. This action-based research approach helped us to learn more about the practical use of the design of new business models.

We applied the methodology with teams in the following companies: *BASF* (chemicals), *Bühler* (machinery), *Hilti* (construction tools), *Holcim* (cement), *Landis&Gyr* (electricity metering), *MTU* (turbines), *SAP* (software), *Sennheiser* (audio technology), *Siemens* (health care), *Swisscom* (telecom). In all companies, investments have been initiated as a result of the business model project, in some companies up to double-digit million amounts are invested. In addition we used the approach during three years of teaching Executive MBA students at the Executive School in St. Gallen and applied it in a one-day workshop for more than 50 companies. This experience has been built into the methodology as well.

2. Creative Imitation and the Power of Recombination

The phrase ´There's no need to reinvent the wheel´ describes the fact that, at a closer look, only few phenomena are really new. Often, innovations are slight variations of something that has existed elsewhere, in other industries, or in other geographical areas. We have looked at several hundred business model innovators and were not surprised to find that about 90 % of the innovations turned out to be such re-combinations of previously existing concepts. We identified 55 repetitive patterns that form the core of many new business models (see Gassmann et al. 2012; Gassmann et al. 2013). The business model innovation map (see Figure 2) depicts the 20 most popular patterns as lines, along with the companies which applied them in their new business models.

The RAZOR AND BLADE pattern, for example, goes back to *Gillette's* 1904 move to give the base product (the razor) away for a low price and earn money through higher-priced consumables (the blades). The pattern, which defines the value proposition and revenue logic of a business model, has spread across many industries since then. Examples include inkjet printers and cartridges, blood glucose meters and test stripes, or *Nespresso's* coffee machines and capsules. In the world of business models, there is really not much that is actually new – but many powerful adaptations and applications contexts and industries can be found.

What can we learn from this observation? Clearly, the patterns of business models identified can serve as an inspiration when innovations of business models are considered. If they could be adopted elsewhere, why not apply them to one's own company? This approach brings in external stimuli while, at the same time, allowing enough room to prevent the NIH syndrome. Over time, we have developed the 55 business model patterns identified into the central ideation tool of our St. Gallen Business Model Navigator™ methodology.

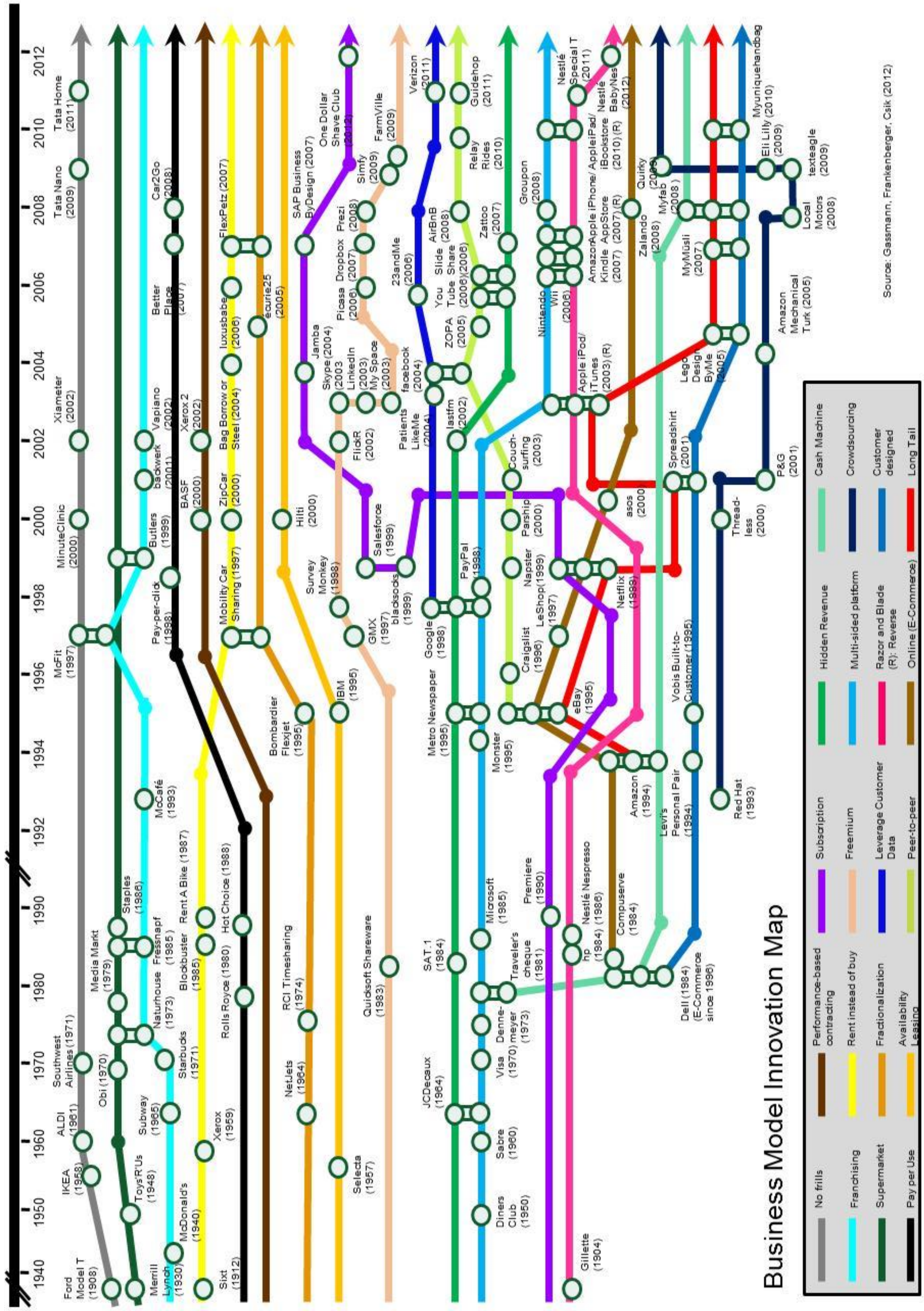


Fig. 2 The business model innovation map: Every node represents a revolution of an industry.

The St. Gallen Business Model Navigator™ transforms the main concept – creating business model ideas by utilizing the power of re-combination – into a ready-to-use methodology, which has proven its usefulness in countless workshops and other formats. Three steps pave the road to a new business model:

Step 1: Initiation – preparing the journey

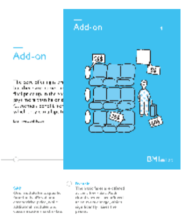
Before embarking on the journey towards new business models, it is important to define a starting point and rough direction. Describing the current business model, its value logic, and its interactions with the outside world is a good exercise to get into the logic of business model thinking. It also builds a common understanding of why the current business model will need an overhaul, which factors endanger its future, or which opportunities cannot be exploited due to the current way of doing business. Explicating these woes and the predominant industry logic provides a rough direction according to which the generic business model patterns should be interpreted in step 2.

Success factors:

- Involve open-minded team members from different functions; the involvement of industry outsiders supports thinking outside the box.
- Overcome the dominant industry logic: Forbidden are sentences like ‘this has always worked like that in our industry’. Instead, a funeral speech for one´s own business helps to overcome the past. Why did the company die? This is a fascinating exercise, which McKinsey has often used successfully in change projects when individuals needed to overcome mental barriers.
- Use methodological support, e.g., card sets, business model innovation software (see www.bmi-lab.ch for our methodological approach and background information).

Step 2: Ideation – moving into new directions

Fig. 3 Pattern card set



Re-combining existing concepts is a powerful tool to break out of the box and generate ideas for new business models. To ease this process, we have condensed the 55 patterns of successful business models into a handy set of pattern cards. Each pattern card (see Figure 3) contains the essential information that is needed to understand the concept behind the pattern: a title, a description of the general logic, and a concrete example of a company implementing the pattern in its business model. During the stage of ideation, the level of information on the card is just right to trigger the creation of innovative ideas.

The way in which we apply the cards is termed *pattern confrontation* to describe the process of adapting the pattern to one’s own initial situation. Participants, typically divided into groups of three to five people, ask themselves how the pattern would change their business model if applied to their particular situation.

At first glance the cards might seem unrelated to the problem, however, the results are quite surprising. Often the stimuli, in the form of pattern cards, cause innovative ideas to emerge, which inspire discussions among the group members. In one instance, for example, the task of fitting the SUBSCRIPTION pattern to the business model of a machine manufacturer led to the idea of training sought-after plant operators and leasing them to customers. The concept was implemented and now contributes to the company’s turnover while at the same time strengthening ties with customers – which had been the original reason for thinking about a new business model.

Success factors:

- Try not only the close patterns, but also confront more distant patterns. We had very surprising results when a 1st tier automotive supplier applied the question: ‘How would *McDonald´s* conduct your business?’. For example, *McDonald’s* front desk employees are fully productive after a 30-minute introduction. The automotive supplier had to learn that reducing complexity would lead to totally new business models and would also stimulate quick learning.
- Keep on trying. At first, it seems impossible to learn something from industry outsiders. Especially individuals with a profound background in the existing industry have difficulties in overcoming the dominant industry logic.

Step 3: Integration – completing the picture

There is no idea that is clear enough to be immediately implemented in a company. On the contrary, promising ideas need to be translated in business model concepts and checked for their internal and external consistency. The first step is to outline the idea in all four dimensions using the BMI Idea Sheet or a business model canvas. To check for internal consistency, it is important to understand the business logic and the potential of the new business model to be profitable. At this stage, do not overcomplicate this by creating a full-blown business case but rather use our Reverse Financials tool to quickly assess prices, market size and potential costs.

Before spending too much time developing the business model concept further, gather your biggest assumptions regarding the customer and your value proposition and conduct qualitative interviews. Use these valuable insights to check for the problem/solution fit of your idea and adjust the business model accordingly. Once you think you have a proposition that is valuable to customers that is also financially viable, start with the implementation.

Success factors

- Don't spend too much time on the details of your business model. Most of what you write down at this stage will change after the first reality check
- Think in assumptions: most of what you gather is not yet proven in the market, so don't act as if it is
- Go to potential customers as soon as possible as their feedback can prevent you from spending a lot of money on a solution that nobody wants
- Follow the feedback: use every feedback you get to change the course of your venture and don't stick to your own ideas

Step 4: Implementation – realizing the new business model

The implementation of a new business model is always iterative. The cornerstone is to gradually test the various dimensions of your business model and step by step launch the new solution. In a nutshell, the testing iteration is based on (1) identifying the most critical assumptions of your business model, (2) developing and conducting tests to validate and falsify the assumptions, and (3) updating your business model concept with the results of the test and entering a new iteration. To guide you through this crucial step, we have developed a BM Testing methodology and a tool set for choosing the best test formats for your assumptions, which you can find on our blog.

Success factors

- Think in the logic of affordable loss: decide on how much you are willing to spend in order to validate your assumptions rather than investing large sums in a business case that everyone in your company knows is wrong anyway
- Decide on the organizational structure early: choose early in the testing phase whether you want to build the venture inside or outside the company, depending on the resources, the strategy and the culture of the company
- Use Minimum Viable Products to get feedback for your solution in a quick and less expensive manner
- Be resilient: after every success there will be a setback. Building a new business model is messy and frustrating at times, don't give up!

3. Conclusions

With the St. Gallen Business Model Navigator™ a new methodology has been developed that structures the process of innovation of a company's business model and encourages outside-the-box thinking, which is a key prerequisite for successful business models. Well-grounded in theory, it has proven its applicability in practical settings many times over.

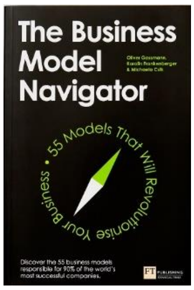
In order to achieve successful business model innovations within a company it is important to not only acknowledge the importance of business model innovation, but to implement an effective business model innovation process within the firm. This is the most difficult, but also the most important step. Various tools have been developed to support managers during the business model innovation process[1]:

Given the overwhelming demand for a new business model innovation methodology, the journey of the St. Gallen Business Model Navigator™ will continue. The future race for comparative competitive advantages has shifted from pure products and services to business models. Firms need to get ready for that race. Identifying the opportunity is not enough, innovators and entrepreneurs have to capture the opportunity and start moving. Knowing the past helps in creating the future.

The following managerial implications should prove valuable for practitioners using this new approach to revolutionize their business model:

1. Get top management support, business model innovation is not a Sunday afternoon walk.
2. Set up a diverse team, outsiders are important to challenge the orthodoxy of the industry.
3. Challenge the dominant logic by using confrontation techniques. The 55 patterns of business models identified support this challenging task.
4. Be open to learn from others, be prepared for change. Keep in mind: The future is already there, just unequally distributed.

5. Use an iterative approach with many loops. Verify assumptions.
6. Use haptic cards or other devices to stimulate the creative thinking process.
7. Carefully decide when to change between divergent and convergent thinking, the management of the balance between creativity and discipline requires some experience.
8. Create a culture of openness: there are no sacred cows in the room.
9. Go towards pilots with real customers: A picture is more than 1000 words, a prototype more than 1000 pictures. Limit the risks with pilots.
10. Don't overcalculate the business cases. Typically, they are totally wrong at the early stage.



The Business Model Navigator

For more information on the methodology, get the book in English and 14 other languages.

55 BMI Pattern Cards

The set of 55 business model cards supports the creative ideation process during workshops.

www.bmilab.com.

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