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Reinventing Your Business Model

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One secret to maintaining a thriving business is recognizing when it needs a fundamental change.

In 2003, Apple introduced the iPod with the iTunes store, revolutionizing portable entertainment, creating a new market, and transforming the company. In just three years, the iPod/iTunes combination became a nearly $10 billion product, accounting for almost 50% of Apple's revenue. Apple's market capitalization catapulted from around $1 billion in early 2003 to over $150 billion by late 2007.

This success story is well known; what's less well known is that Apple was not the first to bring digital music players to market. A company called Diamond Multimedia introduced the Rio in 1998. Another firm, Best Data, introduced the Cabo 64 in 2000. Both products worked well and were portable and stylish. So why did the iPod, rather than the Rio or Cabo, succeed?

Apple did something far smarter than take a good technology and wrap it in a snazzy design. It took a good technology and wrapped it in a great business model. Apple's true innovation was to make downloading digital music easy and convenient. To do that, the company built a groundbreaking business model that combined hardware, software, and service. This approach worked like Gillette's famous blades-and-razor model in reverse: Apple essentially gave away the "blades" (low-margin iTunes music) to lock in purchase of the "razor" (the high-margin iPod). That model defined value in a new way and provided game-changing convenience to the consumer.

Business model innovations have reshaped entire industries and redistributed billions of dollars of value.

Retail discounters such as Wal-Mart and Target, which entered the market with pioneering business models, now account for 75% of the total valuation of the retail sector. Low-cost U.S. airlines grew from a blip on the radar screen to 55% of the market value of all carriers. Fully 11 of the 27 companies born in the last quarter century that grew their way into the *Fortune* 500 in the past 10 years did so through business model innovation.

Stories of business model innovation from well-established companies like Apple, however, are rare. An analysis of major innovations within existing corporations in the past decade shows that precious few have been business-model related. And a recent American Management Association study determined that no more than 10% of innovation investment at global companies is focused on developing new business models.

Yet everyone's talking about it. A 2005 survey by the Economist Intelligence Unit reported that over 50% of executives believe business model innovation will become even more important for success than product or service innovation. A 2008 IBM survey of corporate CEOs echoed these results. Nearly all of the CEOs polled reported the need to adapt their business models; more than two-thirds said that extensive changes were required. And in these tough economic times, some CEOs are already looking to business model innovation to address permanent shifts in their market landscapes.

Senior managers at incumbent companies thus confront a frustrating question: Why is it so difficult to pull off the new growth that business model innovation can bring? Our research suggests two problems. The first is a lack of definition: Very little formal study has been done into the dynamics and processes of business model development. Second, few companies understand their existing business model well enough—the premise behind its development, its natural interdependencies, and its strengths and limitations. So they don't know when they can leverage their core business and when success requires a new business model.

After tackling these problems with dozens of companies, we have found that new business models often look unattractive to internal and external stakeholders—at the outset. To see past the borders of what is and into the land of the new, companies need a road map.

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