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Evolutionary or revolutionary business model innovation through coopetition? The role of dominance in network markets

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ABSTRACT

This paper examines how the level of dominance in firms affects when they engage in coopetition in order to innovate their business model. We present a longitudinal and in-depth single case study of the business model innovation decisions of investment banks in the US corporate bond trading market. We find that, in network markets, when firms choose to engage in coopetition in light of competitive threat it is done so in order to adopt a defensive or offensive strategy. The study shows that in network markets the less dominant firms tend to engage in coopetition to innovate their business model in an evolutionary manner before the dominant firms, as a defensive strategy to protect their existing business model. In contrast, the dominant firms tend to engage in coopetition to innovate their business model in a revolutionary manner after the less dominant firms, as an offensive strategy to alter radically their existing business model. We draw implications of coopetition in network markets for both theory and practice.

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1. Introduction

Firms are increasingly cooperating and competing at the same time in order to create and capture value (Bouncken & Kraus, 2013; Ritala, Golnam, & Wegmann, 2014; Rusko, 2014). Shorter product lifecycle, convergence of multiple technologies and increasing costs of conducting R&D require firms to have multiple resources to improve continuously on delivering the existing value proposition, while exploring new opportunities to foster innovation (Gassmann, 2006; Gnyawali & Park, 2011). Such multiple resources often do not reside within a single firm and, hence, firms in the same industry often cooperate in order to share such resources and then compete to divide the created value jointly. Such collaborative activity has been termed coopetition (see Bengtsson & Kock, 2014; Yami, Castaldo, Dagnino, & Le Roy, 2010). Recent research has highlighted the importance of understanding how organizations can affect the mechanism of value creation and capture in a coopetition context using the concept of business models (Ritala et al., 2014). However, research in this area has not explored when and how firms in an industry might decide with their competitors to adopt a coopetition strategy in order to innovate their business models. This study aims to explore the incentive for incumbent firms of various sizes to innovate their business model over time by adopting a coopetition-based strategy.

Studies on strategic management have focused primarily on interfirm competition to create competitive advantage (Brandenburger & Nalebuff, 1996; Gnyawali, He, & Madhavan, 2008). Competition and cooperation have been considered separate modes of firm interaction (Chen, 2008; Tidström, 2014). However, more recently scholars have been placing emphasis on studies that examine firms simultaneously engaging in cooperation and competition (see Bengtsson & Kock, 2014; Ritala & Hurmelinna-Laukkanen, 2013). Such studies have examined the motivations for coopetition as a need to innovate in order to gain and sustain competitive advantage (Ritala, 2012). A recent study has also emphasized the emergent as opposed to the planned mode in inter-organizational relationships in that coopetition might emerge as unplanned competition within firms that are cooperating (Czakon, 2010). Studies have shown that coopetition can enhance the innovativeness of firms (Belderbos, Carree, & Lokshin, 2004; Quintana-Garcı'a & Benavides-Velasco, 2004; Tether, 2002), but it is moderated by the degree of competition (see Park, Srivstava, & Gnyawali, 2014; Ritala, 2012). These studies have focused predominantly on the influence of coopetition on product innovations. However, recent studies have emphasized that business-model innovation takes place when a firm adopts a new approach to commercializing its assets and could be a source of innovation activities (Ehret, Kashyap, & Wirtz, 2013; Mason & Spring, 2011).

A business model summarizes the architecture and logic of a business (Baden-Fuller & Morgan, 2010) — it defines the organization's value proposition and its approach to value creation and value capture (Teece, 2010). Therefore, business model innovation involves the adoption of fundamentally different modes of value proposition, value creation and/or capture (Markides, 2006). Business model innovation can redefine what a product or service is, how it is provided to the customer,

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and the means to monetize the customer value proposition. The degree of business model innovation can be either incremental or radical (Velu, 2015). Incremental business model innovation is when there are minor changes to the value proposition, value creation and approach to value capture with respect to the existing business model, while radical business model innovation involves major changes to these elements. Moreover, the degree of business model innovation needs to be studied by transcending the firm boundary and examining how partner firms with complementary resources might influence its outcome (Berglund & Sandtrom, 2013; Zott & Amit, 2008). The intensity of competition in an industry could affect the need for sharing such resources, which in turn could affect the incentive to cooperate among competing firms and influence the degree of business model innovation.

One of the key resources for a firm is the installed customer base. The dominance of the firm, often measured in terms of market share, captures the resource in terms of the installed customer base. The dynamics of how the installed customer base changes are particularly important in network markets, which are subject to externalities in demand, whereby the utility to each customer of adopting a firm's proposition increases with an increase in the total number of customers who have adopted the proposition (Farrell & Saloner, 1986; Katz & Shapiro, 1985). Therefore, the resulting customer adoption dynamics[1] in network markets will influence how and when firms engage in coopetition. This is because as customers dis-adopt an existing product or service proposition in order to adopt a new proposition provided by a new entrant, the resource base of the incumbent firms diminishes. Such diminishing resource base of the incumbent firms might incentivize them to cooperate with their competitors. Such cooperation with competitors enables incumbents firms to regain market share in order help innovate their business models as a means to retain their leadership position in the industry. The research question we pose in this paper is as follows: 'How does the level of dominance of incumbent firms affect when they engage in coopetition and how they would innovate their business models in doing so?'

We present a longitudinal and in-depth single case study (based on 60 interviews with senior management) of the business model innovation decisions of investment banks in the US corporate bond trading market, a huge industry with trading volumes exceeding $US400 billion per day. Despite its importance, this industry has rarely been studied from an innovation perspective (Frame & White, 2004). We find that, in network markets, when firms choose to engage in coopetition in light of competitive threat it is done so in order to adopt a *defensive* or *offensive strategy*. We show that, in network markets, the less dominant firms tend to engage in coopetition to innovate their business model in an evolutionary manner before the dominant firms, as a defensive strategy to protect their existing business model. On the other hand, the dominant firms tend to engage in coopetition to innovate their business model in a revolutionary manner after the less dominant firms, as an offensive strategy to alter radically their existing business model. In doing so, we make two contributions to the literature. First, we contribute to the coopetition literature by showing that one of the mechanisms, namely the customer base, can act to influence the interplay between competition and cooperation in order for firms to engage in coopetition. Second, we contribute to the business model literature by showing how the resource base, namely the installed customer base, drives firms to engage in coopetition in order to innovate the business model in an evolutionary or revolutionary manner.

The next section reviews the relevant literature. Section 3 describes the data and method adopted for the case study, and Section 4 uses the empirical evidence to extend the theory on coopetition. Section 5 discusses the managerial and theoretical implications, and Section 6 concludes.

[1] The customer adoption dynamics describes when customers adopt or dis-adopt a product or service proposition.

2. Literature review

2.1. Coopetition

Coopetition is seen as a paradoxical relationship whereby firms compete and cooperate at the same time (Bengtsson & Kock, 2014). Coopetition could exist between either two firms or many firms simultaneously. Researchers have examined coopetition by examining when a 'win–win' relationship could come about by balancing value creation and value capture. Brandenburger and Nalebuff (1995, 1996) use concepts from game theory to articulate how coopetition could enhance value for firms. The authors do so by examining how other firms in the network could acts as complementors or competitors to a focal incumbent firm depending on their respective roles (Brandenburger & Nalebuff, 1995, 1996). They show how firms might cooperate to create a new product and then compete to get a share of the market in order to distribute the returns from the value that has been created. Such coopetition often requires the management of tension between cooperation and competition (Tidström, 2014); several factors are important for balancing such tension. These include leadership, organizational design and relationship-specific trust (Chin, Chan, & Lam, 2008; Lacoste, 2012). Some scholars have examined coopetition from the network perspective, such as learning and knowledge-sharing (Powell, Koput, & Smith-Doerr, 1996; Gnyawali & Madhavan, 2001). Other scholars have explored such balancing of value creation and capture by examining the resource-based view of sharing technologies and resources (Chen, 1996; Emden, Calantone, & Droge, 2006). Studies have argued that the main motivations for coopetition are access to resources in order to create competitive advantage from existing business or for growth through innovation (Bengtsson & Kock, 2014; Raza-Ullah, Bengtsson, & Kock, 2014).

Competitive advantage has been discussed from the perspective of examining the position of the firm and the characteristics of the network (Gnyawali & Madhavan, 2001). Such a network-centric approach allows firms to obtain better information, resources and status and to facilitate learning, which could stimulate knowledge-sharing, market expansion and technological progress (Dahl, 2014; Bengtsson, Eriksson, & Wincent, 2010). Studies have argued that competitive advantage could manifest itself in the form of strategic flexibility as a result of coopetition (Bengtsson et al., 2010). The role of firms within a business network has been shown to be a key enabler of coopetition (Bengtsson & Kock, 1999, 2000). In particular, coopetition will be more prevalent in the case where there are heterogeneity in terms of the resources of the firms (Bengtsson & Kock, 2000). However, the degree of coopetition might differ according to the position in the value chain whereby competition might be more prevalent in activities closer to the customer or downstream activities whereas cooperation might be stronger in the activities further away from the customer or upstream activities (Bengtsson & Kock, 2000).

Studies have also shown that competition and cooperation are influenced by industry structure in network markets, which are markets that display network externalities in which the addition of a new customer adds value to other customers (Katz & Shapiro, 1985). In network markets the utility of each customer is an increasing function of the number of other customers in the market (Katz & Shapiro, 1985). In such markets the addition of a new customer adds value for others. The externalities derived by customers in network markets as a result of other customers are called demand-side externalities. Studies have shown that the likelihood of coopetition among incumbent firms increases with market concentration and greater customer penetration, and diminishes with time (Fjeldstad, Becerra, & Narayanan, 2004). In particular, the objective is to avoid competitive retaliation when market concentration is high, the incentive to increase transaction volume among existing customers when customer penetration is high or the desire to cooperate among competitors could be driven by the need to compete to create standards early in the industry's evolution (Gwynne, 2009; Spiegel, 2005).

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