



Do you see what I see? How differing perceptions of the environment can hinder radical business model innovation

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ABSTRACT

Incumbent firms face the challenge of how to adapt to disruptive changes in the external environment. One way to solve this challenge is to allocate resources to identifying and exploring new trends and opportunities emerging from the environment that may affect existing business models, and guide the development of new ones. As has been widely acknowledged, many incumbents fail at more radical business model innovation. Few studies have examined the role of cognition in this context. We suggest that differences in strategic issue identification and interpretation can help to explain the cognitive barriers that emerge when incumbent firms try to engage with radical business model innovation. We propose and test a Delphi-based method to elicit and examine differences in the perception of industry trends, comparing innovators, core business employees, and external experts, in the context of a leading Nordic insurance firm. We find considerable disagreement between members of the innovation department and the core business, in this firm. We suggest this helps explain why internal innovators find it challenging to “sell” radically new business models to the core business. More generally, we contribute to the growing literature on business model innovation in incumbent firms.

1. Introduction

In highly dynamic business environments, firms must continuously adjust their business models to shifting market conditions in order to be successful (Casadesus-Masanell and Zhu, 2013; Massa and Tucci, 2014; Mitchell and Coles, 2003; Wirtz et al., 2016). Yet, cognition scholars widely acknowledge that even within a single firm, groups of managers may have very different perceptions of changes to the external environment of the firm, and of the uncertainty attached to such changes (Huff et al., 2016; Smith and Tushman, 2005; Sund, 2015; Thomas et al., 1993; Walsh, 1995; White et al., 2003). Such perceptual differences can help us explain one of the open questions of innovation management: why do so many incumbents appear to fail at radical business model innovation (BMI)? A number of existing studies of BMI have highlighted cognition as playing a role in enabling or restricting such innovation (Chesbrough, 2010; Doz and Kosonen, 2010; Snihur et al., 2018; Sosna et al., 2010; Sund et al., 2016). We propose that at the heart of BMI failure may be differences in the perception of which environmental changes are the most salient. In short, if innovators within an incumbent firm perceive the world differently than colleagues in the core business, they will propose solutions to the “wrong” problems (in the minds of core business managers), and therefore face resistance.

There is no doubt that environmental developments continually change the competitive game and place great demands on firms and their competitiveness (Casadesus-Masanell and Ricart, 2010; Wirtz et al., 2016). In this context, BMI is an effective way of dealing with environmental challenges (Fjeldstad and Snow, 2018). We here take a wide definition of a business model as describing how value is created and appropriated by the organization (Amit and Zott, 2001; Teece, 2010). Among scholars and practitioners there is a common agreement that firms that manage to utilize the environmental and structural changes to innovate their business models in order to achieve competitive advantages are also the fastest growing firms (Bojoaga and Petrisor, 2013; Casadesus-Masanell and Ricart, 2010; Wirtz et al., 2016). Johnson et al. (2008), for example, emphasize that “business model innovation (BMI) is seen as a powerful management tool that supports companies in facing today's intensified global competition and dynamic market conditions.” Practitioners from a wide variety of industries thus actively seek guidance on how to innovate their business models in order to improve their ability to both create and capture value (Casadesus-Masanell and Ricart, 2010).

While much literature on business models pays attention to entrepreneurial firms and the creation of new business models through start-ups, a much smaller part of the literature focuses on incumbent firms that already have established business models, and their decisions

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to add new business models that can be disruptive (Bogers et al., 2015; Kim and Min, 2015; Sosna et al., 2010). Incumbent firms, defined as firms that are already in a strong position in the market, face the unique situation of having to balance the exploration of new business models with the exploitation of existing ones (Bogers et al., 2015; Frankenberger et al., 2013; Jensen and Sund, 2017; Sosna et al., 2010; Teece, 2018). A common way of organizing such business model exploration is to establish an innovation team, unit, or lab. In this approach, a team of what are perceived to be creative people is put in charge of developing a vision of how the world is changing, and what new products, services, or business models could be developed to adapt to those changes. The business model literature contains a number of studies that have highlighted how developing new business models in particular (as opposed to simpler incremental product enhancements) is a challenge for such innovation units. For example, Chesbrough (2010) describes how ideas developed at Xerox's five global research labs that were seen as departures from the firm's existing business model that were too radical were systematically pushed aside. In another study, Bogers et al. (2015) describe how tensions emerged between the old core business and the innovation unit during BMI in the case of three postal firms. While "cognitive biases" (Chesbrough, 2010, p. 355) and "cognitive barriers" (Bogers et al., 2015, p. 277) are mentioned in these studies, the source of such barriers is not further explored.

In this paper we contribute to the discussion of what constitutes such cognitive barriers, building on interpretative cognitive theory. Specifically, we construct an argument that the barriers to more radical BMI may stem from differences in the awareness and perceptions of environmental changes. We go on to propose a methodology for measuring such differences in perceptions, using the insurance industry as an example of an industry in which incumbents currently face changes to the external environment that could alter the way they do business. They see changes such as more self-driving cars, the spread of smart homes (the Internet of Things), and potential future competition from IT firms like Google (who have access to a range of data that allows them to tailor insurance products). The traditionally people-intensive insurance service faces substitution from smaller, nimbler, and more efficient online players, keen to cherry-pick lucrative market segments. In order to prepare for the competitive challenge of new digital entrants in the insurance market, in 2016 a leading Nordic insurance company established a new dedicated innovation department, whose main purpose is to work with innovation and new business models. We develop a two-stage Delphi-inspired method as a simple cognitive mapping tool to illustrate how differences in the awareness and perceptions of salient environmental changes have led to possible challenges for this innovation department. We conclude that achieving some degree of cognitive alignment with the core business is necessary for an innovation department to succeed in selling innovative ideas internally.

2. Cognition and incumbent business model innovation

In this section we will first discuss the particular context of BMI in incumbent firms, then briefly summarize what we know about cognition and BMI, before finally introducing an interpretative view of cognitive barriers to radical BMI in incumbent firms.

2.1. BMI in incumbent firms

The context of BMI in an incumbent firm is particular. Incumbent firms search for new business models either when the intention is to add to an existing portfolio of business models, or in order to substitute an old business model (Snihur and Tarzijan, 2018; Snihur and Wiklund, 2019). Jensen and Sund (2017) suggest that awareness of the need for this search is typically triggered by perceived changes to the external environment, such as changes in customer expectations. Yet, the organizational tensions that emerge during this search are not well addressed by existing theoretical frameworks (Foss and Saebi, 2015,

2017; Sund et al., 2016). Where a start-up exploring a new business model typically has a "blank sheet" in terms of organizational design, resource allocation, and so forth, the incumbent has pre-established structures, resources, and relationships. Balancing the exploration of new business models with the needs of existing business models leads to considerations of organizational design. Such design can be thought of in terms of the degree of differentiation of activities (for example, giving both cognitive, resource, and capability freedom to innovative business units), and integration mechanisms (both vertical and horizontal), to encourage information and knowledge sharing and transfer. A common way of organizing BMI, including in firms in the service sector, is to empower a dedicated R&D or innovation department with the tasks of monitoring environmental changes and generating new ideas (Bogers et al., 2015; Chesbrough, 2010; Djellal and Gallouj, 2001; Lawson and Samson, 2001).

One of the major challenges that incumbent firms have to deal with are the strategic contradictions that are likely to occur when working with BMI. On one hand, the organization with its current business model(s) has to perform in the short term, but on the other, long-term performance depends on the organization's abilities to adapt and change through innovation (Brown and Eisenhardt, 1997; Tushman and O'Reilly, 1996; Van de Ven et al., 1999). It is the responsibility of top management to balance short-term performance and long-term adaptability. This is typically done by resource and organizational design decisions (Edmondson et al., 2003; Eisenhardt and Zbaracki, 1992; Hambrick, 1994). Such strategic decisions require negotiations within the organization between the present core business units and the innovation team, by identifying outcomes that will ensure the performance of both agendas. In such situations structural, cognitive, and socio-psychological barriers can prevent progress (Bazerman and Watkins, 2004; Smith and Tushman, 2005; Van de Ven et al., 1999; Virany et al., 1992).

Firms exploring new business models may not fully recognize that tensions will almost inevitably emerge regarding, for example, resource allocation and top management control, and thus may be ill prepared to manage these (Bogers et al., 2015; Sund et al., 2016). Several challenges and barriers may be associated with BMI, and established firms often face strong organizational rigidities that lead to tensions. Thus, although many incumbent firms in different industries have added new business models, there is a great variety in whether they have benefited from this or not (Sohl et al., 2018). Unlike start-ups, established firms have one or more existing business models and assets that can either complement or conflict with a new business model. This can lead to growing complexity and organizational dilemmas when trying to manage the existing business model simultaneously with a new business model (Snihur and Tarzijan, 2018). Also, managers are likely to resist experiments that might threaten their ongoing value creation within the company. Therefore, incremental innovation is likely to be favored over more radical innovation, which may be perceived to be associated with greater risk and uncertainty (Chesbrough, 2010). There is a risk that managers and employees may feel threatened by a new business unit and its possible success. If the new business model does not immediately fit the core business "dominant logic", there is an additional risk that future value creation and innovation might be overseen or missed (Kim and Min, 2015; Sund et al., 2016).

2.2. The role of cognition

Some studies of BMI as a change process have highlighted the importance of paying attention to the micro-processes of BMI (Klang et al., 2014; Markides, 2013). In fact, in their recent review of the BMI literature, Foss and Saebi (2017) give a rather scathing critique of this literature as lacking "clear-constructed, well-delineated boundary conditions, identification of explanatory mechanisms, and other traditional hallmarks of good theory" (p. 201). They furthermore suggest that the role of cognition is an important gap to be explored in this

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