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Business models and organization design

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ABSTRACT

Despite a voluminous literature, business model research continues to be plagued with problems. Those problems hinder theory development and make it difficult for managers to use research findings in their decision-making. In our article, we seek to make three contributions. First, we clarify the theoretical foundations of the business model concept and relate them to the five elements of a business model: customers, value propositions, product/service offerings, value creation mechanisms, and value appropriation mechanisms. A clear definition of a business model enables theory to develop systematically and provides coherent guidance to managers. Second, we suggest that value configuration is a contingency variable that should be included in future theorizing and model building. Each of the elements of a business model is affected by a firm's value configuration depending on whether the firm is a value chain, value shop, or value network. Third, we link business models to organization design. We show how organization design is affected by value configuration and how new collaborative organizational forms enable open and agile business models. We derive the implications of our analysis for future research and management practice.

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More than sixty years ago, Peter Drucker insightfully declared that “the purpose of a business is to create a customer” (Drucker, 1954: 31). In hindsight, Drucker seems to have understood what is meant by the term business model, and much of the jargon used today in describing business models merely reflects Drucker's original ideas. For example, rather than saying the purpose of a business is to create a customer, we say that business models are “customer centric.” Drucker also asked, what will the customer buy? Now we say that a business model must contain a “value proposition.” Drucker said the business enterprise must organize its resources and capabilities in order to generate revenues and profits. This is now called “delivering value” to the customer.

Had management and marketing researchers built on Drucker's ideas about business enterprise from the beginning, the literature on business models would not be in its current state. A recent review of 681 peer-reviewed articles concluded that “... a basic clarification of the business model concept seems to be necessary” (Wirtz et al., 2016: 36). From a theoretical perspective, Wirtz et al.'s conclusion reflects our belief that the business model literature is in a rudimentary stage of development. In order for business model theory to progress, it needs to converge on the definition of basic constructs and then move systematically to the stages of explanation and prediction (Kerlinger and Lee, 1999).

In this article, we offer ideas for researchers to consider when studying business models and for managers to harness the power of business model innovation in developing their organizations. In the first section on theoretical foundations, we

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describe two discourses that we perceive in the business model literature, operational and dynamic, and relate these to the broader literature on organizations. In the second section, we discuss the application of value configurations to business models. In the third section, we link business models to organizational design. In the final section, we derive implications for future research and management practice.

Theoretical foundations of business model research

According to [Zott et al. \(2011\)](#), business model research needs conceptual consolidation in order to cumulatively develop. We believe that the conceptual building blocks were laid many decades ago and that revisiting them will not only help researchers interpret the existing literature but also guide future model building and theory development.

Drucker (1954: 29) asked the essential question: “What is a business?” In answering that question, he articulated the main elements of a business model. “The purpose of a business is to create a customer” (p. 31) ... “The business must control wealth-producing resources to discharge its purpose of creating a customer” (p. 35). He further elaborates: “Who is the customer?” (p. 44) ... “What does the customer buy?” (p. 45) ... “What is value to the customer?” (p. 47). Drucker later notes, “...only a thorough and careful activities analysis can bring out what work has to be performed, what kinds of work belong together, and what emphasis each activity is to be given in the organization structure” (p. 168-169). Finally, he calls attention to value appropriation: “The objective ... is to increase the proportion of contributed value retained as profit” (p. 60). Drucker's book thus described the essential elements of a business model: customers, value propositions, product/service offerings, and mechanisms of value creation and appropriation.

Writing around the same time as Drucker, [Forrester \(1958\)](#) provided a general theoretical statement linking the elements of a business model to organizational processes (he called it a “company model”): “...company success depends on the interaction between the flows of information, materials, money, manpower, and capital equipment” (p. 37) ... “After adequately representing the current operations of a particular company ... the next step is to determine ways to improve ... company success” (p. 47). He also introduced a dynamic dimension to the company model: “It is not just the simple three-dimensional relationships of functions that counts, but ... their relationships as dynamic activities” (p. 52).

We perceive two discourses running through the business model literature that can be traced to the works of [Drucker \(1954\)](#) and [Forrester \(1958\)](#). The first discourse deals with the operation of a business – how a firm creates value for customers and appropriates value by performing its activities efficiently and effectively. The second discourse deals with dynamics – how a firm modifies the elements of its business model over time in order to adapt to changes and disruptions in its environment.

Operational dimension

The operational dimension of a business model refers to how a firm conducts its business. A firm makes choices about its product/service offerings, its target customers, and the markets it intends to cover, as well as choices about how it will produce and deliver its products and services. Having made such choices, the firm forms an organization that can control and coordinate the activities it performs to satisfy customers and sustain the business ([Miles and Snow, 1978](#)).

Ideas related to the operational dimension can be found throughout the business model literature. For example, [Christensen \(1997\)](#) contrasts the activities and cost structure of Dell's business model of selling computers over the telephone and the Internet and then assembling to order vs. Compaq's and HP's model of selling through distributors. [Applegate \(2001\)](#) classifies e-businesses based on their vertical position in a value stream. [Chesbrough and Rosenbloom \(2002\)](#), emphasizing the importance of a business model as a guiding framework to maintain focus on and coherence among activities, describe how Xerox's established way of doing business prevented the company from pursuing its revolutionary breakthroughs in personal computer technology because the inventions did not appear to complement the company's strengths in activities such as copier services. [Amit and Zott \(2001\)](#) describe how e-commerce companies create value by introducing novel, more efficient ways of transacting and appropriate value by exploiting lock-in from network externalities. Accounts such as these in the business model literature typically make reference to the elements covered by [Drucker \(1954\)](#) – customers, resources, and revenue sources as well as their inter-relationships with the firm's activities. For a comprehensive review that highlights the importance of the operational aspects of business models, in the form of activity systems and cost-revenue architectures, see [Zott et al. \(2011\)](#).

Several organization theories are related to the operational dimension of business models. Theories of scale, scope, and transaction costs ([Chandler, 1990](#); [Porter, 1980, 1985](#); [Williamson, 1975](#)) inform choices about the economics of performing certain combinations of activities and governing the transactions among them. They therefore apply to understanding choices that firms make about value creation and value appropriation mechanisms. Theories of transaction services ([Economides, 1996](#); [North and Wallis, 1994](#)) and institutions ([North, 1991](#)) show the importance of technological innovation and network externalities in transaction services and the institutions that they embody, which in turn affect other major aspects of the economy. Theories of industry transformation and disruption ([Christensen et al., 2002](#); [Schumpeter, 1934](#); [Tushman and Anderson, 1986](#)) explain how technological and institutional innovations lead to new scale and scope configurations and industry structures. Taken together, these theories highlight the necessity of studying business models at the ecosystem level in order to understand how firms with different business models symbiotically and competitively affect each other.

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