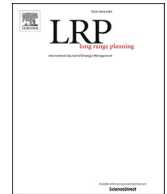




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Long Range Planning

journal homepage: <http://www.elsevier.com/locate/lrp>

Business models and dynamic capabilities[☆]

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ARTICLE INFO

Article history:
Available online xxx

Keywords:
Dynamic capabilities
Business model design
Organizational design
Strategy
Intellectual property

ABSTRACT

Business models, dynamic capabilities, and strategy are interdependent. The strength of a firm's dynamic capabilities help shape its proficiency at business model design. Through its effect on organization design, a business model influences the firm's dynamic capabilities and places bounds on the feasibility of particular strategies. While these relationships are understood at a theoretical level, there is a need for future empirical work to flesh out the details. In particular, studies that provide a better understanding of business model innovation, implementation, and change will also shed light on important aspects of dynamic capabilities. © 2017 The Author. Published by Elsevier Ltd. This is an open access article under the CC BY-NC-ND license (<http://creativecommons.org/licenses/by-nc-nd/4.0/>).

Introduction

A business model describes an architecture for how a firm creates and delivers value to customers and the mechanisms employed to capture a share of that value. It's a matched set of elements encompassing the flows of costs, revenues, and profits.

As the link to profits makes clear, the success of a business depends as much on business model design and implementation as it does on the selection of technologies and the operation of tangible assets and equipment. The business model provides a pathway by which technological innovation and knowhow combined with the utilization of tangible and intangible assets are converted into a stream of profits (Teece, 1986, 2006).

While the resource-based view of the firm focuses on the bringing together of assets that meet the four key criteria defined by Barney (1991) for resources and capabilities that can support durable competitive advantage—valuable, rare, imperfectly imitable, and non-substitutable (VRIN)—this is only one part of a process. The VRIN resources must be harnessed to a coherent strategy and a sound business model. Most successful business models, however, will eventually be imitated to some extent by other firms, and VRIN assets associated with a model can provide at least some protection against inroads by competitors.

The design and operation of business models are dependent on a firm's capabilities. The crafting, refinement, implementation, and transformation of business models are outputs of high-order (dynamic) capabilities. Dynamic capabilities, which are underpinned by organizational routines and managerial skills, are the firm's ability to integrate, build, and reconfigure internal competences to address, or in some cases to bring about, changes in the business environment (Teece et al., 1997; Teece, 2007). The strength of a firm's dynamic capabilities is vital in many ways to its ability to maintain profitability over the long term, including the ability to design and adjust business models.

Dynamic capabilities are easier to understand in the context of an organization's overall portfolio of capabilities, which can be thought of as working on two levels (Winter 2003). At the base level are operational and other ordinary capabilities, the routine activities, administration, and basic governance that allow any organization to pursue a given production program, or defined set of activities, more or less efficiently. Above these are a layer of dynamic capabilities, which can be divided into “microfoundations” and higher-order capabilities (Teece, 2007). Microfoundations involve the adjustment and recombination

[☆] for Long Range Planning special issue on Business Models and Business Model Innovation, Christopher Lettl and Thomas Ritter editors.
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<http://dx.doi.org/10.1016/j.lrp.2017.06.007>

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Please cite this article in press as: Teece, D.J., Business models and dynamic capabilities, Long Range Planning (2017), <http://dx.doi.org/10.1016/j.lrp.2017.06.007>

of a firm's existing ordinary capabilities as well as the development of new ones. They are second-order dynamic capabilities that include new product development, expansion into new sales regions, the assignment of product mandates across divisions in large companies, and other actions that constitute astute managerial decision making under uncertainty. Guiding these are the high-order dynamic capabilities by which management, supported by organizational processes, senses likely avenues for the future, devises business models to seize new or changed opportunities, and determines the best configuration for the organization based on its existing form and the new plans for the future.

In this paper, I will be referring primarily to the highest-order dynamic capabilities, the sensing, seizing, and transforming competencies that aggregate and direct the various ordinary capabilities and the second-order dynamic capabilities. The highest-order capabilities are those on which top management is (or should be) most focused. They are the most relevant for the innovation and selection of business models that address the problems and opportunities the company is endeavoring to solve/exploit.

The paper begins with brief definitions and expositions of business models and dynamic capabilities. This is followed by a discussion that separates business models from strategy and then positions both within the dynamic capabilities framework. Next comes a discussion of the primary interactions between business models and dynamic capabilities: (1) the contribution of dynamic capabilities to business model innovation and (2) the importance of organizational design for both constructs. A concluding section provides a summary and discusses implications for future research.

Definitions

In this section I will briefly define how I am using the terms business models and dynamic capabilities since there are variations of both terms to be found in the literature.

Business models

There are almost as many definitions of a business model as there are business models. Several studies have listed or compared various definitions and lists of business model components. See for example [Zott et al. \(2011\)](#) and [Birkinshaw and Ansari \(2015\)](#).

My own definition is that a business model

... describes the design or architecture of the value creation, delivery, and capture mechanisms [a firm] employs. The essence of a business model is in defining the manner by which the enterprise delivers value to customers, entices customers to pay for value, and converts those payments to profit. ([Teece, 2010: 172](#))

In other words, identifying unmet customer needs, specifying the technology and organization that will address them, and, last but by no means least, capturing value from the activities are important functions of the business model. Without the right balance between creation, delivery, and capture, the model will not be in operation very long, at least not by for-profit enterprises. In short, the business model outlines the (industrial) logic by which customers are served and money is made.

A compact but fairly comprehensive list of components is provided by [Schön \(2012\)](#). His schema is similar to that of [Osterwalder and Pigneur \(2010\)](#) but further compiled into three main categories. Slightly adapted, the list is as follows:

Value Proposition: Product & Service; Customer Needs; Geography

Revenue Model: Pricing Logic; Channels; Customer Interaction

Cost Model: Core Assets & Capabilities; Core Activities; Partner Network

The elements of a business model must be internally aligned and coherent ([Ritter, 2014](#)). For example, the (ordinary) capabilities of the firm must be able to provide the planned customer value. Furthermore, the business model must be aligned with the internal structure and overall management model of the company ([Birkinshaw and Ansari, 2015](#)).

In practical terms, this means that extreme business model transitions (those involving a new field of technology, a very different customer base, organizational re-engineering, or some combination of these and other disruptive changes) within an existing business are unlikely to succeed without major financial resources and steely commitment. For example, taxi cab companies are not attempting to replicate the ride-sharing models of Uber or Lyft because those models are based primarily on software and data skills. Taxi companies, by contrast, are small, low-technology enterprises based on long-term contracts with part-time and full-time drivers employing limited information technology in a delimited geographical area and facing (heretofore) restricted competition. Their managerial and organizational resources are unlikely to be able to handle an engineering- and information-driven revamp of the business. At present, it looks like these companies will simply continue to serve the shrinking segment of the market that has not embraced the use of mobile computing for everyday transactions. Their key assets are often locational, such as regulated privileges to occupy taxi stands and airport-pick-up parking set-asides. An old technology often improves with competition from the new, as when sailing ships became "tea clippers" to compete with steamships, but the changes are rarely sufficient to hold back the tides of change without some sort of regulatory barrier to enforce it ([Mokyr, 1990](#)).

As noted, business model transitions that fit comfortably with the existing business are far easier to implement. Although this rarely suffices to restore a competitive advantage that is under assault, small transitions can enhance value capture. For example, Goldman Sachs was able to increase its business for a complex debt instrument known as structured notes by

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