26

The Challenge of Steering Business Model Innovation

POH MUI HOON

In the modern era of digital disruption, companies are still exploring the full potential of the internet even as they seek to transform their businesses by capitalising on the commercial benefits of cloud computing, artificial intelligence, social media, and a slew of other exponential technologies.

A company's true digital transformation does not, however, come solely from the use of such disruptive technologies. Rather, it is based on how these exponential technologies combine with innovative business models so that the business transformation produces a disruptive power that disproportionately affects the value of goods and services.

In other words, it is the innovative quality of the business model that makes the difference. That, for example, is how the sharing economy has emerged led by start-ups like Uber and Airbnb which are disrupting taxi companies and hotels.

Innovative business model is something that large, established incumbent companies, and their boards in particular, struggle with. Consider the fate of Kodak and Blockbuster who were left by the digital wayside when they stuck to old products and old business models.

STUCK IN A RUT

But why have such incumbent companies, and many others like them, struggled to innovate their business models? There are a number of reasons.

First, their focus has tended to be on their bread and butter: the priority is to execute an existing business model, and to ensure that it operates efficiently and satisfies its current customers. The company exists to maximise shareholder value, which implies keeping the stock price high. As a result, it uses financial ratios like return on net assets, internal rate of return, and return on capital deployed to measure efficiency. This means the company needs to invest in things that yield faster returns in the short-term, making it difficult to invest in long-term innovation.

The *raison d'etre* of a start-up, however, is to search for a new business model. A start-up usually gets very little respect from the establishment because of the uncertainty and size of its revenue stream. And if the company within which the start-up division is "germinating" emphasises established lines – because these are its bread and butter – then, it is inevitable that the start-up activities are viewed as extra-curricular indulgences, and therefore expendable.

The second reason established companies are often slow to react to digital disruptions is their low risk appetite and corresponding reluctance to experiment. Finding a viable business model is not just hard work, it is also a process that requires trying new things, talking to customers and continually making adjustments. The whole process is time-consuming.

Large corporations generally want their ventures, new or otherwise, to produce revenue in a predictable way. The mentality requires certainty. Ironically, this approach only increases the possibility of failure. Because the ability to pivot is key, and plans cannot be cast in stone.

The third reason is that people with the ability to do start-ups do not fit well in established organisational structures. If the company's emphasis is on seniority and the size of the P&L, it will be averse to people with a start-up approach. It will view such people as risk takers, corporate rebels to be exact. Their predisposition to question rules and experiment means they cannot be easily managed in an environment that values continuity, compliance and stability.

THE ROLE OF THE BOARD

As corporate stewards, the board needs to ensure that the company grows, or at least stay around for the long term. The company needs to proactively address the threat and the opportunity presented by digital disruption. The board should help the management think beyond what may be their core business today, to innovate and invest in new areas to mitigate the risk of business obsolescence.

In this regard, the board should ensure that innovation is nurtured by supporting entrepreneurship and start-up development – business model innovation, in other words. It can do this in several ways:

- Actively sponsor business model innovation projects. Directors can help formulate objectives and provide oversight by drawing on their collective experience and networks.

- Take the necessary risk by understanding the need to experiment, pivot new business plans, and provide real support through action and not just words. Business model innovation need not be an all-or-nothing approach. Instead, it can often be prototyped on the cheap by creating a "minimal viable business model" and experimenting with it.

- Ensure that people who run the start-ups within the company are accorded the same respect as people who run huge legacy P&Ls.

At the end of the day, the CEO takes his or her cues from the board. If the board is risk adverse, looks for certainty and loathes uncertainty, the CEO will end up tip toe-ing around the board with small incremental innovations. He or she will not implement the necessary bold business model innovations for the company to survive. And as Blockbuster and Kodak will tell you, that is never a good thing. ■