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Business Model Design Themes, Value Propositions and Firm Performance

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Abstract

This paper presents the results of a study of business model design themes of 30 retailers from Russia. We find a positive relationship between novelty-centred business models and company performance. Furthermore, companies achieved the best performance by combining elements of the efficiency and complementarity business model design themes.

Introduction

While there has been much research on business model configurations (Gassmann, Frankenberger, & Csik, 2015), business model types (Baden-Fuller & Haefliger, 2013) and business- model innovation (Foss & Saebi, 2017) during the past 15 years, little has been done on the link between business models and firm performance (George & Bock, 2011). In turn, the lack of research (Morris, Shirokova, & Shatalov, 2013; Zott & Amit, 2007, 2008) hinders the analysis and assessment of the link between business model configurations and firm performance (Amit & Zott, 2001; Tretyak & Klimanov, 2016). The aim of this paper is to help fill this gap. This line of research is considered important for the insights it can provide to researchers and practitioners on how to increase firms' value creation and capture (Zott & Amit, 2007).

This paper is based on the notion that a company's business model signifies its value propositions, value creation, value delivery and value-capture activities. Moreover, the business model can be viewed as a representation of its realised business strategy (Casadesus-Masanell & Ricart, 2010). Here, business strategy is

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understood as the way in which a firm chooses to position itself against competitors in its potential markets (Zott & Amit, 2007).

Drawing on research by Amit and Zott (2001) and Zott and Amit (2008), we investigate how a company's value proposition, driven by its business strategy, influences its performance. We define a company's value proposition as the bundle of products and their characteristics (e.g. product or service, level of standardisation, differentiation, brand, etc.) required to solve a customer need (Holm, Günzel, & Ulhøi, 2013), or to "get a job done" (Johnson, Christensen, & Kagermann, 2008) for a consumer. A company's value capture is represented by its cost structure and revenue model, which result in monetary consequences, i.e. its economic performance.

Approach

As we have indicated above, we follow Amit and Zott (2001) in recognizing four sources of value creation: efficiency, complementarities, lock-in and novelty. Later papers by Zott and Amit (2007, 2008) concluded that these four sources of value creation can be analysed as design themes that determine the construct of a business model. By efficiency is meant transactional efficiency, according to which efficiency is increased when the price of a transaction is reduced. Complementarity is understood as achieving some synergistic effect from selling a set of products and / or services. In other words, the value of A and B is higher when these goods are purchased together than if they were purchased separately and at different times. How effectively a company manages not only to attract new customers, but also to retain them, is also directly related to the creation of additional value. A lock-in design theme mainly focuses on preventing customers switching from a company to its competitors. The development of new products and services, new methods of production, distribution, marketing technologies, and new markets are all ways of creating new values. The source of value creation - novelty, or innovation - is aimed at creating completely new markets or developing new approaches to improving transactions in existing markets. Thus, companies employing one of the design themes will adjust their business models' components, including their value propositions, to the chosen design theme.

Following Amit and Zott (2001) and Zott and Amit (2007), we proposed the following five hypotheses:

H1: The more a company's value proposition is efficiency-oriented, the better the company's performance.

H2: The more a company's value proposition is complementarity-oriented, the better the company's performance.

H3: The more a company's value proposition is lock-in-oriented, the better the company's performance.

H4: The more a company's value proposition is novelty-oriented, the better the company's performance.

H5: Value-propositions from different business model design themes will have a positive effect on a company's financial performance.

To test the hypotheses, we collected data on the value propositions and business model design themes of the top 30 Russian retailers in the home appliances and consumer electronics markets in Russia. The selected firms are either national players or international subsidiaries, with a combined market share of approx. 70%. The economic crisis in Russia in 2014 resulted in a sharp drop of around 25% in the sale of consumer goods, so most of the retail companies in the study were already looking for new ways of generating profits and experimenting with various business model configurations. This made them very suitable for studying business model elements and their influence on performance.

The data were collected by means of a survey instrument and structured face-to-face interviews in March and April, 2015. Five experts from the Russian branch of the German marketing research company GfK were asked to complete a special questionnaire designed to identify business model design themes in each of the studied companies. These experts regularly conducted market and company analyses of the home appliances and consumer electronics retailers and markets in Russia, and interacted with top- and middle-level employees in the studied companies on a daily basis. Thus, they were aware of most of the internal processes in the companies, including business objectives and

market strategies, so their knowledge of the companies' business models is both profound and relevant. Moreover, given that they do not work in any of the studied companies, we can probably assume that their evaluations are less subjective and skewed towards the positive than if we had interviewed actual employees from each company.

We asked each expert to evaluate the business model design of all 30 companies, resulting in 150 different questionnaires. Once these questionnaires were aggregated, we then carried out a follow-up discussion with the experts to formulate and confirm a common approach to evaluating all attributes of the business model design themes of each company. For each company in the study, a design theme of the business model and corresponding elements of its value proposition were identified and measured on efficiency, complementarities, lock-in and novelty characteristics. The items for measuring each design theme and value propositions were borrowed from the approach developed by Zott and Amit (2007). The strength of each of these items was measured using 5-item Likert scales and coded into a standardized score. Each business model design theme was measured as a variable at a particular point in time. These variables were then regressed on a range of performance measures, provided by GfK RUS.

In line with other empirical studies (McArthur & Nystrom, 1991; Tushman & Anderson, 1986), we employed financial representation of the growth in sales turnover as the measurement of a firm's performance and our dependant variable. The data were analysed using linear regression analysis with the least square root method. Hypotheses H1, H2, H3 were rejected, suggesting that value propositions based on efficiency, complementarity and lock-in did not determine the financial performance of the studied firms. Hypothesis H4, however, was accepted, pointing to the importance of novelty-focused value propositions for business model performance.

To test hypothesis H5 we built a model using the method of stepwise regression, where individual items from each design-theme value proposition were considered or rejected as part of the set of items explaining the dependant variable, i.e. firm performance in terms of the growth of sales turnover. The coefficients of determination for this model were 0.62 (R^2) and 0.54 (adjusted R^2), suggesting a goodness of fit and good explanatory power of the model, as well as confirming hypothesis H5. Three value-proposition items were found to be highly significant, with positive coefficients:

1. One company's product / service enabled customers to solve their problems with the least effort (an efficiency design-theme attribute);
2. Customers of another company combined the use of several products / services to achieve synergistic effects (a complementarity design-theme attribute);
3. Key business partners do not collaborate with competitors of the company (a novelty design-theme attribute).

However, the efficiency and complementarity items were significant with a positive coefficient only in combination with the novelty items, suggesting that they only influenced firm performance if the firm's value proposition had a novelty focus.

Key Insights

The study has confirmed some findings from existing research and also produced a number of new insights. Like Zott and Amit (2007, 2008), we find that a complementarity and lock-in focus in business model design is insignificant for firm performance, although this research treated them as independent variables, and not as control variables. Furthermore, our analysis confirms a positive relationship between novelty-centred business models and firm performance. With this in mind, we can assume that a positive development in firm performance affects the renewal of the business model, related to the change in the value chain itself. In other words, companies whose business models are more innovative-oriented, e.g. offer and develop new products, create new needs for clients or develop new approaches to doing business, are more likely to demonstrate better economic performance.

An important new finding is that the highest correlation between value propositions and firm performance was found in a business model design composed of items from different initial design themes developed

by Zott and Amit (2007, 2008). More specifically, two items from the complementarity- and efficiency-focused value propositions were found to be significant for firm performance. The first is related to a company's ability to combine its products and services in such a way as to create synergy for its customers, while the second is related to the level of efficiency with which a company's products and services satisfies consumer needs. This proves Zott and Amit's (2008) statement that the identified four design themes of the business model are not mutually exclusive: elements of all the design themes can be present in a single business model, though there should always be a preference for a particular design theme (ibid.).

Discussion and Conclusions

Like Zott & Amit (2007), we also find that novelty-centred business models enhance firm performance, measured here as growth in sales turnover. However, our research further shows that the performance of a novelty-based business model can be improved by adding elements from other business model design themes, when adjusting value propositions to market conditions.

This leads to two important questions for discussion:

1. First, whether business model design themes can be defined as being novelty-, efficiency-, lock-in- or complementarity-centred, as suggested by Amit & Zott (2001) and Zott & Amit (2008). A business model configuration can also be influenced by the business environment as well as the industry, or even society, it is embedded in. For example, a study of Chinese firms by Wei, Song and Wang (2017) finds that manufacturing flexibility promotes both efficiency- and novelty-centred business model designs, and, subsequently, firm performance. Furthermore, the relationship between manufacturing flexibility and an efficiency-centred business model design is strengthened by competitive intensity, but weakened by demand heterogeneity. In contrast, the relationship between manufacturing flexibility and novelty-centred business model design is weakened by competitive intensity, but strengthened by demand heterogeneity. Their findings thus indicate a need to adjust business model design to the competitive landscape.
2. Second, whether a company's business model is secondary to its business strategy, and, as suggested by Casadesus-Masanell and Ricart (2010), represents the company's realised strategy. Zott and Amit (2007) also find that novelty-centred business models can enhance firm performance when coupled with product market strategies that either emphasize differentiation (i.e. innovation) or cost leadership, suggesting that business models and business strategies are complements, not substitutes for each other.

Following this line of discussion, the fundamental question for managers and entrepreneurs is what to choose first, i.e. a competitive business strategy or a business model design. For example, Holm and Günzel-Jensen's (2017) research on freemium business models of online digital firms shows that choosing a freemium business model implies choosing a specific way to compete. The study finds that successful freemium companies employed similar business model designs, a 'prospector' strategy (Miles & Snow, 1978), and similar sets of tactics to outperform their rivals. However, the research does not show what the companies chose first, i.e. a strategy or their business model designs, or whether the two were evolving hand-in-hand.

As in the above-mentioned and other research contributions, our study illustrates and confirms a link between business model design and firm performance, albeit one which depends on the choice of business strategy and its implementation through the business model design elements. However, this complex relationship requires further studies before we can help practitioners design their business models to achieve the desired company performance.

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