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Toward a Theory of Business Model Innovation within Incumbent Firms

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Abstract
Toward a Theory of Business Model Innovation within Incumbent Firms

This paper presents a theory of business model innovation (BMI) within incumbent firms. The process of business model change is examined, with particular attention to business units in a multibusiness enterprise. The paper expands upon past definitions of business models. It identifies four separate but interrelated components in a business model:

- A set of elemental *activities*.
- A set of *organizational units* that perform the activities (some of these units are internal to the firm, others external).
- A set of *linkages* between the activities, made explicit by an isomorphic set of physical *transactions* (between the organizational units that perform the activities) and human *relationships* among the individuals who supervise and/or manage the linked organizational units.
- A set of *governance mechanisms* for controlling the organizational units and the linkages between units.

A business model thus juxtaposes two systems: a system of *activities* and a system of *relationships*. It is only by considering the social contexts in which the internal and external transactions occur that executives can fully appreciate the critical dynamics of organizational change that must accompany BMI.

In focusing on business units within large multibusiness corporations, the paper suggests that those business units can be more likely to produce BMI than freestanding business units if the corporation is able to create a favorable context. The dimensions of that context – what is called the BMI-Conducive Corporation – are explored, as are the transformational organizational changes required to produce such conduciveness. Finally, the paper presents implications for both managers and researchers of the proposed theory of BMI within incumbent firms.

Key words: business model, innovation, competitive strategy, corporate strategy, value creation, strategic renewal

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The Emerging Importance of Business Model Innovation

Academic interest in the concept of business models grew dramatically in the late 1990s in the context of the information technology boom. A search of academic articles using "business model" as a key term revealed 166 such articles between 1975 and 1994, and 1,563 between 1995 and 2000 (Ghaziani & Ventresca, 2005).

Executives too became increasingly focused on the potential for value creation to be derived from business model innovation (BMI); that is, companies finding a performance advantage by altering their existing business models. A recent survey of 765 corporate and public sector leaders uncovered widespread hope that BMI would provide a significant engine for increased profitability (Pohle & Chapman, 2006). In addition, the survey revealed that these same executives believed BMI would be responsible for *a significantly larger impact on performance improvement than would new product or service offers*.

That heightened interest in business models grew largely from a focus on web-based startups: Amazon reached book buyers through the Internet rather than through stores, Netflix allowed video renters first to browse their selection on-line and then to view via the Internet. E Bay took garage sales and neighborhood auctions into the electronic age. And so forth. Intense focus on startups, however, left an important gap. Startups are greenfield sites where almost anything is possible (constrained, perhaps, by the providers of capital). However, startups represent only one of three types of business firms. There is also what can be called the free standing business (B_{FS}) and the business that is a unit residing within a multibusiness corporation (B_{UC}).[1] Managers of startups face many challenges. However, *altering* a business model is not one of them. That challenge exists only for an incumbent company – either a B_{FS} or the B_{UC} – with an existing business model.

Attention to Internet-based business models raises another dilemma. Technological revolutions such as the Internet inevitably create opportunities for BMI. But is a technological revolution a prerequisite? Because the literature on BMI – both academic and practitioner literature - is so deeply rooted in the context of the Internet, executives might conclude that the answer is *yes*. That conclusion, if true, would create a dilemma. Businesses eager to exploit opportunities for value creation through BMI would need to await the invention of a new technology or, if they were more proactive, to invest in R&D with the aim of generating technology breakthroughs. Both of these options are risky, slow, and expensive.

However, the conclusion that BMI depends on technological innovation is mistaken. BMI offers a route to strategic renewal for both the B_{FS} and the B_{UC} that does *not* rely on breakthrough technologies or new product launches or the development of new markets.

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[1] To provide examples, Starbucks, E. Leclerc, and Lowe's are B_{FS}s, and NBC Universal (GE), Louis Vitton (LVMH) and Geico Insurance (Berkshire Hathaway) are B_{UC}s.

Furthermore, the firm typically does *not* need to invest in the development of the knowledge required of BMI. That knowledge already exists within the firm.

BMI offers the opportunity for what we refer to as *lean* value creation. The true "cost" of BMI value creation from within both the B_{FS} and the B_{UC} is the cost of organizational change, not the cost of heavy investments in new ventures, R&D, and/or new technology acquisition. At this time of particularly severe economic constraint, BMI offers an especially attractive alternative.

Although BMI provides an opportunity for lean value creation, the existence of a business unit within a corporation presents a unique set of circumstances. Managers of the B_{UC} are typically constrained by their relationship to the corporation: both to the corporate center and to the other B_{UC}s within the corporation. B_{UC} managers rarely have the autonomy to alter their existing business models without the involvement, or even perhaps the permission, of the corporate center. And when the corporation has created tight operating linkages among the various units, each individual B_{UC} becomes further constrained, which renders BMI more difficult, as innovations in the business model of one B_{UC} affect the others.

At the same time, membership in a corporation offers greater opportunity for BMI. Corporate B_{UC}s can more easily share deep BMI knowledge or insights concerning shifts in the marketplace with managers from other business units than can unlinked B_{FS} units. The "internal network" is greater and broader, allowing more exploration about business model innovation. Even if the corporate strategy is to pursue unrelated diversification, B_{UC}s operating in one product/service market might gain insight into potential activity configurations from their fellow B_{UC}s operating in different markets. As Spanish textile group Inditex and French hotel operator ACCOR. Have demonstrated, BMI can become a main corporate value drivers.

By analyzing the dynamics of BMI within both the B_{FS} and the B_{UC}, we suggest three associated characteristics:

1. The B_{FS} and the B_{UC} share many of the challenges and opportunities of BMI.

2. By virtue of its membership in the larger corporation, the B_{UC} has an additional set of constraints and opportunities.

3. The corporate center can manage its relationship with its member units (B_{UC}s) in such a way that lessens these constraints and increases the opportunities for BMI.

This paper is conceptual and theory generating rather than empirical and theory testing. We offer a set of propositions concerning BMI within incumbent firms, both the B_{FS} and the B_{UC}, and the role of the corporate center in maximizing the opportunity for BMI from within. We conclude the paper by suggesting future avenues for research on the topic of business model innovation, as well as practical implications of our theories for practicing managers.

Research Methodology

As noted, the paper is conceptual and theory generating rather than empirical and theory testing. A number of examples are presented as first evidence for our theory of BMI. Those case examples are drawn from three sources: research conducted by one or more of the authors, publisher case studies, and publically available articles and books:

Company	Author Research	Published cases	Published articles / books
Zara	✓	✓	
Gap		✓	
H&M		✓	
Embraer	✓	✓	
Taco Bell		✓	
Joplin Clinic*	✓		
Lufthansa	✓	✓	
Sears			✓
Auratek*	✓		
Nissan	✓	✓	✓
ACCOR		✓	
Disney		✓	
Vail Ski Resorts			✓
Jeronimo Martins	✓		
General Motors			✓

*Denotes disguised names.

Defining the Business Model

The first barrier to successful BMI is the lack of understanding that often exists within firms, both the B_{FS} and the B_{UC}, of just what the current business model is (Johnson, et al., 2008). Analysis and management cannot proceed without agreement on terms and definitions, and currently there is not a widely agreed definition that would allow clarity to emerge and academic science to progress.

The term “business model” first appeared in an author-supplied abstract in 1947 (Lang, 1947), in a listing of subject terms in 1949 (Mertes, 1949), and in the title of an article in

1960 (Jones, 1960).[2] None of these articles offered a definition of the term "business model." It was used, instead, largely as shorthand for business strategy, a confusion that continues even today.

Modern usage of the term grew out of the Internet revolution and its impact on transactions both within the business and across the multiple activities in the value chain (Evans & Wurster, 1999; Timmers, 2000; Hamel, 2000; Mahadevan, 2000; Afuah & Tucci, 2001; Amit & Zott, 2001; European Commission, 2002; Elliot, 2002; Mansfield & Fourie, 2004). The Internet, after all, offered the opportunity to create new value propositions and new linkages with external customers, suppliers, and partners. Priceline, for example, innovated the business model of travel agencies by using the Internet to offer customers the opportunity to swap travel features for price, while simultaneously allowing suppliers (airlines and hotels) to claim value from excess inventory (Amit & Zott, 2001; Zott & Amit, 2008).

The business model construct has far broader applicability than the capacity of new technologies to information transactions or knowledge transfer (Margetta, 2002; Chesbrough, 2007). Innovative business models have emerged in industries with tangible elements. Zip Car developed a car rental business that removed the requirement to pick up and drop off a car at a reservation center, and Metro introduced an innovative business model – a daily newspaper dependent entirely on advertisements and given away free of charge to readers – in an old and declining industry.

Still, no single definition exists (Schweizer, 2005). Ghaziani & Ventresca (2005), in fact, identify 11 separate constructs of the term from academic and popular literature. Due to the confusion and uncertainty in the literature, we believe it is critical for both practitioners and academics to agree upon a definition.

A Business *Model* is not a Business *Strategy*

The most frequent confusion is to equate, either explicitly or implicitly, the terms "business model" and "business strategy" (for example, in Styles & Goddard, 2004; Yip, 2004; Markides, 2008; Johnson, et al., 2008). We suggest that, even though the two concepts are closely related, a business model exists as a concept of its own that needs to be distinguished from a business strategy. If the terms were interchangeable, the use of separate terms would only result in confusion.

A business strategy is specified by the answers to three questions: *what* is the offer, *who* are the customers, and *how* is the offer produced and delivered to the customers? It is the *how* question that subsumes the firm's choice of business model. Organizations can have essentially the same product or service offer (the *what*), aim for the same market segment (the *who*), and do so with different business models (the *how*).

[2] Based on a search of academic journals conducted via Business Source Premier in August 2008.

Case 1 ("Business Model Value Creation at Zara") provides details of Zara's innovative business model. It is notable how Zara's rise to fast fashion dominance did not depend on product or market innovation. The heart of the company's innovation lay in its configuration of activities within its design and supply chains. Of course, Zara's founder innovated in offer by offering fashion to the 16 to 24 year old segment (which was used to branded goods, not fashion goods that were mostly available to an older, more mature, wealthy, fashion-conscious segment). By introducing weekly new collections to this segment, "freshness" was offered to the market that was not even available in the classical fashion segment (but that was the hallmark of Benetton which only offered freshness in color). The Zara offer was thus radically new, in that no other fashion player could introduce new collection items biweekly or even weekly in contrast with the industry norm of seasonal collections. Yet, the heart of this new strategy was the answer to the *how* (indeed the focus of the entire industry already was on "quick response") that made this continuously changing young fashion offer possible.

Case 1
Business Model Value Creation at Zara

Amancio Ortega was an established supplier to the apparel retail industry in Spain.[3] He became increasingly worried by the ever more pressing demands that retailers like El Corte Ingles were putting on him. In addition, he felt that on some issues he could do a better job in merchandising than they did.

In the end, following a suggestion from someone close to him, he opened a new store in La Cruna in Northern Spain, where some of his factories were located. The store very soon was the talk of the town: it was catering to the young, offering them fashion garments that were affordable. Given that Ortega was on both sides of the street, managing both store, product design and manufacturing, new collection items were made at very high speed and the idea of a rapidly changing offer was born.

It then took a few more years to define the ZARA business model. It had many innovative features, but the most remarkable one was an extended supply chain (that is including design) configuration that was radically different from anything known in the apparel industry. For one, design was partially outsourced (at very low cost) to the market where designers would show their creative ventures in famous fashion shows run in Paris, London, New York and Milan. Fashion designs shown there would hit the mass market only one year later at the earliest and if at all, due to the 12 month lead times in bringing the new collections to the mass markets. What the fashion world was missing was a fast supply chain linking the world of fashion designs to that of contemporary fashion-conscious shoppers visiting fashion stores displaying collections that were "hits" in the fashion shows one year earlier. Zara thus would not commit to a single designer, as this in addition would only increase the risk that their designer in any season would not necessarily be "in fashion." Furthermore, designers were known for being inflexible, difficult to deal with, and prone to risk.

[3] This case is based on the authors' research plus Harlé et al. (2002).

Zara made a fundamental decision to remove value design from the traditional fashion industry business model. Instead, Zara would scan for the best designs by following the world's leading fashion shows and scanning promising designs of others. Only Zara, with its quick scanning and adapting processes could take advantage of the information gathered from attendance at the world's fashion shows by, at the limit, deploying their versions of leading new designs a few weeks later in their own stores. That is where Zara truly innovated in business model design by focusing on quick adaptation of the models of trendy fashion designers taking also into account (through test shops and actual experiments where prototypes would be worn) the preferences and emerging trends of its chosen market segment of young, price conscious, and not so wealthy fashion-seeking customers.

Style, speed, and cost were key imperatives. Fighting complexity and keeping things manageable was a corollary implication. If new products had to come out every week, final design had to use whatever raw materials were currently in stock. No designer would accept such constraint. Finally, during the season, these same designers would respond to requests from store managers who had a close pulse on their repeat lead customers and knew what "their market" was eagerly waiting for. The "PULL" concept was introduced in the world of fashion. Finally, to make operations go smoothly, the lead management team, for each product line, consisted of a trio: the (final) designer (using CAD-CAM technology), the commercial person (talking to the store managers and analyzing previous sales), and the supply chain person ensuring that the collection that would be agreed to on the table could actually be made in order to deliver new fashion to shops every week and change seventy percent of the stores. This team was the key governance instrument for orchestrating internal activities. Preferences of fashion conscious customers provided the other governance input.

The underlying value creation of Zara's business model can be brought into clearer focus by looking at a principal international competitor: the GAP. That company maintained value chain configurations and linkages that were traditional for the apparel industry. At GAP, design preceded manufacturing and commercial activity, while Zara's business model configured the same activities simultaneously by taking a team approach to the design-manufacturing-commercialization activities.

Another competitor, H&M, aimed for much the same market as Zara with a business model that was closer to that of the GAP than to that of Zara. **Exhibit 1** illustrates how Zara's business model differed from that at H&M. Although aiming at much the same market segment, H&M outsourced all of its production. Zara's retained many production activities in house and kept all internal and external activities under its strict control. H&M's competitive strategy differed also in certain attributes of its offerings: prices were lower, its spending on advertising much higher, and its stores less upscale. Both GAP and H&M relied on a traditional "push" approach, devoting substantial resources to advertising. Zara used a "pull" approach, attracting shoppers with small collections and

new weekly offerings in reaction to customers. As a result, Zara did not use any product-specific advertising.

Exhibit 1

Comparing ZARA and H&M

	Zara	H&M
What?	**Fast fashion**	**Fast fashion**
Who?	**Young, suburban, fashion-seeking shoppers**	**Young, suburban, fashion-seeking shoppers**
How?	**Substantial vertical integration, including final design, raw material warehousing, cutting, assembly and logistics**	**Traditional vertical disintegration, with most production outsourced to an independent and dispersed supply network**

A model is a theoretical construct of a bordered set of activities used to depict structure, components, and relationships. In our view, a model possesses three characteristics:

1. It is *explicit* – that is, it can be codified in a precise and formal way.

2. It is *public* – that is, it can be transmitted and understood widely.

3. It is *general* – that is, it has applicability that is not individual or specific.

When those characteristics are applied to a business model, we can say that a business model is *not* firm specific. The business model of one firm can be seen, understood, even (theoretically) replicated by another firm.

We do not mean to imply that the explicit, public, and general nature of a business model makes replicating another firm's business model trivial. All evidence is to the contrary. The multiple failures of established airlines – Delta, Continental, and so forth – to replicate the business model of Southwest Airlines suggest the challenge of copying a model that is explicit, public, and general. Porter and Siggelkow (2000) have noted the complex interaction between activities and context that creates an activity system that can be difficult for competitors to imitate. Szulanski and Winter (2002) note that attempts to replicate best-practice operations typically disappoint. Replicators often fail to appreciate the complex interconnections of multiple activities that constitute a "best practice."

Replicators, in Szulanski and Winter's view, typically do not replicate at all. Instead, they copy piecemeal from one or multiple models, hoping to achieve not just strategic parity but superiority. Therefore, we suggest that, although a business model itself is explicit, public, and general, replication is difficult. That difficulty arises from the interactions of that model with the set of operational parameters the firm uses to determine the intensity at which the various activities that compose the business model will be performed, as well as with the *who* and *what* elements of the firm's strategy.

Business strategy represents a system in which each of the three defining elements interacts with the other two. The adoption of a new business model (the *how)* may therefore generate some variance in the *who* and the *what*. That is a straightforward implication of the systemic nature of business strategy choice. A company that chooses to outsource, for instance, may impact customer preferences. At firm that places it offerings online, the type of customer and the full scope of the offer typically is extended.

The major point is that strategic renewal initiated by BMI differs from approaches based on new products, new markets, and/or new technologies. The BMI approach is typically is less expensive and less risky, as it avoids the risky and costly development and experimentation that is typically associated with product-market choices.

Building a Definition on Past Business Strategy Theory

Our conceptualization of business model as an integral part of strategy builds on existing strains of business strategy theory. We start with Porter's notion of the value chain: the activities involved in producing and delivering a good or a service (Porter, 1985, 1996). Value-chain analysis points to *activities* – say, inbound logistics, operations, outbound logistics, marketing, sales, and so on – as well as *linkages* across activities. Linkages are defined largely in economic terms, the focus being on the value flows across activities and in particular, how activities in one category impact the cost of other activities.

Stabell and Fjeldstad (1998) expanded the notion of value "chain" to value "network." In a value network, the firm organizes and facilitates a complex set of exchanges among "actors, people, and organizations" (p. 427). In such a network, linkages among activities are reciprocal rather than sequential. Because people are involved in the linking activities – expanding on Porter's more economic transactions – an opportunity exists for learning (see also, Normann & Ramirez, 1993; Allee, 2003).

Amit and Zott (2001) integrated multiple streams of analysis - among them, value chain analysis, innovation, strategic resources, strategic networks, and transaction cost economics - to provide a specific definition of business models: "A business model depicts the content, structure, and governance of transactions designed so as to create value through the exploitation of business opportunities" (Amit & Zott, 2001: 511). In that definition, content referred both to the goods and information being exchanged as well as the resources and capabilities required to enable the exchange; structures refers both to the involved parties and the ways in which the parties are linked; and governance refers to the controls placed on the exchanges. Recently, the authors added a point of

specification: "It [a business model] represents a conceptualization of the pattern of transactional links between the firm and its exchange partners" (Zott & Amit, 2008: 3). The focus, then, was placed exclusively on external linkages.

From a managerial perspective, Zott and Amit's definition lacks two vital aspects. First, by including only inter-firm linkages to the exclusion of intra-firm linkages, the business model definition fails to consider the organizational system as a constraint. Given Zott and Amit's focus on startups, that omission is understandable. After all, when individuals start an organization, there is no organizational system to act as a constraint. However, the requirement for BMI within the B_{FS} and the B_{UC} assumes the existence of an organizational system that will exert significant influence over internal linkages. The sole consideration of external linkages is insufficient for managers operating an existing business model and hoping to undertake BMI. For example, it would be hard to conceive a change of an existing business model by altering the governance of an internal transaction, say, through resequencing internal activities, because such transaction would not be identified in a definition of business model that specified only external linkages.

Second, by focusing on transactions, the authors omit the centrality of relationships – that is, particular human interactions that include social, political, and interpersonal dimensions – as part of the business model. The exchange of information is dependent on the nature of social networks and the quality of relationships among the individuals engaged in the exchange (Borgatti & Cross, 2003; Abrams, et al., 2003; Levin & Cross, 2004). Distance (both physical and psychological), trust, strength of the relation, even motivation to send and receive are among the characteristics of the relationship between linked parties that help determine the quality and quantity of information flow. Information is exchanged between people, and that transaction is dependent on the relationship among those people.

Because activities are performed by people in organizational units which are in turn supervised or managed by other people, linkages among activities have a social/political/interpersonal as well as an economic element: that is, a relationship aspect as well as a transactional aspect. The intention to change a business model will be hampered if the social dimension of activity linkages in ignored. The relational and the transactional are distinct but not separable. Indeed, it is not possible to change a transaction without considering the people in organizational units that perform the transaction and those who supervise the units.

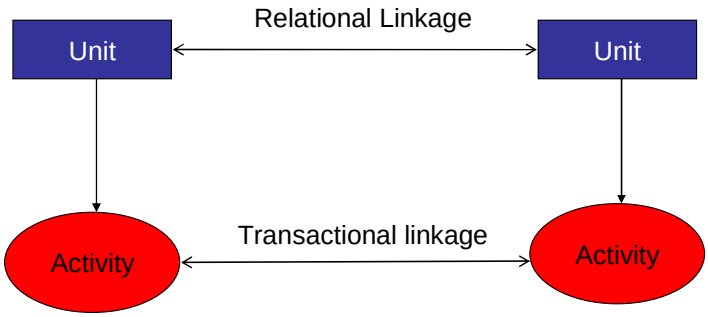
Our definition of business model builds on previous streams, and particularly on the work of Porter, Amit, and Zott, and adds a relationship dimension:

> *Definition 1: A business model is a configuration of activities and of the organizational units that perform those activities both within and outside the firm designed to create value in the production (and delivery) of a specific product/market set.*

We define an organizational unit as the individual or group of individuals who perform an activity.[4] We consider both the activity performed by the units of the focal firm and by the units of its exchange partners, suppliers or customers as part of the business model. It is the inclusion of organizational units and the management of those units within the scope of a business model that allows for the examination of relationships among the managers of the units performing activities. By supplementing physical transactions among activities with human relationships between the individuals who perform those activities (see **Exhibit 2**), we mean to call attention to the social, political, organizational, and interpersonal context in which the model is embedded.

Exhibit 2

The Dual Linkage Nature of Business Models



We also recognize, as did Zott and Amit, that linkages must be governed; that is, subjected to control mechanisms that define the management of the linkages. A key governance mechanism in Zara was the "operations team" for each product market in which a designer, a commercial person interacting with stores and a supply chain person interact and make decisions pertaining to next week's collection. This team provided an instrument for governing the supply chain, design and sales/stores. It is only by considering the social context in which the internal and external transactions occur that executives can fully appreciate the critical dynamics of organizational change that must accompany BMI.

[4] We mean to distinguish between an "organizational unit" – by which we mean an individual or collection of individuals who perform a single activity – from a "business unit." We use "business unit" as it is commonly understood as a collection of organizational units with a business strategy and identifiable revenues and costs.

Our definition, then, identifies four separate but interrelated components in a business model:

- A set of elemental *activities*.
- A set of *organizational units* that perform the activities (some of these units are internal to the firm, others external).
- A set of *linkages* between the activities, made explicit by an isomorphic set of physical *transactions* (between the organizational units that perform the activities) and human *relationships* among the individuals who supervise and/or manage the linked organizational units.
- A set of *governance mechanisms* for controlling the organizational units and the linkages between units.

A business model thus juxtaposes two systems: a system of *activities* and a system of *relationships*. It is only by considering the social contexts in which the internal and external transactions occur that executives can fully appreciate the critical dynamics of organizational change that must accompany BMI.

The business model does completely specify *how* the firm delivers its offer to the market. It refers specifically to the configuration of activities and their organizational units. Within any configuration of activities, firms also make operational choices, such as choosing the number of operators in a call center, the cycle time of a production line, or the size a fleet of airplanes. These operational choices are made within the activities that constitute a business model but are separable from the business model itself.

In addition to pointing to the configuration of both internal and external activities, we include the requirement of value creation in our definition (as do Amit & Zott, 2001; Hammermesh, et al., 2002; Afuah, 2002; Zott & Amit, 2008; and Birkinshaw & Goddard, 2009). We mean to draw attention to the fact that business model dynamics focus on both revenue and costs, and are not only a cost issue.[5] However, it also should be said that much of what has allowed Southwest Airlines to sustain its growth was a business model focused on internal costs (Gittell, 2002). Simultaneously, much of what led to the failure of other airlines in their attempts to duplicate Southwest's success was their inability to alter their business models to reduce costs and thus generate profitable revenue.

[5] We follow Zott and Amit (2008) in distinguishing between a revenue model and a business model. They are not interchangeable; rather, the revenue model is part of the business model.

Finally, by focusing on the units that perform activities, our definition embraces the management of those units that must also create linkages as well as the organizational context that must create governance mechanisms to control the linkages. Amit and Zott (2001) included "transaction governance" in their definition of business model to refer to the flow of information, resources, and goods, as well as the legal forms and incentives that linked "participants in transactions" (p. 511). Our concept of governance is broader in two ways:

- We look at the governance of relationships – which include issues of organizational partitioning, power distribution, control, and hierarchy – between managers of organizational units performing activities.

- We look at intra- as well as inter-governance issues.

With that definition of business models, we can next examine the challenge of altering business models.

Innovating the Business Model

The literature on business models has focused on new business models most typically within startups (Amit & Zott 2001; Siggelkow 2001; Mitchell & Coles 2003; Geoffrion & Krishman 2003; Mitchell & Coles 2004 a, b; Yip 2004; Schweizer 2005; Scafer, et al., 2005; Hunter, 2006; Wallace, et al., 2006; Zott & Amit 2007). In order to shift attention to both B_{FS} and B_{UC} firms with pre-existing business models, we offer a definition of business model innovation that focuses on reconfiguration:

> *Definition #2: Business model innovation (BMI) is a reconfiguration of activities in the existing business model of a firm that is new to the product/service market in which the firm competes.*

Our definition stresses "new to the product/service market in which the firm competes" purposefully. Often, business model innovation actually involves importing a business model from one product/service market into another. For instance:

- Southwest Airline borrowed a business model from interstate bus transportation and applied it to the airline industry.

- McDonald's brought traditional assembly line techniques into the fast food business.

- Metro imported free newspapers from the shopping supplement segment into the daily news and features segment.

These and other firms are engaged in BMI that introduced business models new to their product/service market segment.

A BMI Typology

It is possible to specify further the multiple possibilities of BMI. As a baseline, BMI involves a reconfiguration of activities. That reconfiguration can take one of four forms:

1. **Relinking** - an alteration in the connections between organizational units currently performing activities.

2. **Repartitioning** - an alteration in the physical, cultural, and institutional boundaries of the organizational units currently performing activities.[6]

3. **Relocating** - an alteration in the (physical, cultural, and institutional) distance between organizational units currently performing activities.

4. **Reactivating** – altering the set of activities that constitute the current business model of the firm**.**

In **Exhibit 3**, we summarize the types of alterations that characterize each of these four classifications, as well as a definition of what changes and an example of each type of change. **Case 2** ("Privatization through BMI at Embraer") illustrates a BMI within Brazilian-based Embraer that involved three types of reconfiguration: relinking, regoverning, and relocating. **Case 3** ("BMI Value Creation at Taco Bell") presents a case of an apparently simple alteration at Taco Bell that created lean value through a complex BMI.

Case 2
Privatization through BMI at Embraer

The position that the Brazilian Embraer enjoyed in recent years in commercial aircrafts for commuter and regional airlines shows how BMI was a key in turning the performance of an existing and relatively unknown player in an industry into global leadership. [7] Embraer performed BMI in its commercial aircraft business (the company also has a defense aircraft business, in which not much has changed). Here are main elements of the company's reconfiguration of existing activities:

- Turned the arms-length relations with selected suppliers into risk-sharing partnerships (for instance, there is no minimum number of aircraft of a new model stipulated in the contractual arrangements with the suppliers, which are not

[6] Through relinking and repartitioning, our definition of BMI subsumes what is often referred to as "restructuring" or "reorganizing."

[7] This case is based on the authors' research plus Ghemawat & Montéro, 2000 and Lopes, et al., 2007.

assured of recovering the development costs of the new model-specific modules or major components) (*relinking by regoverning*).

- Selected suppliers co-design with Embraer and other suppliers, under the coordination of Embraer, the new model-specific modules or major components; this co-design phase happens very early-on in the development of the new plane, with the suppliers engineering teams co-located with Embraer's engineering team at the company's headquarters and major site in Sao Jose dos Campos, near Sao Paulo, Brazil. (*relinking by resequencing and reinforming*).

- Outsourced a number of ancillary design and production activities outsourced to local companies (many of which with ex-members of the Embraer cadre as owner-managers) (*repartitioning by outsourcing*).

- The relevant market research and lead customers for a new aircraft was no longer Brazil, but rather the US (indeed, sales in Brazil of the two series of Embraer aircraft made under the new business model were minimal – until the very recent announcement of the launch of a new Brazilian airline, Azul ("Blue", in English), just created by the American -- born in Brazil -- founder and former CEO of "Jet Blue" (no wonder…), itself a large customer of Embraer); (*relocating by offshoring*).

- Certain design and production activities, including major parts of the aircraft (such as the wings), are made by suppliers outside Brazil (*repartitioning by outsourcing and relocating by offshoring*).

I

In summary, the new business model meant that a new plane was conceived by Embraer by looking at the needs and trends of foreign lead customers in their home countries, and then designed and built by a consortium-like set of strategic, but independent, suppliers from several countries, orchestrated by Embraer, which finally assembles, sells, and services the plane to customers around the world. As a direct result of this BMI, Embraer emerged as the fourth largest aircraft manufacturer, and the leading supplier of regional jets in the world.

Case 3
BMI Value Creation at Taco Bell

In the late 1980s, Taco Bell, then a B_{UC} within PepsiCo, engaged in a BMI labeled K-Minus in which the kitchen was removed from the stores.[8] Schlesinger, et al. (2001) describes the innovation:

> With 'K-Minus' (standing for kitchen minus), the restaurant kitchen became a heating and assembly unit. Virtually all chopping, cooking, and associated clean-

[8] This case is based on Schlesinger, et al. (2001).

up was transferred to corporate headquarters. Ground beef, chicken, and beans all arrived at the restaurant pre-cooked in plastic bags ready to be heated and served. Other food products, such as lecture, tortillas, and even guacamole also arrived prepared, packaged, and ready for use in assembling menu items.

Note the complexity of BMI involved in that apparently simple move:

- *Regoverning by recontrolling* – control of the cooking process moved out of the store employees and into the manager of a centralized kitchen.

- *Reactivating by augmenting* –new activities - delivering the cooked food to the stores and reheating at the stores – were added to the business model.

Those innovations allowed Taco Bell to capture value in two ways:

1. By centralizing cooking, Taco Bell gained from the economies of scale.

2. Centralized cooking also led to dramatic improvements in efficiency and quality control accompanied a reconfiguration of space within the stores themselves, allotting more space to customer service and less to cooking.

A BMI and an old technology allowed for lean value creation at Taco Bell.

Case 4 – "Insourcing Relationship Linkages at the Joplin Clinic" – is useful in drawing attention to the relationship component of a business model and the requirement to alter relationships that necessarily accompanies BMI. In the Clinic's initial business model, the referral of patients from suburban clinics acted as a kind of outsourcing of the value chain. With its decision to purchase the suburban operations, the Clinic engaged in a BMI (*repartitioning by insourcing*) by insourcing the referrals. The Clinic now owned the transaction, but had not impacted the relationship component of the linkage. It was only when the Clinic actively worked to build up the relationship linkages – through placement of new doctors on strategic committees, social activities, and professional gathering all designed to build the relationship linkages – that the transactions changed and more patients were referred internally.

Case 4
Insourcing Relationship Linkages at the Joplin Clinic

The Joplin Clinic was founded by five physicians to be a full-service multi-specialty clinic.[9] The city of Joplin, located in the southwestern corner of Missouri, is hundreds of miles from the metropolitan health care facilities of Kansas City and St. Louis. The Clinic was envisioned as a full-service medical treatment facility for the city and the

[9] This case is based entirely on the authors' research. All names are disguised.

surrounding rural area.

The Clinic employed 65 doctors (48 are partners, 17 are associates) and a staff of 300. The flow of patients within the Joplin Clinic can be understood as something of an inverted triangle. Patients "entered" the Clinic through primary care physicians: family practitioners, pediatricians, obstetricians, and general internists. These physicians, in turn, funneled their patients to various specialists. It was these specialists who charged the highest rates and generated, proportionately, the highest and most profitable revenues.

For most of its existence, the Clinic operated out of a single building in downtown Joplin. As part of the Clinic's aggressive efforts to broaden their presence in Joplin and surrounding communities, it purchased two small, highly successful family practices, both operating in the wealthy suburbs of Joplin. These represented the Clinic's first purchase of an existing practice. The primary care doctors in each of those two practices funneled a number of their referrals to specialists at the Clinic, although the lion's share went to other specialists in the Joplin area. The goal of the Clinic's BMI – *repartitioning by insourcing* – was to gain ownership of the referral transaction in anticipation that more referrals would come the Clinic's way.

Concern over how well these purchases were working out first surfaced at an off-site strategic planning meeting. An ophthalmologist noted that he had yet to receive a single referral from any of the new doctors (none of whom attended the session). A surgeon acknowledged that she had received "one or two" referrals, but had noticed no significant change in referral patterns. The physicians at the planning session were concerned.

Chris Colt, administrative head of the Clinic did some informal research and learned that, as far as he could determine, internal referrals from these two newly acquired practices remained insignificant, adding, "We have to do something about this."

Exhibit 3

Typology of BMI – Reconfiguring a Firm's Activities

Classification	Type	What changes	Examples
Relinking – altering the linkages between units performing activities	Regoverning	The governance of transactions among units	An arms-length relation with a supplier becomes an alliance
	Resequencing	The order in which activities are performed	Design and procurement activities become mutually reciprocal instead of sequential
Repartitioning – altering the boundaries of the focal firm by moving activities and the units that perform activities	Insourcing	Moving inside activities that were performed outside the focal firm	A manufacturer opens its own retail stores to supplement its dealers
	Outsourcing	Moving outside activities that were performed inside	A firm outsources its IT activities
Relocating - alerting the (physical, cultural, and institutional) location between units performing activities	Off-shoring	Moving activities from a unit in the firm's home country to a foreign country	A bank moves back-office activity to a foreign subsidiary
	On-shoring	Moving activities from a foreign country unit into the home country of the firm	A call center is moved back to the original country
Reactivating – altering the set of activities performed by the firm	Augmenting	Adding a new activity to the firm	A free give-away newspaper adds people to hand out the paper at subway stops.
	Removing	Removing an activity from the firm	An airline removes cooking hot meals from its service.

The BMI Path to Strategic Renewal

As we have noted, a business model is not the same as a business strategy, and BMI is separate from other types of innovation: corporate entrepreneurship, product and technology innovation, etc. As we saw with Taco Bell, BMI does not require a new technology, a bold corporate venture, or a totally renewed strategy. Let's look at Lufthansa (**Case 5** – "The BMI Path to Strategic Renewal at Lufthansa"). Lufthansa's BMI consisted of repartitioning by regoverning. The company unbundled its existing activities in five distinct businesses, loosely coupled under the group's governance. No new technologies, no new businesses identified, just a reconfiguration of existing activities. That BMI led to further product innovations and substantial market development in *all of its five business units***.** This was one of the major developments in the airline industry in the 1990s, and went largely unnoticed, partially because the shift in business model was not widely recognized as a value-producing innovation.

Case 5
The BMI Path to Strategic Renewal at Lufthansa

Lufthansa was hardly alone in facing high losses in the early 1990s.[10] Competition of the European space was forcing the German government to envisage privatization of the company. CEO JÜrgen Weber was charged with doing so. After attending a seminar at INSEAD, Weber called his 20 top managers to an off-site weekend at the firm's training center to address Lufthansa's crisis. Mergers among airlines had offered little hope for future success. And Germany's labor market regulations offered little opportunity for improvement through human resource practices. Instead, Lufthansa's management team turned to BMI, specifically *relinking by regoverning*.

As an outgrowth of the work of multiple project teams, the company changed from a tightly integrated business model centered on airline transportation to a group structure including five businesses: Passenger Transportation (Lufthansa AG), Logistics (Lufthansa Cargo AG), Catering (SkyChefs AG), Systems (Lufthansa Systems AG), and Airline Maintenance (Lufthansa Technik AG).

At the time of the announcement, the company was heavily subsidized and unsustainable in a competitive environment. Many employees complained and thought the announced reconfiguration would kill the company and was a pre-amble to selling off major parts that would not be able to be profitable. Indeed, management confirmed that this would be the outcome if profitability would not be achieved, but that this sales of this nature were not the desired outcome.

More than 10 years later, the results are in: with the benefit of BMI, Lufthansa is now the largest profitable airline company in the world. Furthermore – and no one did foresee this at the time of the change - *each* of its business units has achieved leadership in its industry:

- *Lufthansa AG*, the airline transportation unit, keeps growing profitably with its leading Star Alliance concept; the group by now has the world's leading scheduled airfreight services business;

- *LSG Sky Chefs* has a 30 percent market share of the global airline catering business, has gone through an IPO and has dropped Lufthansa from its name, so as to be better positioned to cater to the competitors of Lufthansa AG.

- *Lufthansa Systems* has become one of the world's leading providers of IT services to the airline and aviation industries, and is starting to offer services outside of these industries.

[10] This case is based on the authors' research plus Bruch & Sattelberger, 2001.

- *Lufthansa Technik* is the world's leading aircraft maintenance company, having profited from outsourcing of these services by the major airlines.

- *Lufthansa Cargo* is one of the world's leading provider of international scheduled airfreight services, in a market that is very difficult and competitive.

BMI is not synonymous with corporate venturing, defined as the creation of a new business within a corporation (Block & MacMillan, 1993). Venturing relies on entrepreneurialism within a company in a process of linking new products or new technologies with opportunities in the marketplace. Meyer (2007) highlights an example of corporate venturing that led to BMI within Mars. Internal entrepreneurs matched a new printing technology that had been developed by the company's centralized R&D group with an existing product, M&M candies, to produce a new product, My M&M's.[11] That new product (M&M's printed with personalized messages) opened a new high-end, customized market (for corporate activities and event planners) and required a new business model (customized, small batch production, direct distribution to end users rather than through broad retail channels). In that case, the BMI *followed* entrepreneurial corporate venturing that led to a new product enabled by a new technology.

Likewise, BMI does not depend on either product innovation or the adoption of a new strategy. Both may lead to BMI (or not). To see the lean value creation that can be derived from BMI, absent either new product innovation or new strategy, we can look at fast-food chain Taco Bell, highlighted in Case 3. Taco Bell captured BMI-generated value without altering either the offer or the customer. *No* technological breakthroughs were required, *no* investment in R&D, *no* corporate venturing. K-Minus was an example of pure, lean value-producing BMI generated from within.

BMI: A New Term – Not a New Phenomenon

As noted earlier, the concepts of business models and BMI captured the attention of business executives and academics as a response to the Internet. But the phenomenon of BMI has been ongoing for decades. Sears provides an example of internally generated BMI (repartitioning by insourcing) dating back to the 19th century (see **Case 6 –** "Richard Sears – BMI Pioneer"). The story of BMI at Sears resonates for three reasons. First, it demonstrates that BMI is not a new phenomenon, just a new expression. Second, it shows clearly that BMI does not rely on the Internet. Finally, it illustrates the degree to which BMI has been and can continue to be a lean engine for increased profitability growth separate and independent of new product development.

[11] My M&Ms was named one of the 50 best new products by *Business Week* in 2005.

Case 6 – Richard Sears: BMI Pioneer

Richard Sears, a young entrepreneur from Minnesota, began selling watches in 1886.[12] He purchased the watches from manufacturers for $12 and sold them for $14, requiring only that the buyer paid in cash. The R.W. Sears Watch Company soon outgrew its Minneapolis office and moved to Chicago. The first innovation to his existing business model occurred as Sears reflected on a new opportunity. He realized he could increase his profitability if he bought watch parts and assembled them himself rather than acting as an intermediary for watches manufactured elsewhere. At this point, Sears engaged in BMI – *repartitioning by insourcing* – when he imported an activity that had been performed outside of the firm. That BMI proved especially momentous for Sears: lacking the skill required for that activity himself, Sears advertised for a watchmaker and soon hired A.C. Roebuck.

The next innovation also involved *repartitioning by insourcing*. Sears sold his watches through agents scattered around rural areas. That reliance on agents served an important role: customers could see the watches before purchase and could develop a relationship of trust with the agents. But it also imposed a high cost, as the agents claimed a significant proportion of the margin. By insourcing sales, Sears eliminated the independent salesmen.

BMI and the Requirement for Transformational Change

We can now focus on the process of change that accompanies BMI. By adding units that perform activities and the people who manage those units to our definition of business model, we observe that, BMI is, by its nature, competency destructive. Tushman and Anderson (1986) applied the competency-enhancing / competency-destroying framework to technology innovations, and we find it helpful in understanding business model innovations as well.

Competency-enhancing innovation is a "bit-by-bit cumulative process" that builds on competencies already extant in the firm (p. 441). Conversely, competency-destructive innovations "are so fundamentally different from previous dominant technologies that the skills and knowledge base required to operate the core technology shift" (p. 442). In that sense, BMI requires both new skills and new knowledge from the perspective of the firm. Business unit managers are knowledgeable about its business model and able to conceive of new business models, and therefore design BMI. However, the adoption of a new business model will most likely render irrelevant some of competencies extant in their

[12] This case is based on Emmet & Jeuck, 1950; Hoge, 1988; and Worthy, 1984.

organization.[13]

We can look at a BMI (**Case 7 –** "Competency Destructive BMI at Auratek**"**) to understand the dimensions of destruction that accompany such innovation. Verification engineers at Auratek were asked, as a result of reactivating by augmenting, repartitioning by outsourcing, and relocating by off-shoring, to act as coordinators and liaisons, a skill that they neither possessed nor wanted to develop. The fact that the outsourcing was accompanied by offshoring only made the reqiuirements for new competencies all that more urgent. Additionally, literal competency destruction – the elimination of 27 verification enginneering jobs – undermined commitment on the part of the remaining engineers to change. **Exhibit 4** reviews the BMI examples cited thus far to demonstrate this competency-destructiveness.

Case 7
Competency Destructive BMI at Auratek

Auratek began manufacturing an industry-leading data storage device, DataSafe, in 1999.[14] At the heart of the system were field-programmable gate arrays (FPGAs), the microchips that ran the DataSafe's director boards. From Auratek's perspective, the main drawback to the product was the cost to fabricate the many FPGA revisions necessary for a reliable, finished product.

To help control costs, Auratek's vice president of hardware engineering announced the creation of the Verification Group (VG). That step amounted to a BMI – *reactivating by augmenting* - by inserting an operational step between design and fabrication (manufacturing) of the FPGA. The BMI required competencies not then extant in the engineering function. Auratek hired 33 skilled engineers to work closely with the existing engineers responsible for designing the FPGAs. The main responsibility of the VG engineers was to identify flaws in the chip design *prior* to fabrication. The cost of the 33 engineers was approximately $3.3 million / year, and the benefits to Auratek were greatly improved product quality and a decrease in the development and fabrication process as well as decreases in after-sales support.

The engineers from the design and verification groups created a close and interactive

[13] Furthermore, BMI may have high socio-emotional costs to the managers of the business unit, as well as a loss of relative power. Suppose the general manager in charge of a B_{FS} or B_{UC} that has several thousand workers and a few hundred managers and recognizes the potential value of innovating by outsourcing and off-shoring most of the manufacturing and back-office activities. This will mean reducing the headcount to a few hundred and the layoff of thousands of persons who happen to live in the same small city where the general manager lives since he was born and where he and his family are highly appreciated by everyone. This is perhaps an extreme situation, but illustrative of the dilemmas that BMI invokes.

[14] This case is based entirely on the authors' research. All names are disguised.

relationship. They developed shared pride, mutual trust, and a willingness to pull together for long days and nights when delivery schedules required. Even as DataSafe shifted from FPGA to application-specific integrated circuits (ASICs), the complex interactions continued effectively.

Under further pressure to cut costs, Auratek corporate executives made a public commitment to shareholders. The company would double the amount of engineering work to be outsourced. The vice president of hardware engineering, looking at the $3.3 million annual budget allotted to VG, decided that the company had the opportunity to cut costs with little risk to the overall process. Auratek would now become an industry pioneer in outsourcing and offshoring of verification work. In our language, Auratek innovated in BMI by outsourcing its verification group abroad.

That BMI – *combining repartitioning by outsourcing and relocating by offshoring* – immediately destroyed competencies in the verification group. VG in corporate headquarters would be reduced from 33 to 6 engineers, and the main verification work would now be subcontracted to an R&D services provider located in Bangalore, India. The cost savings to be achieved by the move would be significant: approximately $2 million annually that were generated due to the reduced cost of engineering personnel in India. The vice president believed that the verification work itself was relatively routine and well within the capacity of the Bangalore-based engineers. The verification engineers at headquarters would act as liaisons – yet another BMI, *reactivating by augmenting*, that added an additional activity for which the incumbent employees were not qualified - between design engineers and the verification work performed in India.

Employees soon experienced a major competency gap between what they knew how to do well and what they needed to do to make the new configuration work. Misunderstandings in e-mails swapped between Bangalore and the US, combined with the 12-hour delay due to time zone differences, led to confusion. Engineers in India hesitated in raising concerns about product designs in order to avoid offending their American managers. Root cause analysis of product design defects all but disappeared.

Morale among the six remaining VG engineers at Auratek soon deteriorated. Few had skills to act as coordinators and liaisons, and were in any case not interested in tilted their jobs towards a more administrative responsibility. A number of them threatened to resign. Auratek countered with stock options and retention bonuses to motivate them to stay. Even so, four resigned. The remaining two verification engineers found themselves under increasing pressure to pick up the workload, not just that of the US-based engineers that had left, but also of the Indian engineers the company no longer trusted.

The results proved disastrous. The decision to try an innovative BMI had failed and had resulted in delayed product releases and lengthened the cycle time to fix defects. Auratek's previously dominant market position in storage devices was lost. "Maybe we saved $2 million in salaries," concluded a manager, "but I am afraid to even consider what we've lost in present and future sales."

Reconfiguration of activities necessitated other changes in the role demands placed on the much smaller number of verification engineers who remained at the home office. The altered linkages required that they act as coordinators and liaisons rather than as engineers. They lacked both the competencies and the motivation for these new roles. Attempts by the company to purchase their commitment failed. What appeared to be a simple alteration actually represented a complex BMI.

Exhibit 4

BMI is Competency Destructive

Company	Incumbent Job Holder	Competency Destruction
Zara	Designers	From fashion designers to industrial designers
Lufthansa	Managers	From function managers to autonomous business managers
Embraer	Managers	From internal service managers to independent service company managers
Taco Bell	Store managers	From managing kitchen to managing assembly process
Auratek	Verification engineers	Loss of jobs
		From engineering to coordinating
		From operating in one country to working across national boundaries

The BMI literature has raised questions about structural changes that may be required within a business. Markides (2008) presents an overview of structural options – separation, integration, phased integration, and phased separation – and concluded that there is "no single best way" to structure innovative business models within incumbent firms. That debate does not, however, focus on the *requirement for behavioral change* that accompanies any BMI. Indentifying the presence of human relationships among the managers of organizational units in enabling business model linkages between activities allows recognition of the requirement for behavioral change.

Competency-destructive innovation requires transformational behavior change (Lewin, et al., 2004). The notion that innovation requires organizational change is well established

(Rudduck, 1991; Clark, 1995; Poole, et al., 2000). Organizational infrastructure – decision-making processes, reporting structures, performance measurements, and rewards – will need to align with both the motivation and the capability of employees to identify new opportunities for revenue generation (Burgelman, 1983, 1984; Hornsby, et al., 1990; Hornsby, et al., 1999).

Optimally, transformational change occurs in a systemic and strategic way: aligning multiple design elements with the shifting goals of the firm (Spector, 2009). Often, however, organizational leaders prefer to avoid such fundamental change, opting instead for incremental, piecemeal approaches when systemic change is needed (Gould & Campbell, 2002). Miller (1990) has documented the tendency of once-successful organizations to hold onto, with only occasional tinkering, the designs and arrangements that provided success in the past. That desire to avoid the upheaval of transformational change may be understandable. However, transformational change is a requirement of BMI. The failure to engage in deep change was evidenced at Marks and Spencer in its ineffective attempt to respond to the GAP, Zara, H&M, and Delta in its ineffective attempt to respond to Southwest Airlines.

Case 8 ("Transformational Change Accompanies BMI at Nissan") presents a case of BMI within Nissan Motors that illustrates the requirement for effective change implementation to accompany BMI. Carlos Ghosn's first principle of change – assume nothing and find answers within the company – led him to initiate his change implementation with diagnosis, traveling around the world and engaging in "deep listening." The subsequent innovations to Nissan's business model grew out of both that diagnostic process and cross-functional teams set up to recommend changes that would enhance value creation. The dialogue initiated by Ghosn between himself and employees ensured mutual engagement and built commitment to the organizational changes that accompanied the BMI.

Case 8
Transformational Change Accompanies BMI at Nissan

As part of a 74-firm Japanese zaibatsu - a powerful, interconnected industrial combination that included Hitachi, Nippon Mining, and Nissan Chemical—Nissan leveraged its considerable assets into becoming Japan's number-two automaker (behind Toyota.[15] Nissan began exporting their Datsun cars to the United States in 1958 and 17 years later became the top-selling import in the U.S. market.

A number of management missteps kicked off a debilitating and long-lasting decline starting in the 1980s. Less obvious but even more troubling than the missteps was Nissan's inability to find flexibility in its relationship with suppliers. Nissan's cost of parts ranged from 15 percent to 20 percent above Japanese competitors. Aggressive

[15] This case is based on the authors' own research plus Farhi, 1999; Thornton, 1999; Dawson, 2002; Yoshino & Egawa, 2002; Ghosn, 2002a and b; Larimer, 2003; Magee, 2003; Bremmer, 2004; Ghosn & Ries, 2005.

competition from Honda in the United States forced Nissan to take a $1,000 discount on their cars.

Sales declined, but costs did not. Despite severalrestructuring plans, Nissan executives achieved little real improvement. The company had to borrow money from the government-owned Japan Development Bank to stay afloat. Executives decided to court potential partners. After talks with both DaimlerChrysler and Ford proved fruitless. France-based Renault agreed to an alliance in 1999. As a precondition for the alliance, Nissan executives agreed that Renault's second-in-command, Carlos Ghosn, would come to Japan as COO under CEO Yoshikazu Hanawa.

Ghosn's first job with Michelin had allowed him to work his way through several manufacturing positions in France, South America, and the United States. At Michelin, Ghosn developed a philosophy of change leadership that was based on three premises:

- Assume nothing and find answers within the company.
- Work fast.
- Earn trust and respect with strong results.

The 1999 alliance resulted in Renault acquiring a 36.8 percent stake in Nissan. At the time, Nissan had $19.9 billion in debt and losses of $250 million for the year. The company had lost money in seven out of the previous eight years.

Upon his arrival in Japan, Ghosn announced that his goal was not to advance the interests of Renault but rather "to do everything in my power to bring Nissan back to profitability at the earliest date possible and revive it as a highly attractive company." Between April and late June 1999, Ghosn toured Nissan plants, subsidiaries, and dealerships in Japan, the United States, Europe, and Taiwan. He had learned from his experience to start change without any preconceived ideas.

Performance numbers provided him with a great deal of explicit knowledge about Nissan but not the underlying causes of their problems. To gain that tacit knowledge, Ghosn engaged in a process he called "deep listening":

> I asked people what they thought was going right, what they thought was going wrong, and what they would suggest to make things better. I was trying to arrive at an analysis that wouldn't be static but would identify what we could do to improve the company's performance. It was a period of intensive, active listening. I took notes. I accumulated documents that contained very precise assessments of the different situations we had to deal with, and I drew up my own personal summaries of what I learned. In the course of those three months, I must have met more than a thousand people.

To specify action plans, Ghosn pulled together nine cross-functional teams to examine all

aspects of the business operation: from business development to manufacturing and logistics to supplier relationships to organizational structure. Each had 10 members, all from middle management. Teams could also create subteams to help them collect data. In total, the effort involved about 500 people. Ghosn gave the teams three months to review the company's operations and make recommendations.

With the recommendations from the nine cross-functional teams, Ghosn and the executive committee pulled together what became known as the Nissan Revival Plan. The Nissan Revival Plan maintained the company's *what* (a wide portfolio of cars) and the same *who* (all major car market segments). What Ghosn changed dramatically was the *how* (the business model) as he reconfigured activities both inside and out of the firm. Among those sweeping business model changes were:

- *Relinking by regoverning*: The nature of the relation with suppliers changed from a "keiretsu" close partnership to a more arms-length, competitive kind of relation (with a reduced number of suppliers), which also freed up much-needed cash. Such change included the disposal of Nissan's shareholdings in hundreds of suppliers.

- *Relinking by regoverning and repartitioning by outsourcing*: Manufacturing of certain models for specific markets were outsourced to Renault (and vice-versa). Certain procurement and IT activities were outsourced to joint-venture units with Renault. New car platforms developed jointly with Renault and involving multicultural, dispersed teams. New model introductions and market development activities coordinated with Renault via the Renault-Nissan alliance incorporated in the Netherlands. In addition, market research activities were included in the new car development process. Car design activities were taken out of the supervision of engineering
- *Relocating by off-shoring*: Production capacity cut in Japan and increased in the USA.

Nissan's BMI required vast changes in the both firm's values and organization. For example, Nissan's core values of technical excellence and loyalty (time) were kept but downgraded and replaced, respectively, by customer satisfaction and performance (profit). Decision-making processes and incentives also changed. And people changed, mostly at the highest management levels. Ghosn brought with him 20 executives from Renault. Additionally, his hiring of Shura Nakamura from a competitor to head Nissan's design function violated long-standing Nissan practices.

Nissan achieved the results promised in the Nissan Revival Plan a full year ahead of time.

The BMI-Conducive Corporation

The cases presented thus far represent the variety of BMIs from within business units (summarized in **Exhibit 5**). We have concentrated on what the B_{FS} and the B_{UC}, have in common in terms of BMI and distinguished between the dynamics of startup and incumbent firms. We can now focus on the *differences* between the B_{FS} and the B_{UC} by taking into account the corporation as a key stakeholder.

Exhibit 5

Typology of BMI –Placing Examples

Classification	Type	**Zara**	**Joplin Clinic**	**Embraer**	**Taco Bell**	**Lufthansa**	**Sears**	**Auratek**	**Nissan**
Relinking	Regoverning			✓	✓	✓			✓
	Resequencing	✓		✓					
Repartitioning	Insourcing		✓				✓		
	Outsourcing			✓				✓	✓
Relocating	Off-shoring			✓				✓	✓
	On-shoring								
Reactivating	Augmenting	✓			✓			✓	
	Removing	✓							

We use Chandler's definition of a corporation as a multibusiness enterprise characterized by a corporate headquarters and relatively autonomous, discrete operating units (Chandler, 1961).[16] The executives who comprise the corporate center engage in a set of activities clearly distinguished from those at the business units. By taking the B_{UC} as our unit of analysis, we can now observe how the challenge of BMI differs between the B_{FS} and the B_{UC}.

The Corporate Stake in B_{UC} – Generated BMI

It can be expected that the corporation will act as both a constraint on and an opportunity for BMI. Our focus on the corporation does not overlook – in fact, takes into account – the fact that BMI occurs *within* the B_{UC}. Still, it is an inescapable conclusion that the corporate center has an interest in any BMI that might occur within its own divisions.[17]

[16] Our definition corresponds to Williamson's (1975) description of the M-form corporation.

[17] "Division" and "business unit" are used interchangeably.

The Corporation as a Potential Constraint. At first glance, it may seem that corporate interest would be entirely positive and supportive of internally-generated BMI. After all, the purpose of BMI is to generate value. However, the corporate center has interests in BMI that could mitigate support. The corporate center acts as a "parent" to the member B_{UC}s (Goold, et al., 1994). Beyond the potential to generate value, BMI merits parental attention because of its potential impact on the collective performance of the corporation as an entirety. That potential impact occurs in three interrelated domains:

1. *BMI potentially alters the scope of the corporation*. If a B_{UC} elects to offshore, for instance, the corporation may find itself operating in geographic regions in which it has a stake to protect, or where it may have an interest in avoiding. BMI alters the scope of the business. Conversely, insourcing increases the scope of the corporation by bringing into the unit activities that formerly resided on the outside. Changes in business scope on the part of member units impacts the scope of the entire corporation.

2. *BMI potentially impacts the strategic operations of other units*. Any one of the four categories of BMI – relinking, repartitioning, relocating, and reactivating – may have an impact on other B_{UC}s within the corporation. Any of these decisions may have a positive impact on a unit's performance while placing another unit at a disadvantage. Outsourcing IT activities by one B_{UC} may impact the performance of the corporate IT function and work to the detriment of another B_{UC}.

3. *BMI potentially changes the risk exposure of the organization*. Corporate risk is a function of the risk assumed by each individual B_{UC}. An alteration in a unit's business model may alter the unit's risk or perception of risk as expressed by its beta coefficient; that is, its measure of systematic risk. This may simply be the effect of analysts' view of the B_{UC} if the innovation results in placing that B_{UC} in a different "industry" (expressed by a different standard industrial classification code) or by a change in the geographic risk of the unit. That perception of changed risk exposure can impact the share price of the whole corporation and its cost of capital.

Some BMI alterations will attract little attention from the corporate center. But others demand the involvement in and likely the approval of the corporate center. markets. Another way in which the corporate context might help is when different business models might be combined, or when one might be improved as a result of its presence with another business model. Thus, the constraint of corporate membership is felt by the B_{UC}.

The Corporation as a Provider of Opportunity. In addition to the potential for imposing a constraint on the B_{UC}, the corporate center can enhance the likelihood that BMI will emerge. That opportunity grows out of the corporation's capacity to create shared space among B_{UC} managers and corporate executives for knowledge exchange and learning. As noted previously, BMI often occurs when a business model from one product/service market is applied to another – when McDonald's applies industrial

assembly to fast foods, for instance. The knowledge that will support BMI comes from awareness not just of a firm's current market dynamics but also the market dynamics that exist in other, often unrelated markets.

The challenge of gaining deep knowledge of suppliers, customers, and business model solutions in multiple market settings is one faced by the B_{FS} as well as the B_{UC}. However, corporate membership offers an opportunity for both deeper and more timely learning than for units that operate independently. Corporate executives and B_{UC} managers can work to develop what might be thought of as creative space: a shared space (physical, mental, and/or psychological) among B_{UC}s and the corporate center that offers an opportunity for embedding and acquiring knowledge.[18] The goal is for the corporation to offer the opportunity for unit managers to embed and acquire knowledge that "transcends one's own limited perspective and boundary" (Nonaka & Konno, 1998: 41).[19]

Note the number of occasions in our previous case examples when BMI emerged from the creative space within units:

- *Lufthansa's* BMI grew out of an off-site management meeting and a number of cross-functional teams.

- The *Joplin Clinic's* awareness that relationships had not been altered despite the insourcing of referring clinics grew out of regular management off-site sessions.

- *Nissan's* sweeping BMI emerged out of the diagnoses and recommendations of multiple cross-functional teams.

Corporations likewise have the opportunity, often under-exploited (Kleinbaum & Tushman, 2007) to develop creative space. For the corporation, that creative space pulls together B_{UC} managers and corporate executives by providing an opportunity to embed and acquire tacit as well as explicit knowledge. That space can be created by corporate executives through mechanisms that promote face-to-face exchanges and opportunities for socialization. For instance:

- French based hotel operator ACCOR allows its B_{UC} managers from Ibis, Mercure, Formula 1, and so on almost complete autonomy over operations (Rosenzweig & Raillard, 1992). The corporate center provides expertise to the units – financial, human resource, external relations – while allowing the B_{UC} managers to innovate

[18] That definition is from Nonaka & Konno (1998) who use the Japanese term "Ba" to denote creative space.

[19] A similar point is made by Kleinbaum & Tushman (2007) who point to the potential of corporate executives to create opportunities for "interdependent innovation" among business units. In addition, Burgelman and Doz (2001) have demonstrated that opportunities for innovation exist in the spaces between member B_{UC}s.

on their own within chosen product market choices for each of the B_{UC}s. A corporate committee structure, made up of representatives from the B_{UC}s, provides a mechanism for sharing learning and best practice among the various brands.

- Entertainment giant Disney works in several ways to socialize the heads of its many divisions in order to allow opportunities for innovation (Rukstad & Collis, 2009). All B_{UC} managers go through an eight-day "boot camp" in which they experience the Disney "magic" from the ground up: traveling to its many sites, cleaning bathrooms, working in stores, even playing characters in theme parks. "When they go back to their jobs," said Michael Eisner, former Disney CEO, of the B_{UC} manager participants, "what happens is synergy naturally. When you want the stores to promote *Tarzan* [an animated Disney feature film], instead of the head of animation calling me, and me calling the head of the Disney Stores, what happens is the head of *Tarzan* calls the head of the stores directly" (Rukstad & Collis, 2009: 11).

With explicit attempts to develop creative space through socialization, membership in the corporate club has the potential of increasing trust and lowering distance and institutional barriers to sharing (Levin, et al., 2006; Cross, et al., 2007; Cross, et al., 2009). Although knowledge transfer within a multibusiness corporation can and often is hampered by stickiness (Szulanski, 2000), institutional distance among members of the same corporation can be overcome through socialization. The key organizational change question becomes how to loosen the ties among B_{UC}s while developing such a shared space.

The BMI-Conducive Corporation develops creative space between the B_{UC}s and the corporate center that allows innovation to flourish. If a corporation is able to generate that space, then the B_{UC} can be better positioned that the B_{FS} to create BMI which we define as:

> *Definition #3: The BMI-Conducive Corporation is a corporation that maximizes the opportunity and likelihood that BMI will emerge from within its business units.*

We can now turn to the transformational changes required to create the BMI-Conducive Corporation.

Altering the Corporate Context

The concept of creative space suggests a characteristic of the BMI-Conducive Corporation. But the development of creative space involves significant change, both , structural and behavioral changes. We now turn to an examination of the two aspects of that required change.

Changing the Structural Elements: Loose Horizontal Coupling. That the corporate center determines the nature and scope of member businesses is well understood. The corporate center also is the main player in determining the nature of the linkages among its business units (Goold, et al., 1994). In determining the nature of those linkages, corporate executives face three options:

- In a *pure portfolio strategy*, the corporate center plays no direct role in managing the business units, which are largely autonomous. Corporate executives appoint the business unit heads and monitor the financial requirements (capital and investments budgets) and outcomes. The key strategic decisions made by corporate executives will be choosing the businesses to invest in and to manage and balance the corporate portfolio. One key question in this regard is the issue of scope, as unrelated diversification enhances the potential to balance the portfolio holdings. Other than the corporate center rather than the financial market place allocating capital to the businesses, the B_{UC} in a portfolio operates essentially as a B_{FS}.

- In a *tight horizontal coupling strategy*, the corporate center seeks to capture value through the exploitation of operational efficiencies and cost savings. The key strategic decisions made by corporate executives in this case concern opportunities for joint sharing of services, operations, or other value chain components in order to reduce overall costs and improve corporate profitability. Related diversification enhances the opportunities for tight horizontal linkages. As such initiatives become implemented, operations *within* the B_{UC}s become increasing linked *across* the B_{UC}s.

- In a *loose horizontal coupling strategy*, the corporate center creates opportunities for business unit managers to share and learn. What Goold, et al. (1994) call the "mutual self-interest" of "energetic and enlightened business unit managers" (p. 80) will guide the exploitation of those learnings, and the corporate center will manage mechanisms for creative space without actually imposing operational synergies. Either related or unrelated diversification can be used in a loosely coupled corporation, as innovation might more easily flow from businesses that are not already known and are outside of usual business scope.

But why is it that loose horizontal coupling offers the best opportunity for BMI? To answer that question., we need to compare loosely coupled B_{UC}s both to tightly coupled units and to units that operate within a portfolio where there is, essentially, no horizontal coupling.

Knowledge about business models and potentially value-creating BMI rests largely within the business units. Even though corporate executives might have some knowledge from past experience, there is a fundamental *informational asymmetry* concerning BMI knowledge between B_{UC} managers and corporate executives. Even though corporate executives might have some *explicit* knowledge of business model concepts, they lack

the *tacit* knowledge of operations required to manage these business models and to improve them (Nonaka & Takeuchi, 1995).

Tight horizontal coupling among business units is intended to create operational efficiencies, but will do so typically at the expense of business unit autonomy. **Case 9 (“**Tight Horizontal Coupling at Vail Ski Resorts”) presents an example of tight horizontal coupling. Note that the coupling mechanisms were imposed on the B_{UC}s by corporate executives who lacked the deep and tacit knowledge both of the context within which each unit operated and the internal operations of the units. That decision imposed such tight horizontal coupling on the units that it interfered with the capacity of those units to respond to their external environment. Only when corporate management backed off the enforced coupling were the individual operating units again able to craft their own response to their competitive and natural environments.

Case 9
Tight Horizontal Coupling at Vail Ski Resorts

To illustrate how the loss of autonomy can diminish business unit innovation, we look at an example of a group of ski resorts, Vail Ski Resorts, that dealt with tight horizontal coupling imposed by the corporate center in pursuit of efficiencies (Eisenhardt and Galunic, 2007: 97):

> When the group formed in 1997 as a result of a merger, the rationale was to gain extensive synergies by tightly linking the four member resorts – Vail, Breckinridge, Keystone, and Beaver Creek – with numerous collaborations, particularly branding under the Vail name. It was a classic top-down plan, with little engagement, and producing the usual sub-par results. Vacationers wanted unique resort companies, not four ‘would-be Vail’ destinations.

Eisenhardt and Galunic note that when the corporate center “cut back on these linkages” and allowed a higher degree of operating autonomy to the business units, the unit managers were able to respond in unique ways to their own circumstances:

> For example, Breckenridge’s location next to a classic mining town has particular appeal for European skiers seeking a ‘Western’ experience. Breckenridge’s managers capitalized on this by introducing unique features that appeal to such customers, such as longer-stay vacation packages and western attractions and features. Having loosened the connections Vail Resort managers figured out, with time, the right number and nature of connections amongst the 4 resorts.

The final design solution at Vail Ski Resorts was to encourage horizontal coupling only when the individual businesses chose to do so and only around what Eisenhardt and Galunic call “high-payoff areas: such as procurement, information systems, and interchanging lift ticketing.”

The desire to identify and exploit efficiencies among linked operations across business units became something of a fad in the 1990s, leading to what Goold and Campbell (1998) called a "synergy bias." That fad emerged from the explosion of corporate takeovers in that decade. The rationale for those takeovers typically rested in the presumed (and frequently unrealized) efficiencies of synergy. Although imposed operational synergies may make sense to a corporation as a way of enhancing efficiencies, they will, unless applied with a subtlety that is uncommon, work *against* corporations seeking to nurture BMI.

Loose horizontal coupling provides two distinct advantages over tight horizontal coupling for BMI maximization. First, loose horizontal coupling allows for greater experimentation around configuration of activities within the units than does tight horizontal coupling. The logic is that loose horizontal coupling allows for a more efficient "seal off" of failures or breakdowns, while failures within a tight horizontally coupling system risks overall system failure (Weick 1976, 1982; Beekum & Glick, 2001). The willingness and ability to generate novelty in business models is thus enhanced.

Second, loose horizontal coupling allows for local responsiveness that can set the stage for BMI. Portuguese retailer Jeronimo Martins, now the leading retailer in Poland, understood that in order to succeed in that country, it would have to create a business model for a discount retail chain (called *Biedronka*), very different from its home operation based on quality supermarkets. Had corporate insisted on replicating Jeronimo Martins' Portuguese business model, it would have failed in Poland. The business model innovations generated in Poland not only improved Jeronimo Martins' global performance, but business model ideas developed in Poland were brought into Portugal and adapted to home country retailing in the home country.

Loose horizontal coupling has an advantage not just over tight horizontal coupling but over a portfolio corporation as well. A portfolio strategy seeks *no* horizontal coupling. Corporations such as Fortune Brands, Matsushita Electric, Berkshire Hathaway, and KKR manage portfolios of businesses. Matsushita Electric, for example, granted each of its divisions almost complete autonomy. The corporate center acted as a bank by providing working capital, charging market rates to the divisions, setting uniform performance expectations across the businesses, and welcoming high levels of internal competition (Ghoshal & Bartlett, 1990).

Our argument is that loose horizontal coupling provides an advantage not just to tight horizontal coupling, but also to B_{UC}s operating within a portfolio corporation and B_{FS}s operating independently. Neither B_{UC}s operating within portfolio corporations nor B_{FS}s forfeit the opportunity to generate BMI. What each lacks, however, is the opportunity to share business model knowledge within a corporate creative space.

Changing the Behavioral Elements: Mutual Engagement and Organizational Justice. That structural change - moving from tight or no horizontal coupling to loose horizontal coupling – is necessary but not sufficient to create the BMI-Conducive Corporation. Behaviors of managers and executives will need to change as well. The

development of creative space for B_{UC} managers who initiate BMI and corporate executives who judge the final merit of innovation proposals will depend on an organizational context that allows for, even encourages, both initiative and risk-taking (Baer & Frese, 2003). Innovation requires risk-taking behavior on the part of initiators (Byrd & Brown, 2002). Risk-taking will be subdued if the organizational context is seen by B_{UC} managers as punishing to risk takers. Because it is mainly the B_{UC} managers who possess the knowledge for BMI, these managers will require a context of psychological safety in which they can offer innovative ideas without fear of punishment or personal rejection (as opposed to rejection of an idea) (Edmundson, 1999).

To encourage the development, proposing, and sharing of innovative business models, corporations can create mutual engagement between corporate executives and B_{UC} managers. That mutual engagement builds on five components (Van der Heyden & Limberg, 2007):

- An *open and engaged dialogue among relevant stakeholders (by virtue of their authority, knowledge, or implication)* regarding the proper framing of the issue that requires deeper *dialogue*.

- A *thorough exploration of the available options* with their implications on all stakeholders.

- *A clear decision* by those with responsibility for the issue, with a *satisfying explanation of the decision* reached as well as the *expectations as to regard roles, responsibilities and rewards* for the execution of the decision.

- A full execution of the decisions explained at the previous step with full communication on execution difficulties, if any, to maintain integrity in execution, and concluding with an *implementation of rewards* as announced at the previous step.

- A thorough *evaluation of results and of the execution of all previous steps,* leading to appropriately validated lessons and organizational adjustments as

Mutual engagement lies at the heart of the creative space among B_{UC} managers and corporate executives. Mutual engagement allows, even encourages cross-unit sharing about business models. Lacking mutual engagement, creative space will be drained of creativity and the potential for innovation.

Despite the advantage of mutual engagement, a number of contextual factors make mutuality difficult to achieve in the corporate setting. The relationship between B_{UC} managers and corporate executives is characterized by a significant power disparity. As the hierarchical authority as well as the source of capital allocation within the corporation, corporate executives ultimately serve as the judge and jury for B_{UC} generated BMI. Large power distance can lead to flawed communications and distrust (Kim & Mauborgne, 1998). Those conditions will undermine mutual engagement and deprive the

corporation of creative space.

Another potential barrier to the process of BMI lies in the motives of the B_{UC} manager. For the most part, BMI will emerge from within the B_{UC}. The closeness of the business units to customers, suppliers, and competitors provides the source of innovation.[20] Unless B_{UC} managers feel confident that the corporate center wants to engage them in BMI even when such innovation may go counter to the scope of their responsibilities or unit interests (like in an outsourcing decision) they will not strongly pursue such opportunities. It is precisely a deep conviction of the presence of organizational justice inside the corporation and especially at its top levels as practiced by corporate executives that will lead B_{UC} managers to pursue BMI notwithstanding the possibility that for some managers this exercise will be destructive of their current authority and responsibility.

The task here is two-fold: corporate management needs to convince B_{UC} managers that they are open and eager for BMI; while B_{UC} managers who are at the source of ideas for BMI need to advocate for their innovative ideas and simultaneously remain sensitive to the potential for impact on other BUCs as well as on the corporation. The reality of status and power differences combined with a context of limited resources to be allocated across B_{UC}s creates a context where organizational justice is required to maintain openness, trust, sharing, and the context of innovation.

Organizational justice refers to the perception among organizational members that decisions are fair, both in terms of the process by which they are derived (procedural justice) and the content of the decisions (distributive justice): [21]

- *Distributive justice* pertains to a perception of fairness in the distribution of resources and outcomes (Tyler, 1984). Outcomes are judged economically, but also socio-emotionally (Deutsch & Malmorg, 1985). The main result of distributive justice is that individuals are more accepting of outcomes that adhere to the standards they apply in judging these outcomes.[22]

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[20] We acknowledge the possibility that the originating idea for BMI may emerge from the corporate center, especially from corporate executives who have experience within the operating units. However, given the disparity of power between the corporate center and the B_{UC}s, there is a danger for imposed BMI which violates the requirement for mutual engagement. Case 10 offers an example of the dangers of BMI imposed by the corporate center on the B_{UC}s.

[21] Greenberg (2001) has noted that organizational justice will be especially salient in circumstances that involve change, the presence of status and power differences, resource scarcity, and the potential for negative outcomes for some. Those characteristics are exactly applicable to BMI within the B_{UC}.

[22] Equity theory supports the importance of perception of fair distribution of organizational rewards to employee motivation. See Jacques, 1961; Adams, 1963, 1965.

- *Procedural justice* pertains to a perception of fairness regarding the decision making process by which the outcome is obtained. Procedural justice is built on employee perceptions of voice or representation in making decisions about matters that impact them. Consistency of procedure, transparency in the explanation of the decision process and logic), the possibility of "correction" as a result of new information, and the compatibility of the decision making procedure with prevailing moral values all work to enhance employee perception of procedural justice (Leventhal 1980; Lind & Tyler 1988).

Organizational justice then refers to the perception among organizational members that decisions are fair, both in terms of the process by which they are derived (procedural justice) and the content of the decisions (distributive justice). The main result of organizational justice is that employee motivation and commitment to the goals of the organization and their execution – and hence to the performance of the organization - are enhanced.

Mutual engagement enriches both the understanding and the commitment of corporate executives and B_{UC} managers as well as the quality of the decisions that are reached. **Case 10** – "The Rise and Fall of 'Participative Decentralization' at General Motors" – traces both the original source of competitive advantage and the later decline of organizational justice and mutual engagement between B_{UC} managers and corporate executives. Note that the initial BMI – relinking by regoverning – established a system of loose horizontal coupling and high organizational justice and mutual engagement. That BMI allowed GM to overtake Ford, with its reliance on technological innovation.

Case 10 – The Rise and Fall of "Participative Decentralization" at General Motors

Just when did the recent decline and potential demise of General Motors (GM) begin? Perhaps it was the 2008 spike in oil prices followed quickly by a worldwide recession. Maybe the decline started decades earlier, in the 1970s, during the OPEC boycott, the accompanying rise of foreign imports, and the failure of GM's answer to those imports, the Chevrolet Vega. There is an argument to be made that, although each of those shocks played a decisive role, the real turning point occurred over sixty years ago, in a simple corporate restructuring announced by the newly appointed CEO in April 1958. To understand the impact of that date and decision, we need to delve even further into the history of GM, back to the creation of the modern corporation by Alfred P. Sloan, back to the originating BMI.

In 1921, when Sloan and his management team took over the 13-year old company from founder William Durant, they found a chaotic operation.[23] The company had grown by purchasing mainly failing independent auto companies. Under Durant, GM was little more than a "formless aggregation" (Sloan's words). The corporate center, such as it was, had no data on the revenues and operating costs of the units. Durant had no ability

[23] This case is based on Drucker, 1946; Chandler, 1962; Sloan, 1964; Kahn, 1986; and Freeland, 2001.

to make rational resource allocation decisions even if he had been so inclined, and apparently, he was not.

GM's main competitor suffered no such confusion. Henry Ford had harnessed the genius of technology and the clarity of strategy to guide his own company to market dominance. Large-scale industrial mass production turned out row-after-row of identical Model T cars. That technology made Ford's strategy simple: mass production of the lowest price car on the market. Under Durant, Sloan complained, GM had developed no "concept of the business" to serve as an alternative to Ford.

Sloan and his team set out to change that, not through the introduction of new technology or new products but rather through what today we can recognize as BMI: *relinking by regoverning*. Guided by his fundamental belief that "good management rests in a reconciliation of centralization and decentralization, or decentralization with consolidated control," Sloan created a corporate policy committee. Now, one body – made up of corporate executives – would make policy decisions for all of the divisions: Chevrolet, Buick, Cadillac, and the others. Additionally, the policy committee would track the profit-and-loss performance of each decision.

Sloan's BMI created the modern M-form corporation with multiple divisions. What it had not done, at least not to Sloan's satisfaction, was to create a sense of mutual engagement among corporate executives and B_{UC} managers. Divisional managers were excluded from policy committee membership, leading to occasionally paralyzing deadlocks between the corporate center and the divisions. In 1924, Sloan inserted divisional managers directly onto the newly constituted Executive Committee. With those managers now dominating the committee, the divisions could cooperate with each other when they chose to do so and "consent" (the term Sloan used) to corporate policies. To further enable collaboration, Sloan created formal interdivisional operating committees. Sloan and at least one other corporate executive sat on all such committees.

Sloan's push toward what he called "participative decentralization" was not universally embraced in the upper reaches of the GM corporation. Representatives of large shareholders, the DuPont family most prominently, worried that too much authority had been ceded to divisional managers. The balance of power shifted occasionally, leading to the nominal separation of policy formulation (the domain of corporate executives) from policy execution (the domain of B_{UC} managers). Even then, Sloan made sure that the Administrative Committee remained the primary source of operational policies.

And it worked! Ford stuck with the lowest priced market strategy (leaving its Lincoln division to serve the upper reaches of the market). GM's relinking BMI, supplemented by loose horizontal coupling and mutual engagement, allowed for divisional autonomy and emergent collaboration. GM's new "concept of the business" was a pricing pyramid that allowed for "a car for every purse and purpose." Each division would pursue its own market – Chevrolet at the bottom to take on Ford, Cadillac at the top to compete with Lincoln, and others aligned in-between. Furthermore, each division would place its offer at the upper end of the range, charging a slight premium for quality while nudging

customers further up the pyramid. GM overtook Ford and became not just the dominant automaker but also one of the world's most successful and significant industrial giants.

In the immediate aftermath of World War II, emerging management guru Peter Drucker gained unparalleled access to General Motors. What he discovered was a system of governance overseen by the Executive and Administration Committees:

> These two committees . . . pass on all major decisions in the fields of policy and administration. They hear periodic reports on conditions, problems, and achievements in all branches of the business. And they are the court of last appeal should there be serious disagreements on policy within the organization (Drucker, 1946: 43-44).

Membership assured that top executives and divisional managers would fully share information about operations in the divisions as well as about the overall policies of the corporation in the creative space developed by Sloan two decades earlier.

All that changed – or at least began to change – in 1958. Frederic Donner, an accountant who worked his way up the ranks of GM corporate by virtue of being a "true financial genius," took over the helm. He immediately set out to dismantle Sloan's carefully constructed and balanced system of "participative decentralization." A number of factors motivated Donner and his supporters (which included, at least nominally, Sloan himself). Remember, there had always been strong shareholder sentiment for tightening centralized control over the corporation. Donner, with his lack of operating experience, saw the separation of policy formulation from execution as a useful step toward greater discipline and lower costs. Furthermore, GMs resounding success in the market – controlling over 50 percent domestic share – attracted the attention of newly energized federal antitrust prosecutors. Donner and his board worried that GM's highly autonomous divisions could be split off as a result of such zealous anti-trust enforcement.

Donner's move, announced in April of 1958, was both simple and profound: remove divisional managers from top corporate committees. Now, instead of being fully engaged in policy decisions, divisional managers would be told what to do and how to do it. That change kicked off a downward spiral of mutual engagement described by Robert Freeland:

> Deprived of representation in the planning process, the divisions began to dismiss policies formulated by the general office as irrational and uninformed – an assessment that was undoubtedly exacerbated by Donner's lack of operating experience. As resistance grew, the divisions increasingly sought to circumvent general office oversight (Freeland, 2002: 272)

In response to increasing divisional resistance, Donner escalated his disengagement, increasingly relying on fiat and centralization. The Executive Committee moved Chevrolet out of the low-priced segment, allowing cheaper import cars (mainly Volkswagen) and small cars to gain market share at GM's expense. Pursuing cost

reduction goals, Donner mandated additional shared parts on reluctant divisions, in particular helping to increase the weight and costs of Chevrolet models even more.

In 1965, Donner took decisive control of the B_{UC}s. He created the General Motors Assembly Division (GMAD), formally ending the autonomy of the divisions. "With initial design and styling carried out by the general office, assembly in the hands of GMAD, and an increasing number of shared parts, bodies, and components," Freeland observes, " mid-sized automobiles from GM's various divisions began to resemble each other more closely than they had in the past, both in appearance and engineering" (Freeland, 2002:279). An attempt to respond to the rising demands for small, inexpensive cars in the early 1970s – the Chevy Vega – proved disastrous. Designed entirely at corporate headquarters – where weight and cost calculations proved to be erroneous once manufacture and assembly began – and imposed on a resistant Chevrolet division, the Vega joined the list of ineffective responses to shifting competitive realities.

Another set of decisions, made by corporate executives in the 1950s and expanded upon in the following decade, systematically reduced organizational justice and mutual engagement. The creative space that had been carefully built and cultivated by Alfred Sloan – co-participation by corporate executives and B_{UC} managers on planning committees and other cross-functional committees – disappeared. The managers of GM's many B_{UC}s lost their voice in corporate policy making and they were forced to accept tight horizontal coupling. The downward spiral of GM in terms of loss of market share to foreign imports, decreased return on investment, and eventually corporate profitability began with that reversal of corporate strategy (Freeland, 2001).

The behaviors of corporate executives and B_{UC} managers will need to change in order to create mutual engagement and organizational justice. The new behaviors, summarized in **Exhibit 6**, will enhance the motivation for B_{UC} managers to bring forth BMI ideas. Those ideas will be shared within the creative space and receive a fair hearing from corpoprate executives who will ultimately pass judgment. All parties will now understand and validate their mutual responsibilities for BMI for the present and the future.

Exhibit 6

Required Behavioral Changes Needed to Create the BMI-Conducive Corporation

Changes in:	Defined as:	For corporate executives	For Business Unit Executives
Roles	The tasks that re expected to be performed by the individual	To develop a creative space and invite and participate in dialogue with business unit leaders concerning potential BMI	To embed knowledge through a mutual dialogue with business unit employees concerning potential BMI and raise those insights to the corporate level
Responsibilities	The outcomes for which the employee accepts either sole or shared accountability	To be held accountable for the alignment of rewards, measurements, and controls with the requirements of BMI and to capture value as a result	To be held accountable for value improvement as a result of BMI
Relationships	The manner in which individuals react with each other	To work collaboratively with business unit managers regularly on potential BMI	To share learning with other business unit executives and corporate executives within the creative space an to apply that learning, when appropriate to the unit's business model

Toward a Theory of BMI

Having defined our concepts and illustrated their use and relevance, we are now able to step back from the specific and offer a theory of BMI within incumbent firms. Our theory builds on four separate but highly interrelated propositions.

Our first proposition looks at the nature of a business model itself and adds a linkage of managerial relationships embedded within an organizational context that has been missing from previous definitions:

> *Proposition #1 – A firm's business model juxtaposes two systems of relationships: one involves transactional linkages among activities and the other involves*

governance linkages between the organizational units that perform those activities.

Changes in governance relationships between the organizational units affect the performance of the corresponding activities.

Supplementing physical transactions with human relationships at the core of business models leads to our next hypotheses concerning altering a business model:

Proposition #2 – Because business models involve relationships among organizational units, alterations in business models require transformational behavioral change within the impacted units.

By placing people and relationships firmly within the domain of business model, it becomes clear that BMI never involves simply a physical reshuffling of activities. New linkages require new transactions. Transactions are supervised by managers within an organizational unit. Changing a business model, therefore, includes changing the nature of human relationships between the corresponding managers. The first proposition applies universally. The second applies to any incumbent firm attempting to alter is current business model.

Our next set of propositions looks at the special conditions that apply to the B_{UC} as opposed to a B_{FS}. We start with the nature of constraints and opportunities:

Proposition #3 – When a business unit is a part of a corporation (rather than a free standing business), the corporation presents both constraints on and opportunities for BMI. The constraints arise from the potential impact of unit-level BMI on corporate scope and risk as well as the potential impact on the operations and strategies of fellow units.

The opportunities arise from the process of shared knowledge across units and with the corporate center.

Finally, we propose the contextual conditions that will maximize BMI within a corporate setting.

Proposition #4 – A combination of loose horizontal coupling among the corporation's business units combined with mutual engagement and organizational justice between the units and the corporate center will maximize opportunities and minimize constraints on business unit level BMI.

This set of conditions – loose horizontal coupling combined with mutual engagement and organizational justice – defines what we have called the BMI-Conducive Corporation.

Implications for Practice

This paper is, by design, conceptually orientated and intended to generate hypotheses. The four hypotheses that constitute our theory of BMI lend themselves to practical implications for executives interested in promoting BMI from within.

We can now develop the implications of our theory for executives seeking to promote BMI within incumbent firms:

- BMI offers an opportunity for lean value creation.
- Managers do not need to await breakthrough technology or invest heavily in new products, new business ventures, or new market development to gain the advantages of BMI.
- Managers first need to understand the firm's current business model before undertaking BMI.
- Managers should remember: people and relationships are as much a part of the business model as are technological linkages and economic exchanges.
- An alteration in business model will require transformational behavioral change.
- Corporate executives desirous of encouraging BMI from within will have to work to develop a creative space among member business units.
- In order to create the BMI-Conducive Corporation, executives will need to engage in both structural and behavioral change.
- The BMI-Conducive Corporation will be characterized by loose horizontal coupling combined with a deep sense of mutual engagement and organizational justice.

We are suggesting that corporate executives seeking to maximize the emergence of BMI from within their units need to move their corporation toward the "sweet spot" of high opportunity / low constraints. BMI generation from inside the corporation does not fail because of a lack of existing creativity, but rather because managers at both the corporate and business levels have not jointly created a context where BMI can arise and flourish. If executives can undertake the transformational process necessary for a BMI-Conducive Corporation, they will create the necessary preconditions for BMI as well as a corporate climate that allows BMI to flourish

Implications for Further Research

We have offered in this paper a set of definitions, hypotheses, and practical implications concerning business models and business model innovation (summarized in **Exhibit 7**).

Exhibit 7
A Summary of Conclusions

Definitions	Propositions	Implications
A business model is a configuration of activities and of the organizational units that perform those activities both within and outside the firm designed to create value in the production (and delivery) of a specific product/market set.	A firm's business model juxtaposes two systems of relationships: one involves transactional linkages among activities and the other involves governance linkages between the organizational units that perform those activities.	BMI offers an opportunity for lean value creation.
Business model innovation (BMI) is a reconfiguration of activities in the existing business model of a firm that is new to the product/service market in which the firm competes.	Because business models involve relationships among organizational units, alterations in business models require transformational behavioral change within the impacted units.	Managers do not need to await breakthrough technology or invest heavily in new products, new business ventures, or new market development to gain the advantages of BMI.
The BMI-Conducive Corporation is a corporation that maximizes the opportunity and likelihood that BMI will emerge from within its business units.	When a business unit is a part of a corporation (rather than a free standing business), the corporation presents both constraints on and opportunities for BMI. The constraints arise from the potential impact of unit-level BMI on corporate scope and risk as well as the potential impact on the operations and strategies of fellow units.	Managers first need to understand the firm's current business model before undertaking BMI.
	A combination of loose horizontal coupling among the corporation's business units combined with mutual engagement and organizational justice between the units and the corporate center will maximize opportunities and minimize constraints on business unit level BMI.	Managers should remember: people and relationships are as much a part of the business model as are technological linkages and economic exchanges.
		An alteration in business model will require transformational behavioral change.
		Corporate executives desirous of encouraging BMI from within will have to work to develop a creative space among member business units.
		In order to create the BMI-Conducive Corporation, executives will need to engage in both structural and behavioral change.
		The BMI-Conducive Corporation will be characterized by loose horizontal coupling combined with a deep sense of mutual engagement and organizational justice.

We do so to invite discussion, debate, and further research. A number of specific topics lend themselves to additional work:

- We have recognized the occurrence of what can be called Business Model Replication (BMR), as well as the frequent failure of such efforts. Szulanski and Winter (2002) have studied the replication problem associated with "best practices." The question of whether that research applies to BMR in a way that explains failure would be useful to explore.

- We looked peripherally at the question of corporate strategy, focusing our attention on the mechanisms that linked (or did not link) business units. Defining business unit linkages is, of course, only one aspect of corporate strategy. The corporation also determines which business to operate in and how to add value directly to the business units through what is traditionally called parenting (vertical linkages). Further research could ask about the relationship between these strategic choices and the conduciveness of the corporation to internally generated BMI.

- We purposely concentrated on BMI that did not rely on new technologies, new products, and/or new markets. BMI may lead to new value offers and new markets. But the phenomenon of BMI that we have described does not follow or depend on renewed strategies, breakthrough technologies, new products, or new markets. Are the antecedent conditions for such BMI different for new strategies and new products that also require reconfiguration? Are there additional conditions required to support BMI when it is embedded in a larger renewal effort?

- We can also ask questions about the broader economic context in which corporations operate. We have referred to BMI as "lean" value creation that does not rely on heavy investments in new technologies and/or new businesses. It might be suggested that BMI offers an especially useful avenue for value creation in difficult economic times. Historical data could be scanned to determine what impact, if any, macro-economic context has on BMI.

- Finally, we can raise the question of assigning a BMI role to a corporate office. Paralleling the role of a Chief Venturing Officer or Chief Marketing Office, a Corporate BMI Officer could act as a facilitator for and consultant to business units. We can speculate, based on our arguments, that such an office could potentially do more harm than good. By adding a "third party" to the required engagement between business unit managers and corporate executives, we note the potential for diminishing mutuality. Our premise is simple: a three-party dialogue is more difficult to manage than a two-party dialogue. The question, however, is open to additional conceptualization and possible research.

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