Research-Technology Management

ISSN: 0895-6308 (Print) 1930-0166 (Online) Journal homepage: https://www.tandfonline.com/loi/urtm20

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Alex Osterwalder & Jim Euchner

**To cite this article:** Alex Osterwalder & Jim Euchner (2019) Business Model Innovation, Research-Technology Management, 62:4, 12-18, DOI: 10.1080/08956308.2019.1613114

**To link to this article:** https://doi.org/10.1080/08956308.2019.1613114

Published online: 26 Jun 2019.

# Business Model Innovation

## An Interview with Alex Osterwalder

*Alex Osterwalder talks with Jim Euchner about the Business Model Canvas and its uses and evolution.*

**Alex Osterwalder with Jim Euchner**

The Business Model Canvas has become an integral part of the practice of Lean Startup and also a tool for established companies seeking to strengthen their business models against disruption. In this interview, Alex Osterwalder, coauthor of *Business Model Generation* and *Value Proposition Design*, discusses the increasing importance of business model innovation and the application of the visual tools he has invented, which have been useful to companies of all sizes seeking to develop new business models.

**Jim Euchner [JE]:** *Business Model Generation* is a different kind of book, with more than 400 contributors. How did it come about?

**Alex Osterwalder [AO]:** My PhD supervisor at the University of Lausanne, Yves Pigneur, was interested in a more systematic look at business models. I did a PhD on the topic, and my research culminated in a thesis called *Business Model Ontologies*. That was a scientific publication, because we tested the ideas and we built it on the knowledge that was already there.

We were not the first to write about business models, but it seems that we were a bit more pragmatic, and we created something that practitioners found useful. People started downloading the PhD, and I got invitations from companies to speak about it. I didn't even know that people read doctoral dissertations.

**JE:** They don't that often.

**AO:** There was a lot of interest, so I went back to Yves Pigneur and suggested that we write a book about business models, because we always wanted to make the content more accessible. As we thought about it, we decided that we couldn't write a book about business model innovation without an innovative business model for the book.

We ended up making a book together with 470 practitioners. They actually paid to be part of the book project, so it was like Kickstarter before Kickstarter and crowdfunding. People got very raw book chunks, and they could give us feedback. That made us very vulnerable as authors, but at the same time, we got very good feedback about what works and doesn't work in practice. That made it a better book.

What we learned from the process is that visual tools are very powerful. Yves and I believe that creating something visual is not just differentiation; it makes things more accessible. The visual is not just lipstick on a pig; it really helps simplify things that you can't easily describe with words. Using visual techniques in business management, for us, is at the heart of what we do: to simplify complex topics down to something that's simple but not simplistic.

**JE:** Let's talk a little about the use of the tools. The focus that I'm aware of has been on use of the canvas, either as a brainstorming tool or as a representational tool. But that's only the first 40 pages of your book. Is that mostly how the tools are used? What are some of the pros and cons with that approach?

**AO:** The Business Model Canvas is used in very many different ways. It's really used the way we envisioned it to be: to visualize and assess an existing business model or to create

One of the world's most influential proponents of business model innovation and value proposition design, **Alex Osterwalder** provides a framework for large companies and startups to rapidly innovate. Ranked number 7 among the top 50 business thinkers worldwide, he is cofounder of Strategyzer, an innovation powerhouse that helps organizations develop more powerful growth engines, better customer understanding, more attractive value propositions, and stronger business models. Osterwalder invented the Business Model Canvas, the Value Proposition Canvas, the Culture Map, and the Business Portfolio Map—practical tools to address important strategic jobs. He is a sought-after speaker and author of the international bestsellers *Business Model Generation* and *Value Proposition Design: How to Create Products and Services Customers Want*. alex@strategyzer.com

**Jim Euchner** is editor-in-chief of *Research-Technology Management* and Honorary Professor at Aston University (UK). He previously held senior management positions in innovation leadership at Goodyear Tire and Rubber Company, Pitney Bowes, and Bell Atlantic. He holds BS and MS degrees in mechanical and aerospace engineering from Cornell and Princeton Universities, respectively, and an MBA from Southern Methodist University. euchner@iriweb.org

DOI: 10.1080/08956308.2019.1613114

**Alex Osterwalder's** visual tools help businesses approach complex topics like business model innovation.

an entirely new business model. We envisioned both uses, but it's just one tool.

Over time, the Business Model Canvas has been used together with other tools. People use the Business Model Canvas to shape their ideas very quickly and to extract the core assumptions behind an idea—what would have to be true for this business idea to work. They go on to test them with the customer development process pioneered by Steve Blank or the Lean Startup process popularized by Eric Ries. That combination is very powerful.

We also see established companies use it to assess the business model of a business unit or their entire company, and they use the canvas to try to improve the business model. What we are really trying to do is to help people compete on business models—not on product and price and service alone and not just on technology innovation alone, but on business models. I really do believe that better business models will always out-compete better technologies or better products.

We want people to turn their thinking around, to start with designing a better business model and then design the offerings and other elements of the business to support it.

**JE:** That's the basic premise behind *Blue Ocean Strategy* as well.

**AO:** There are very powerful tools in *Blue Ocean Strategy* that we use together with the other tools we have. The focus of *Blue Ocean Strategy* is often more on differentiating the value proposition, but you can also use a tool like the Business Model Canvas to systematically think through the business model. The best practitioners use all of the best tools out there, and they combine them.

**JE:** There is a somewhat limited number of coherent business models to choose from. Digital models are growing the set, but there is a risk of putting together pieces that don't fit well together. How do you deal with that?

**AO:** I would argue that there is an unlimited number of potential business models. There are unlimited ways that you can combine channels with value propositions and key resources and activities and the partners you work with. There's no limit to the creativity you can have.

What is important to understand is there are no right or wrong business models; there are business models that work in a certain context, and those that don't. Obviously, the magic is to figure out which ones work, which ones don't, and you can't do that on paper. You shouldn't spend weeks and weeks using the canvas to shape your business model. You have to get out of the building, to use Steve Blank's words, and go test it.

There are two factors for success. One is better-designed business models—models that are scalable and incorporate sources of competitive advantage, like switching costs. The other is whether a business model works in the real world. That means you need to test your concept with stakeholders—customers, of course, but also key partners, distribution channels, and access to certain resources.

**JE:** The critical point about design is that you have some sort of strategic control point that differentiates you from your competitors.

**AO:** Yes, but it's differentiation of the business model, not just the value proposition. You can use business model design to out-compete others with very similar value propositions. So understanding how a business model is different—inferior or superior—is very important. This is something that I think not many people have deeply understood yet. I think we're only at the beginning of understanding business model innovation, which is exciting.

**JE:** When you talk about whether it works, that depends to a large extent on the pragmatics—can people buy it, can you deliver it, et cetera. But it also depends on economics. The

**There is an unlimited number of potential business models. There are unlimited ways that you can combine channels with value propositions.**

canvas doesn't really have any quantitative view of the economics. How do you help people deal with economic viability before they spend lots of money and time experimenting with something that just has no legs?

**AO:** I think that you need to add numbers immediately to the Business Model Canvas. You have customer segments, for examples, and so you can start thinking about the size of a market. And you have revenue streams, so you know how you're going to earn money, and with which pricing mechanisms.

Once you have decided on these things, you need to prototype the numbers as quickly as you prototyped the business model. The spreadsheet is just a set of assumptions, so you get out of the building and start to test the assumptions.

**JE:** The whole process is a learning process. People use the canvas as a representational tool, and then they track assumptions in other ways. The canvas changes daily or weekly. How do people keep track of where they are?

**AO:** When we started doing this with real teams and real companies, we realized that the tool set was not complete. We created another tool, the Value Proposition Canvas, to fill a gap. That helped people focus on the more detailed aspects of creating value for customers, which is one thing you need to get right. The Business Model Canvas is more about creating value for the company.

When we started watching teams over three months, we realized a couple of things. First, teams have a tendency to focus on the end point, the final presentation. But that's not how entrepreneurship works. An entrepreneurial team actually needs to understand every week what has changed. Are we on track? Do we need to throw away our canvas and do a pivot? Second, we realized that we needed to help people track their progress, from idea to validated business case.

We started looking at the metrics out there. Does anybody know how to measure the reduction of risk? Does anybody know how to measure progress in innovation? We created innovation metrics that allow teams to understand if they're minimizing risk in their idea along four dimensions.

They look first at desirability: do customers want what you have to offer? Then they look at feasibility: can we actually create this thing and support it? The third dimension is viability: can we earn more money from it than we spend? And the last dimension is adaptability: can this business model survive in today's world with evolving technologies?

Without these metrics, it's very hard for teams to understand whether they're making progress or not. These metrics let you start to compare ideas. One idea has huge, huge potential, but the team hasn't actually taken any risk out. You're probably not going to invest $50 million or $100 million or a billion into that idea. And you might see smaller opportunities, but ones where the risk is substantially reduced. They might be worth starting to invest in to help them scale. Innovation metrics, for us, are hugely important to help teams progress.

**When you're starting out with a crazy new idea, you have 100 percent risk. The more evidence that you develop, the more you reduce this risk.**

**JE:** Those are the four categories that are often used in design.

**AO:** Exactly. We took those dimensions and broke them down into something that is measurable. What's measurable is the evidence that you collect. We look at the evidence in the different categories and at the strength of that evidence. If, over three months, you built up a pop-up store and you generated a certain amount of sales, your evidence is extremely strong. You haven't scaled your concept to five different markets yet, but at least in one market you created real sales. And that kind of thing is possible at a very low cost.

**JE:** Say you're doing a review of the team, perhaps on a weekly basis, and you're looking at these four categories. Are you looking at thermometers that show that there is growing evidence or weak evidence?

**AO:** Exactly. We created an algorithm, if you will. The algorithm allows you to look at the overall risk factor. When you're starting out with a crazy new idea, you don't know the market, you don't know if you can build your concept, you don't know if you can make money: you have 100 percent risk. The more evidence that you develop, the more you reduce this risk.

**JE:** How do you help teams with tracking from sprint to sprint, keeping the thread of changes and making sure you're not fooling yourself? If you change something critical (or pivot), it may change something else you thought you knew.

**AO:** Exactly.

**JE:** How do you help people deal with that issue?

**AO:** We're working on software to help with the tracking and integrating the metrics into the software. Sometimes this is pretty difficult to do on paper. You realize that this channel is not going to work, or this customer segment actually doesn't need this and then you have to go five steps back. It's like the game of Chutes and Ladders.

This has big implications. We need to train senior leaders that, in innovation, it's not always forward.

**JE:** If you look at it from a learning perspective, it's always forward. If you look at it from the perspective of, how close are we to a risk-reduced business, it's not.

**AO:** Exactly. That's the way to frame it: how close are we to a real business?

We also need to train Chief Financial Officers that spending $100,000 to shut down an idea may save millions of dollars. We have to look at the financials through the lens of a portfolio, and not individual ideas.

Our next book is called *The Invincible Company*, and it is designed to help established companies look at their portfolios and understand whether they are balanced or not. No one can pick a winning idea ahead of time; you can invest in ten, and one winning idea will emerge. You need to evaluate innovation through the lens of the performance of the portfolio, not the performance of any individual project.

**JE:** There are a lot of variants of the Business Model Canvas now. I guess that is sort of a left-handed compliment. Are there changes you would make to the canvas now? Are there variants that you think are particularly effective in some circumstances?

**AO:** I wouldn't change the Business Model Canvas as it is today it for a very simple reason: I think that it does the single job we designed it for well, which is to visualize business models. It never pretended to do everything.

We looked at some of the variants that were successful, and we asked ourselves why. That led us, for example, to create the Value Proposition Canvas. We realized that people wanted something to make their value proposition more explicit, and the Business Model Canvas was never designed to do that. So we created a new tool for that.

Then people started putting stuff into the canvas to integrate the Lean Startup Approach right into the canvas. I said, "No, no! You don't want to integrate the two; you want to use them together."

A business tool should do one thing, one job to be done really well, and that's it. When you have several jobs, you should use several tools, like a surgeon does. A surgeon doesn't use a Swiss Army knife to do heart surgery; that would be crazy. Why do we think one business tool should do everything? If you try to put too many jobs into one business tool, you'll get 25 boxes. It'll do everything, but nobody's going to use it.

**JE:** The tools have to articulate with one another.

**AO:** That's where I would expect more from the community of tool designers. Let's not reinvent tools that work; let's make new tools where there are none, like around innovation metrics, or where they're not good enough. And let's always make sure we can integrate them with the good stuff that's already there. You mentioned, for example, *Blue Ocean Strategy*. I love using the tools of *Blue Ocean Strategy*. The two I use most are the Four Actions Framework and the Strategy Canvas. They are perfectly fine, and they work very well with other tools. I do believe it's the integration of these tools that is very important.

> **A business tool should do one thing, one job to be done really well, and that's it. When you have several jobs, you should use several tools.**

**JE:** Another use of the Business Model Canvas, other than for ideating new business models, is evaluating existing business models. Can you talk about how people use it in this way? I find that, when thinking about their own business models, people tend to get a little glib and assume that things are less threatened than they might be.

**AO:** I really realized how powerful this could be when I did a workshop with the senior leaders at W. L. Gore.

**JE:** A very innovative company.

**AO:** We did a workshop, and I asked the business leaders to assess their existing business units and look at the strength of their business models. These are business models that already work, but the question is, how well do they work? Would it be easy for customers to switch from one supplier to another if a disrupter arrives? Are the business models scalable? Do they have recurring revenues rather than just transactional revenues?

Some of the leaders came up to me afterwards and said, "We thought these tools were just useful for new ideas; we didn't realize that we could assess our existing business units with them." That's when it became very clear to me that we need to broaden people's thinking about the Business Model Canvas.

This is a big topic for us in our new book. We want to show people how to use the canvas to think about their existing businesses. You always want to start with two things. First, ask yourself how much at risk you are of being disrupted. That is a big risk today for many companies, and they don't look carefully enough at it. There are a lot of things that you can do to understand your risk of disruption. How much venture capital is there chasing opportunity in your industry? How many new startups have been created?

But the second question to ask yourself is, Could I strengthen my business model against disruption? How could

**The less known the technology or the business models and the bigger the financial expectations, the greater the number of initial projects you should invest in.**

I shift the business model from what it is to another, stronger model?

One of the cases we consider in our upcoming book is a company called Hilti. They have made tools for builders for ages. They shifted their business model from manufacturing and selling products towards a services-based business. That's one of the most well-known shifts. To do so, they had to completely transform their business model, but doing so helped them out-compete others and overcome a crisis driven by low-cost Asian competitors.

**JE:** You said something earlier that was a little provocative to me, which was the idea that there is an almost unlimited range of feasible business models. The digital world and now AI are really opening up possibilities. How do you help people think about how digital technology and AI could affect their business models?

**AO:** I always see advances in technology as an opportunity for business model innovation, but not necessarily as the driver. You can see the technology as a design constraint.

I often see companies that are in the analog world that say that they would like to become data-driven, potentially AI-driven, companies. They start from that premise and start generating potential business models. You need to realize that you are not going to figure out the right business model immediately. You might come up with 10 different business models, and you probably want to invest in learning something about each of them with 10 different teams.

You might invest $50,000 in each of them. After three months, you might winnow it down to three, and you're going to give each of them $250,000 to further explore the business model. Six months later, after the second sprint, you might give surviving teams a million dollars each. What's really important in this process is understanding the possibilities. The less known the technology or the business models and the bigger the financial expectations, the greater the number of initial projects you should invest in. Ten might not be enough. In early-stage venture capital, you need to invest in 250 projects to produce one that has a financial return that is higher than 50 times. That's what the investment statistics tell us. You just can't pick the big winners. You need to invest in a portfolio of projects.

And it's not just marching forward. Sometimes you move forward with the technology then realize that it's not likely to happen in the next 10 years. What you really want to do is have a vision of the long term but act in the short term and continuously adapt your long-term vision based on what you learn every year. You need to continuously reinvent yourself so that you're ready for the changes 10 years down the road.

**JE:** It's a new world. Business models have traditionally been very stable, but that's no longer true. Most business leaders operate from the assumption that it's extremely costly and risky to change your business model, or even to develop a new channel. If you are scared about developing a new channel, forget about implementing a whole new business model.

**AO:** That's correct. The phrase "business model innovation" is very scary. But business model innovation is not scary if you do it the right way. The biggest innovation myth is that it's costly and risky to develop a new business model. That's only the case when you do it wrong. If you break the process down into smaller, less risky chunks, which you would call assumptions or hypotheses, and you test the smaller chunks, you can reduce the risk.

So some of the fears are irrational because senior leaders don't know how innovation works today. They don't understand the concept of investing to reduce risk. There is a moment where innovation does get expensive, but that's when you're scaling the business. The fear factor is one of the biggest preventers of good innovation today.

**JE:** Finally, I would like to explore business model patterns. There are many different variants of business models, but only a few patterns. In your book, you only list five or six. Tell me how you and your collaborators think about business model patterns.

**AO:** What we're writing about in our new book is breaking down business models into what we call *business model mechanics*—smaller chunks that together create a pattern. We looked at this systematically, and we came up with two categories of business model mechanics. The first one is what we call disruption mechanics, and the second is what we call business model shifts. A business model shift might be a move from product to service, for example. Or you might move from high costs to low costs, or from high tech to low tech. Everybody talks about low-tech companies moving to high-tech digitization. I find it exciting to see companies that go from high tech to lower tech.

We're looking at these different mechanics and we're creating a library, so people can pick from that library and design their own business models. As you noted, business models are expiring faster than ever before. We need to give people the tools to pick from a library of established patterns.

**JE:** Are you crowdsourcing this book as well?

**AO:** We are using a different approach. We aren't crowdsourcing, but we are still crowd-testing. The more we develop, the more we test the spreads—the double-page layout in the book. We put a spread in front of people to see whether they understand it, and what they don't understand. Do they like it, and what don't they like about it? This has been very powerful, and in this case, it's even more important because we're trying to simplify things that are not easy—business model mechanics and business model patterns.

We're testing with different customer segments—from sophisticated coaches all the way to consumers, entrepreneurs, and senior leaders—to see how they understand the material. We're doing what we preach, which is extremely important for us, because otherwise, we might create a flop.

**JE:** What's next? You talked business model patterns and mechanics, and you talked about creating a portfolio view. What other things are on your roadmap?

**AO:** What's really important for us is to put all of these pieces together to show how a leader of an established company can assess a few things. Number 1: what is my innovation readiness? How well am I structured, what's my leadership doing, what's my organizational culture like, what's the state of my innovation practice?

Based on their understanding of their current capabilities—perhaps they do incremental innovation well but are not good at growth innovation—then we help them take the next steps to understand what they have to put in place to create a world-class innovation organization. The goal is to help companies become like Amazon on the innovation side. There are a lot of things we can criticize about Amazon, but what we can't criticize is their world-class innovation.

What we're trying to do is to break that bigger thing, that Amazon vision, into smaller pieces: innovation readiness, the portfolio, the cultural aspect, the organizational structure, all the way down to the tools used to look at a business model or a value proposition. The goal is to assemble these puzzle pieces so that anybody can use them.

**JE:** The challenge, I think, is that people can use the tools in a superficial way. They may have the *perception* that they're doing innovation, but they're really just going through the motions. One of the challenges is getting people to be realistic about the true status of their business model or about how risky a new venture really is. Within a corporate setting, there can be a conflict between encouraging people to look at their innovation very objectively and their need to sell the project within the corporation.

**AO:** The good news is that time is in our favor. Many of those who don't use these tools well, or who use them in a superficial way, are going to die. A lot of established companies are going to go away because they're not doing a good job at innovation.

Today, there's no industry on the planet that's safe from business model disruption. The startups used to be what Steve Blank calls "ankle biters." Today, they're actually better funded than most corporate ventures. The venture capital that startups have access to today is amazing. Ventures within established companies are not as well funded as startups in many cases.

The unfortunate part is that when companies die, the social costs to society and to communities are huge. Consider what is happening at GE; it has huge human implications. I think that there's almost a moral obligation to help companies reinvent themselves if we don't want to have huge external costs to individuals, communities, and governments.

When people say that it is inevitable for large companies to die, they are looking at it from a very comfortable place. There are really, really big implications. It's great to have startups, but it's also great to have large companies that are able to reinvent themselves, because that means a lot of jobs and a lot less social disruption.

**JE:** GE is an interesting example because they tried to adopt the principles of Lean Startup. They called it FastWorks.

**AO:** GE is a good example. I think they did some pretty good work around innovation. But innovation is only part of the story. You can't neglect your core business either. If your core business is in trouble, you'd better be really, really good at innovation to outrun problems in the core. And that wasn't the case.

Companies today need to be ambidextrous. It's not about innovation alone, and it's not about execution alone. It's about "and." That was one of the big challenges at GE, and it's one of the big challenges we see at other companies. Innovation is one aspect; execution is the other. You need to be world-class at both, and few companies are world-class at both.

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