Business Model Innovation and Replication: A Duality in the Growth Path of the Firm

Arash Najmaei

Macquarie Graduate School of Management, Sydney, NSW, Australia

arash.najmaei@students.mq.edu.au
Abstract
Theory of the growth of the firm (TGF) suggests that growth of the firm is the result of administrative tasks that executives perform in managing productive resources of the firm. A key task of executives in this regard is to choose and implement business model of the firm. Literature suggests that business model of the firm may follow two general logics: ‘business model innovation’ and ‘business model replication’. This study aims to conceptualize this duality. By doing so, the present research develops a bridge between business model and growth of the firm and particularly contributes to the literature on the micro-foundations of growth by arguing that different business model strategies could lead to different growth paths.

Keywords: Business Model, Growth, Innovation, Replication

INTRODUCTION
Growth of the firm is a strategic objective of executives (Wunker, 2012). It is, however, a complex and evolutionary process (Lockett, et al. 2011). Complexity of the growth is due to function of numerous factors from exogenous abilities of executives to acquire necessary resources and develop capabilities to exogenous environmental conditions (Achtenhagen, Naldi, and Melin, 2010). Its evolutionary nature however indicates that growth is a non-linear process of continuous changes in the resource structure of the firm (Pitelis, 2007). Resource structures refer to combinations of resources that enable a firm to create and appropriate (capture) customer value (Sirmon, Hitt, and Ireland, 2007). These combinations are developed based on the logic of the business. Literature indicates that little is known about this logic. A key concept which has been argued to encapsulate this logic and represent the resource structures of the firm is the business model of the firm (George, and Bock, 2011). Business model literature is nascent and specifically little is known about the role of business model in the growth of the firm (George, and Bock, 2011; Zott, Amit and Massa, 2011). Given limited understanding of this issue in the extant literature, it is the intention of this article to: 1) develop an understanding of the association between business model and growth of the firm and 2) explain two generic strategies in this context form a managerial perspective.

Literature suggests that executives could emphasize two general strategies to use their business model in stimulating growth: replication and innovation (Aspara, Hietanen, and Tikkanen, 2010). Business model replication refers to the action of repeating current business model in order to enter new markets and offer
similar products and services to new customers while business model innovation refers to creation of a new business model or reinventing the existing business model to offer racially new products or service to new customers in order to stimulate growth (Aspara, et al. 2010). Despite their similarities and differences in both managerial logic and growth paths these two strategies have received relatively little attention (Teece, 2010; Winter, 2010). Thus, this study aims to contribute to this strand of research by adding to and advancing literature on the relationship between business model strategies and growth of the firm. Particularly we aim to address the question of ‘how and when executives’ emphasis on business model replication and innovation contribute to the growth of a firm’. We specifically focus on the role of executives in developing a business model and using it in governing growth and hence situate our research on the literature about micro-foundations of strategy and growth (Felin, et al. 2012). This positioning permits this research to offer additional contributions to the growth literature from a less-explored aspect of executives’ business modeling behavior.

In line with the above objectives, the present study is organized into four sections. The first section reviews the extant literature on the growth of the firm and role of executives in this matter. In particular, it focuses on the salient role of business model in the growth of the firm. The second section continues with clarifying the concept of business model and shows how the business model of the firm is developed by managers and forms the foundation of evolutionary fitness of the firm towards the growth. The third section discusses replication and innovation as two possible evolutionary growth strategies which use business model of the firm at their core and finally the fourth section draws attentions towards the managerial implications of the foregoing argumentations and casts some light on several research directions.

GROWTH, MANAGERS’ BEHAVIOR AND BUSINESS LOGIC

In the contemporary business literature the dominant paradigm for studying the growth of the firm is the Penrose’s theory of the growth of the firm (TGF) (Penrose, 1959). TGF is generally regarded as the most-comprehensive and plausible theory of the growth in business literature (Lockett, et al. 2011). It however
is yet to be fully understood and gains its full potential in the business and strategic management literature (Connell, 2009). Given its comprehensiveness and untapped potential we use this theory in our discussion about the growth of the firm. We specifically aim to advance this theory by incorporating the notion of business model into the foundation of a firm’s growth.

According to Penrose, the term ‘growth’ can be used with two connotations: 1) an increase in amount such as sale, export, number of employees, etc. and 2) improvement in the quality as a result of a process of development. Second sense however has the connotation of ‘natural’ or ‘normal’ (Penrose, 1959:1). That is, growth becomes ‘more or less incidental result of a continuous ongoing or unfolding process’ (ibid).

Strategic management literature tends to adopt an integrative view to the growth of the firm and thus considers growth as a continuous process of developing resources and capabilities that results in an increase in firm’s performance outcomes such as sale, market share, market capitalization, income, number of employees and so on (De Clercq, Lim, and Oh, 2012; Favaro, Meer, and Sharma, 2012; Achtenhagen, et al., 2010).

We thus confine our attention to this notion that, Penrose attributes the growth of the firm to a bundle of actions that managers bring to the firm and particularly their resource management services (Pitelis, 2007). More specifically, in the view of Penrose growth is driven by the interactions between managers and resources of their firms (Kor, Mahoney, and Michael, 2007). These interactions are themselves guided by the managers’ perception of their business which can be limited due to bounded rationality (Kor and Mahoney, 2004). Therefore growth of the firm is limited to the managerial capacities of the firm. This is known as Penrosian effect (Kor, et al. 2007). Managerial capacities refer to the productive services offered by managers in the firm. These productive services are abilities of managers to identify productive opportunities and exploit them through administrative actions that purposefully deploy firm’s resources (Lockett, et al. 2011). Productive opportunities, however, are all productive possibilities that managers can see and take advantage of (Pitelis, 2007). Thus growth is, in nature, a function of managerial entrepreneurial behavior and particularly actions towards identifying and exploiting opportunities.
To do so, managers’ require structures. This is because opportunities are inert and lack agency. That is, they come to life when are acted upon (Shane, 2003). So, human action is required to enact an opportunity (De Jong, 2011). To act, managers must know their business in terms of customers, existing resources and capabilities and the markets they serve or are going to serve (Shane, 2003). In this respect, Penrose argues that growth is directed based on the current knowledge and understanding of the business (Kor, et al. 2007).

We argue and show in the next section that managers’ perception of their business in terms of customers, resources and business ecosystem (i.e. markets and industries) and their subsequent opportunity-recognition and exploitation are based on the business model of their firm. Maintaining this line of thinking we will add that although business model concept has not been fully appreciated in economics literature (Teece,2010) but it conceptually plays a central role in the growth of the firm and had been implicitly been used in the Penrosian view of the growth of the firm.

**BUSINESS MODEL: LOGIC OF BUSINESS AND RESOURCE DEVELOPMENT**

There is an increasing interest in the business model concept in the both strategy and entrepreneurship literature (Zott, et. al, 2011; George and Bock, 2011; Najmaei, 2012). Despite this surge, there still appears to be no generally agreement about what a business model really is (Zott, et al. 2011). Thus, in this section the existing literature is distilled to form a description of business model which could serve the purpose of this study. This is not, however, our intent to criticize or reject existing definitions.

In general, a business model can be reasonably defined as the model of a business. A business can be defined by three components: who (i.e. customers), what (i.e. products, services and in general offerings) and how (production and turning revenue to profit) (Abell, 1980; Markides, 1998). A model, on the other hand, can be defined as any device which attempts to provide a simplified representation of reality (Leyshon, 1982). Synthesizing these two definitions, a business model is defined as the representation of ‘who customers of a firm are’ (market segments it serves), ‘what the firm offers to them’ (products and
services) and ‘how it turns revenue into profit’ (profit formula). Thus, a business model is not a business plan, financial plan or operational plan; rather it is a conceptual picture of the business as a whole entity.

Furthermore, because it is a representation of reality it has a cognitive side. That is, it must be understood and perceived by managers to represent the reality of their business’s customers, products and profit formula accurately in the mind of their. This is consistent with the view of Teece, (2010) who argues that the nature of business model is conceptual rather than financial or operational.

Business model indeed acts as a blueprint of the business’ architecture by which managers conceptualize how their business works (Anderson, and Markides, 2007). This implies that a business model represents logic of the business. This logic shows what resources, structures and governance mechanisms managers need to develop to serve their customers (Casadesus-Masanell, and Ricart, 2011). It also defines the nature of transactions (i.e. exchange of goods, services, information) that a firm needs to perform within its business ecosystem to not only stay viable but also gain a competitive advantage (Zott, and Amit, 2010).

Having said that, a business model plays two roles: 1) it defines value creation logic by showing how a business could create value (i.e. developing products and markets portfolios) and 2) it defines value capture logic by determining how it can capture value (generate profit by executing profit formula and managing revenues and costs ) (Zott, et al. 2011). It can be thus argued that business model of the firm represents the logic of the growth of the firm. This logic has two sub-logics: value creation logic and value capture logic.

Executives hence govern the direction of the growth of their firm based on their business model strategies. Business model allows executives to sift through information in the market, find relevant opportunities and take advantage of them by their resources as defined in their business model. Business model, thus, is a mental model of how growth can be planned and achieved. This argument is consistent with recent research which shows that executives consider business model of their firm as the central component of their growth strategies (Zook, and Allen, 2011; Sinfield, et al. 2012; Lazonick, 2010;
George and Back, 2011). In keeping with this line of reasoning, the next section addresses two general business model strategies namely replication and innovation.

**LINKING BUSINESS MODEL TO GROWTH: REPLICATION VERSUS INNOVATION**

We argued that business model of the firm represents its logic of growth that is how value can be created and captured. It is axiomatic, however, to say that any given firm has a business model and at any given point in time, following the duality of March (1991) a firm is emphasizing on either exploration or exploitation. This implies that a firm is either replicating its business model (exploitation) or endeavoring to reinvent its business model or develop new business models (exploration). These two can be termed as two major business model strategies (Aspara, et al. 2010). Therefore we can conjecture that, there is a dual path towards growth; one path is based on the repetition of the existing business model that is known as replicating path in which growth is directed based on a relatively stable established logic and the other is based on the managerial attempts to develop new growth logic and hence can be termed as innovating path. In this path growth is directed based on a logic that deviates from the established growth logic. In what follows we compare these two paths and accordingly discuss their implications for the growth of the firm.

**Business Model Replication**

Replication refers to reproduction of the practice of an organizational element or unit (Baden-Fuller, and winter, 2005). The philosophical logic behind replication is “to turn a small success into big ones’ (Baden-Fuller, and winter, 2005). However, the strategic rationale, behind it, is the ability to gain advantage such as share of the market faster than rivals can imitate or even innovate (Baden-Fuller, and winter, 2005). Literature suggests that the primary motive behind replication is to achieve a fast growth by repeating application of a successful formula or recipe (Winter and Szulanski, 2001). For instance, a bank through replication increases the number of its branches based on a successfully applied operation recipe (Szulanski, 2000).
Pursuing a replicating strategy requires the firm to know the recipe or formula well and develop required abilities to refine it in order to minimize efforts for replicating it successfully and quickly (Winter and Szulanski, 2001). As a result replication implies the logic of efficiency and exploitation (March, 1991; Winter, 2010). That is, firms try to increase the efficiency of their formula by repeating it and learn how to exploit it more effectively (Winter and Szulanski, 2001). Therefore, the formula must be relatively stable to be replicated and refined during replication (Winter, 2010).

Research suggests that, replication as a strategy can be applied to a variety of activities from simple productive processes, technologies, to product development, services, managerial practices and also business models (Winter and Szulanski, 2001; Davies, Frederiksen, and Hartmann, 2010; Aspara, et al. 2010; Shams, 2012). In this research, however, we choose to focus on only business model replication (BMR).

Once a business model is stabilized after discovery and exploitation it can be replicated to stimulate growth (Winter and Szulanski, 2001). Through this mode of replication firms can replicate their business models entirely such as McDonalds across its new outlets or partly such as spin-offs and spin-outs as well as new subsidiaries which have parts of their parents’ business model (Knudsen, 2008). This is because replication is carried out by copying routines based on products and services that the firm offers in markets. So, similar products and services are offered for different markets through replications of necessary routines (Winter and Szulanski, 2001; Winter, 2010). Therefore, executives choose to expand their markets by offering similar products and services which have been successful in other markets by replicating required routines (Ruuska, and Brady, 2011). This may result in partial or full replication of a firm’s business model. During business model replication executives repeat their previously proved methods in new markets. Key resources and capabilities such as technologies, standards and methods are transferred and market learning is quickly guided based on previously learnt facts (Winter, 2010). Thus managers attempt to find opportunities that fit their previous business model and accordingly develop similar resources and capabilities to sustain their growth following a proven logic. Therefore, Business model replication can be thought of as a path-dependent logic by which growth is stimulated through
developing similar resources and capabilities and transferring knowledge to implement it quickly and successfully (Winter and Szulanski, 2001). So, no new customer value is created rather the current value is diffused to new customers. That is, although markets are expanded, however, competition is also simultaneously triggered (Winter, 2010). So it arguably is a reasonable logic in munificent and stable markets. In adherence to the purpose of this study, we deliberately do not seek to discuss the marketing and competitive consequences of replication and thus proceed by business model innovation as an alternative logic of growth.

**Business Model Innovation**

Business model innovation, on the other hand, implies a different approach to growth. It is an innovation in the logic of business. It is adopted as the logic of growth when the existing business model of the firm loses its competitiveness as competitive moves and market changes erode its value (McGrath, 2010). Over the past few years the notion of business model innovation has attracted a remarkable amount of attention. It has become the center of attention in the literature about strategic resiliency (i.e. flexibility or agility) (Hamel, and Välikangas, 2003) and has been termed as blue ocean strategy (Kim, and Mauborgne, 2005) or strategic innovation (Markides, 1998). In this section we show how this growth strategy differs from business model replication.

Unlike replication in which growth is stimulated by diffusing value, this logic assumes that growth can be stimulated by creating new value logic. Value innovation (Kim and Mauborgne, 1997, 1999) literature offers insights into this issue. Value innovation is an innovation in creating and capturing value (Kim and Mauborgne, 1999b). In the language on Kim and Maurogne, value innovators are those firms which identify new customer value instead of repeating their value. This makes the competition in exiting markets and based on existing customers irrelevant and therefore creates new profit edge for the firm (Kim and Mauborgne, 2005). Value innovation happens when a firm introduces a new business model or reinvents its current business model (Kim and Mauborgne, 2005).

Similarly, the concept of strategic innovation was promulgated by Markides (1997). It refers to the act of introducing a new business model by the firm based on a gap in industry positioning map which enables a
firm to create a new market (page, 12). Accordingly industry positioning refers to how a firm positions itself in the industry in terms of three underlying assumptions of the business model. These include who (customers), what (products and services a firm offers) and how (the production and marketing methods) (Markides 1997). Therefore, business model innovation is essentially a path-breaking strategy by which radically new resources and capabilities must be acquired and developed. Deployment of these new resources and capabilities create a new path for the growth of the firm. It is most likely pursued when markets are highly dynamic and hostile. We conclude this discussion with a brief comparison of the key aspects of this two growth paths.

Table 1: Comparison of BMR and BMI

DISCUSSION: IMPLICATIONS AND RESEARCH DIRECTIONS

Managerial Implications
We highlighted that two possible business model strategies can be pursued by executives to simulate growth. As a result we endorsed the notion that growth is a managerial action-deterministic phenomenon. It is in fact directly governed by business model-based behavior of managers. Two managerial implications can be drawn from this analysis. First, business model of the firm is a coherent unified model in the mind of managers that represents totality of the business from operational to financial and strategic aspects. It defines who customers are what offerings are and how offerings are delivered to customers and revenue is generated. Therefore, it forms the cognitive foundation of growth. Choosing, adjusting and repeating or reinventing business model directly impact growth direction and growth dynamism of the firm based on the functionality of this cognitive side.

This cognition is converted into decisions that define how business model must be linked to growth by the trade-off between perceived competitiveness of the current business model and perceived market conditions that point to new business models. Therefore, misperception of market dynamism may hinder growth and lead to unsuccessful business model strategies.
Secondly, business model strategies in the form of replication or innovation directly impact resource structures of the firm and its knowledge acquisition and transfer practices. Managers must be aware that, both business model replication and innovation require new knowledge that must be acquired from external environment. This is because implementing any strategy including repeating a currently successful logic or developing new one is always followed by uncertainty. So acquisition of knowledge is the main approach to reduce this uncertainty. Inability to acquire new knowledge would slow down the rate of growth.

**Research Directions**

In order for future researchers to advance the current body of knowledge in this field, it must be noted that, the argument we offered above can be situated within the literature related to the micro-foundations of strategy and firm performance (Felin, et al. 2012). The dominant methodological doctrine in this realm is ‘methodological individualism’ (Foss, et al. 2008). It claims that social phenomena such as the growth of a firm as a social entity (administrative organization is a social entity or a collective system of individuals and its behavior is a result of actions and interactions within them) must be explained by showing how they result from individual actions, which in turn must be explained through reference to the intentional states that motivate the individual actors (Foss, et al. 2008). This thesis implies a number of research directions. For instance, future research can investigate the psychological antecedents of business model strategies such as the role of managers’ cognitive style on the perception of the environment and choice of business model strategies. Furthermore, since growth is an evolutionary phenomenon in which roles of managers in business modeling unfold over time, longitudinal case studies that explore interactions between managers, business model and resource structures of the firm towards growth can advance the current understanding the micro-foundations of growth. We assume that future research following these approaches can enrich body of knowledge on both strategic management and entrepreneurship and inform both scholars and practitioners to gain a deeper understanding of firm’s growth and its internal mechanism.
CONCLUSION

In this study a dual view of the link between business model and growth of the firm was explained. It was argued that business model represents the logic of growth and hence can yield growth by being replicated or reinvented. Accordingly, the role of managers in adopting these two approaches was discussed and managerial implications as well as some future research directions were presented.

REFERENCES


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