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Markets, Business Models and the Growth of the Firm

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Abstract

The business press is full of examples of how firms use business models to identify and frame or reshape new markets. Yet to-date our understanding of how business models affect market-making has not received much consideration by the marketing literature. This papers sets out to explore the use of business models in market-making through an assimilation of the business model and market-making literatures and the examination of an illustrative case heralded in the media as the 'way forward for market making' – Nintendo. The paper concludes by considering the implications of business models as a tool for market-making and its implications for the way we think about the growth of the firm.

Key words: Business Models, Networks, Growth, Market Making.

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Introduction

The business press is full of examples of how firms use business models to identify and frame or reshape new markets. Yet to-date our understanding of how business models affect market-making has not been addressed in the literature. This papers sets out to explore the use of business models in market-making through an assimilation of the business model and market-making literature and the examination of an illustrative case heralded in the media as the way forward for market making – the case of Nintendo. Adopting an institutional approach to market-making, we begin with an examination of recent theoretical developments within the marketing discipline. These have drawn heavily on economic sociology to explore and explain how markets are identified, explored and created. In his seminal work, "*The Laws of Markets*", Michell Callon (1998) rejects the position of neo-classical economists, that understand markets purely as mechanisms for the determination of price, and draws on Graovetter's (1985) notion of market exchange as embedded in social structures. Callon (Callon 1998a; 1998b; Callon et al. 2007; Callon and Muniesa 2005) explores the constructs of market exchange by examining the practices that are mobilized to make markets.[1] In this regard, a central tenet of the literature is the practice-based approach to markets. This approach is becoming increasingly common in the field of marketing. For example, Finch and Acha (2008) explore how markets might be understood as emergent constructs that evolve through an array of practices involving different forms of expertise and material devices (also see, Araujo 2007; Latour 2005). However, the practice-based approach reveals a tension between markets being identified and 'mapped' and markets being 'manipulated' and created. This point is well illustrated by Simakova and Neylands (2008) examination of the mapping process of a market for a new RFID[2]-technology. In their paper, Simakova and Newyland (2008) provide an ethnographic account of how a firm developed and launched a new product, illustrating marketing practices developed to map markets that end up contributing to manipulating and '*making'* markets (*c.f.* Araujo 2007).

Callon et al., (2002) highlight the iterative process of market evolution, explaining that markets are continuously being made and remade as a result of 1) the product development processes and 2) the construction of market 'spaces' where goods can be compared and exchanged. But as Araujo (2007) and Cochy (2008) point out, the types 'processes' and 'spaces' that form market practice are likely to be contingent, and context specific. For example, Business-to-business markets such as engineering design services, are likely to draw on different specialist marketing practices from, say business-to-consumer markets such as retailing. Business-to-business market-making might be more influenced by the practice of managing the trade press, while business-to-consumer markets might be more influenced by the effective management of mass advertising campaigns. Thus, different market forms rely on different calculative judgements and practices, and require different assemblages of expertise.

A second stream of literature that appears to be concerned with the issues of the assemblages of experts is the business models literature. Burgeoning in the late 1990s through their association with the rapid growth of e-business, business models seek to find novel ways to conceptualise and deliver value to customers and consumers (Timmers 1999; Weill and Vitale 2001). As such, the business model approach seems to be that of mapping-out and mobilizing resources and markets in ways that are likely to achieve firm growth. Zott and Amit (2007) define business models in terms of the boundary spanning exchange that occurs within business networks and provide empirical evidence to show that some business models are designed for market novelty, while others focus on efficiency and that this has direct implications for growth. Weill and Vitale (2001:34) define an e-business model as:

> *"a description of the roles and relationships among a firm's consumers, customers, allies, and suppliers that identifies the major flows of product, information, and money, and the major benefits to participants"*

Weill and Vitale (2001) suggest that there are three critical aspects of a business model, 1) participants, 2) relationships and 3) flows, and propose a set of building blocks with which business models may be constructed. These building blocks provide a means for designing and framing the business network and its markets. The network perspective raises important questions regarding the boundaries of the firm. Indeed,

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[1] For an informative critique of Callon's work see Araujo (2007)
[2] Radio Frequency Identification

the assumption that the boundaries of the firm are what distinguish it from the market suggests that the market is 'real' and simply needs to be identified (not shaped). But as Richardson (1972) explains, the firm/market dichotomy does not represent market practice. The business network itself is, in practice, a sea of market exchanges that blur the boundaries of the firm. Araujo et al. (2003) explain how firm boundaries respond to the distribution of capabilities in the business network, identifying models used by organisations to access complementary and external capabilities. They describe how the connections between firms blur firm boundaries and provide a architectural structure that creates a market exchange *system* (Axelsson and Easton 1992; Potts 2001). Exchange systems might be viewed as markets within markets or if you like, supply chains. The point that Araujo et al., (2003) make is that this pattern of connections drives the development of capabilities within the network that in turn reproduces and transforms those connections both upstream with suppliers and downstream with customers. In this paper we argue that in-order to frame these activities to achieve firm growth, organisations are using business models and that growth of the firm might more usefully be thought of in terms of 'growth of the network'.

The objectives of this paper are threefold; first is to provide a synthesis of the common elements that define the mapping and manipulation of markets; second to examine the different elements of business models and explore how they frame an organisation's business network and markets; and third, to explore their implications of business models for the way we think about the growth of the firm in the 21st century (Araujo et al. 2003; Penrose 1959).

The Mapping of Markets and Market Exchange

Knorr Cetina (2006) argues that the notion of markets traditionally lies in two central ideas. The first idea that we will deal with here is the view that markets can be understood as a price-making and resource allocating mechanism. This is the neo-classical economists view and is broadly based on the laws of supply and demand and the assumption of the rational decision making of *homo economicus*.

The second idea views markets as a mechanism that solves the problem of bringing together the diverse and dispersed interests of buyers and sellers. This view has social and relational undertones and is associated with the idea of a concrete, geographic place (see for example, Besor's, (2004) description of the Tsukiji fish market in Tokyo). This view is in line with the classical economists such as Adam Smith and David Ricardo (Swedberg 2003) and assumes that markets *exist* as a natural phenomena - that 'marketing' is (at least in part) about identifying markets and their characteristics and developing and applying marketing tools so that firms can effectively and profitably serve them. In this sense, an important role of current market practice remains remarkably unchanged since the late 18th century when Adam Smith (1981 [1776]) referred to the *'invisible hand'* of the market and suggested that business success lay in the ability of organisations to map out these markets for exploitation.

However, taken at face value, a limitation of this view is that it does not account for the fact that the very process of mapping markets is likely to affect the markets themselves and the market practices that emerge (Callon 1998b; Latour 2005). Kjellberg and Helgesson (2008) use the metaphor of the 'natural look' captured by the traditional English country gardens of the 18th century. These gardens were reproduced in line with renaissance landscape paintings. Their point is that, "*Like gardens, markets are constructed, shaped by concrete activities. However, these efforts are regularly concealed by the natural appearance of their outcome, which is portrayed as unshaped and unconstructed….*" Kjellberg and Helgesson (2008:139) conclude "*construction work is highly dependent on ideas*." Thus by codifying and sharing knowledge of markets in diagrammatic representations and descriptive models, firms are not only capturing what the market *is*, but also shaping the market by including what they want the market to be. Alderson and Cox (1948), make this point commenting that we cannot ignore "*this interaction between the system and the processes which take place within it.*" (Kjellberg and Helgesson 2008: 142). In other words, the very practice of mapping markets is also likely to mean that actors are manipulating them in some way.

The Manipulation of Markets and Market-Making

Callon's (Callon 1998a; 1998b; Callon et al. 2007; Callon and Muniesa 2005) investigations into what constructs market exchange by examining the practices that are mobilized to make markets, brings the two central ideas of what 'markets' are together – marrying the classical and neo-classical economics views. Callon (1998a) recognises the interactive nature of processes and systems bound up in the market practices used to realise business models by introducing the concept of perfomativity. Performativity emphasizes that social categories such as those we use to define markets for example, are not ‘natural’ or self-sustaining but enacted by a variety of performances and artefacts and tools (Araujo 2007; Callon and Muniesa 2005). In this sense, Callon’s (1998b) performativity can be viewed as ‘market-making’.

In commenting on the financial markets, Knorr-Cetina (2006) examines the composite and entangled nature of markets explaining that financial markets though viewed as a primary framework for self-contained economic transactions by some, are rather a rich mixture of cultural and global interaction patterns that enable and shape the functioning of these markets. Knorr-Cetina suggests that the scopic systems that the financial markets are based on provide electronic knowledge and information that play a central role in market-making. These electronic co-ordinating mechanisms offer great transparency and allow for the contextualising and back-projection of the market ‘reality’. Knorr-Cetina (2006) explains,

> *“when such mechanisms are in place, coordination and activities respond to the reflected, represented reality rather than to pre-reflexive occurrences.”*

In this sense, knowledge systems in markets not only deliver cognitive information for decision making and help in developing management instruments and tools, but also motivate the reproduction of these markets. Therefore, it seems logical that organisations that try to develop and use tools to capture market knowledge and information and make this transparent to themselves and other firms within their business network, are likely to have an significant role in shaping markets. This paper argues that business models take on this role.

Markets and Business Models

The business press is replete with discussions on organisations needing to develop or adopt new business models in order to thrive and prosper in global markets. Yet despite the first use of the term ‘business model’ being traced back to the 1950’s (Bellman and Clark 1957) it is only in the past decade that the term has become a tenet of academic interest (Schweizer 2005). While business models have been given numerous definitions (Amit and Zott 2001; Linder and Cantrell 2000; Magretta 2002; Morris et al. 2005; Yip 2004), four common elements can be identified:

(1) Network Structure: Almost all of the business model literature gives a central place to the structure between a focal firm and the organizations with which it transacts (Amit and Zott 2001; Mason and Leek 2008). According to Zott and Amit (2008) “*the business model is a structural template that describes the organization of a focal firm’s transactions with all of its external constituents in factor and product markets.*”

(2) Transactions: The business model concept is often defined in terms of transactions. For example, for Amit and Zott (2005: 511) a business model is: “*the structure, content and governance of transactions*”. This leads to the next common theme.

(3) Making Money: This came to the fore in the business model literature as novel revenue-generation approaches were developed in e-business. Morris *et al.* (2005) include ‘How do we make money?’ as one of the foundational elements of business models; Teece (2007) includes ‘revenue architectures’ as a key business model feature.

(4) Knowledge: This is less explicitly present in the business model literature but it is implicit in Morris *et al.*’s (2005) inclusion of ‘How we create value’ and ‘sources of competence’ in their foundation elements of business models and in Schweizer’s (2005) emphasis on the resource-based view as an important basis for classifying business models. Mason and Leek (2008) see an important role for various forms of knowledge in dynamic business models. This has important parallels with the market-making literature that suggests that knowledge flows within the network affect the network structure and emergent market practices (Araujo 2007; Finch and Acha 2008; Kjellberg and Helgesson 2008). Dynamic business models might therefore be understood as market maps that are to be iteratively and interactively realised through systems and practices.

A second important principle that is present (though not always explicit) in the business model literature is the levels at which business models operate. For example, Morris et al. (2005) identify three distinct levels at which business models have been applied and researched; economic, operational and strategic. These levels represent a clear hierarchy. The economic level is concerned with market exchange and profit generation. Stewart and Zhao (2000) describe business models as, ‘‘*a statement of how a firm will make money and sustain its profit stream over time.*’’ Relevant decision variables include revenue sources, pricing methodologies, cost structures, margins, and expected volumes. In this regard, the business model can be seen as having parallels to the neoclassical definition of a market in that it forms a representation of how the actors understand and interpret the price setting mechanisms of a market that they have defined.

The operational level can be understood as the architecture of the business network system. Morris et al. (2005) suggest that the focus at this level is on internal processes and design of infrastructure that enables the firm to create value. However, Mason and Leek (2008) emphasise the importance of the inter-firm nature of value adding systems within the business network. In this regard, decision variables include production or service delivery methods, administrative processes, resource flows, knowledge management, and logistical streams both within and between firms. This perspective is in keeping the Mayo and Brown (1999) describe the operational level as, ‘‘*the design of key interdependent systems that create and sustain a competitive business.*’’

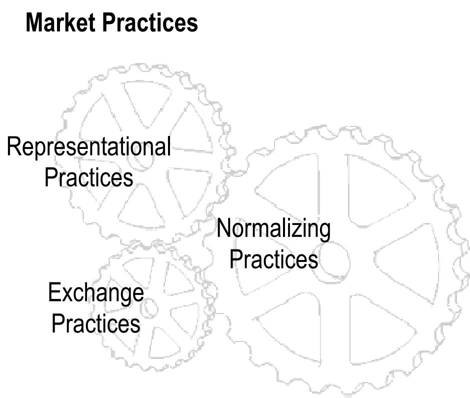
Finally, the strategic level emphasizes the overall direction in the firm’s market positioning, interactions across organizational boundaries, and growth opportunities. Slywotzky (1996) describes this level as ‘‘*the totality of how a company selects its customers, defines and differentiates its offerings, defines the tasks it will perform itself and those it will outsource, configures its resources, goes to market, creates utility for customers and captures profits.*’’

The point that Morris et al., (2005:727) make, is that these three levels at which business models have been examined represent the multiple levels at which they are used, and represent the ‘translation’ of the business model from a strategic intent, to operations, and finally to market exchange. Consider the business concept behind Dell computers. Dell sell customized computing solutions directly to customers at competitive prices. As Morris et al., (2005/727) observe, “… *the Dell business model integrates strategic considerations, operational processes, and decisions related to economics.*” These levels are likely to be linked through market practices.

While Morris et al., (2005) are careful to explain that business models are not in themselves activity sets, they do recognise that activity sets support each element of the business models. This is consistent with the observations of Kjellberg and Helgesson (2008) who identify three levels of market practice; exchange practices, representational practices and normalizing practices. Figure 1. shows the inter-relationships between these market practice categories that underpin the business model. Exchange practices refer to the concrete activities of individual economic exchanges, for example, presenting products, negotiation prices or terms of delivery. Thus it might be claimed that exchange practices may represent the set of activities that occur at the economic level of the business model. Representational practices refer to activities that contribute to depict markets and how they work. This set of activities creates the systems and process that operate the business model (operational level). Finally, normalizing practices refer to guidelines or frames established to suggest how markets might be reshaped, developed or altered in a given direction. This represents the strategic intent framed by the business model at the strategic level.

Figure 1. Interactions between Three Market Practice Categories

Adapted from Kjellberg and Helgesson (2008)



Kjellberg and Helgesson (2008) suggest that these different categories of market practices are linked through what they call ‘translation’. They present translation as, *"a social process through which something – an idea, a rule, a text, a product, a technology, a claim – spreads across time and space. (Latour 1986). …those who do pick it up make an essential contribution to its existence and survival. Such transportations regularly transform that which is being moved ... these translations generate traceable associations between practices (c.f. Latour 2005:108)".*

Kjellberg and Helgesson (2008) illustrate their point by describing the different market practices associated with market segmentation, which involves, designing a study, and sampling, surveying, analysing, identifying clusters and profiling the clusters of 'customers'. This process produces a number of segments that can be targeted by the firm. Each stage in the process involves one or more translations. The market segments captured, in the 'profiles' replace and represent all the customers in that market. This raises two issues. First it illustrates that the activities, tools and instruments involved in the process are as much part of the resulting segments as are the customers they come to represent. Second, their example explains how chains of translations may allow representations from one setting equal validity in others, for example, as a business model might be (c.f. Callon 1986). Thus the different 'sets' of activities that support each of the levels at which the business model operates, are likely to be linked to one another through chains of translation. In this way, as the business model is 'realised' by actors at each level, the translation of their activities reshape the business model making strategy, operations and systems and market exchange layers of dynamic interactions.

Recent media and business analysts' reports of Nintendo Co. Ltd. provides a useful illustration of way that organisations use business models to capture and manipulate these multifaceted, multilayered interactions. On the 19th November 2006 Nintendo launched a new product called Wii. It is perhaps unusual for a new product to gain such a huge amount of press comment tracing its success and directly attributing this success to its 'business model'. Nintendo can take some responsibility for this wide reporting through their careful manipulation of PR, press releases, press conferences and public lectures. With all this information in the public domain, it is possible to trace the business model's development and consequential market-making from the reporting surrounding it.

Nintendo's Business Model and Market-Making Activities

Nintendo Co. Ltd. is a Japan-based game console manufacturer and producer of the Wii, a console which uses a unique wireless controller. Wii allows game players to simply move the controller for onscreen action. A motion sensor determines positioning on the screen in 3-D space (Figure 2). According to Nintendo's Regginald Fil-Aime, Executive VP of Sales & Marketing, this disruptive technology has emerged from the development of a new business model and the reshaping of markets, and some business analysts claim, the entire 'gaming industry'.

Figure 2. Playing a tennis video game with Wii

The stagnant US and the declining Japanese games markets of 2003, together with escalating hardware and software development costs of state-of-the-art game consoles, forced Nintendo to question their target market.

The high skill levels of gamers in the current market required a high degree of commitment and investment of time and money from customers. Mr. Fil-Ame explained Nintendo's approach in moving away from this traditional target market and towards market-making,

> *"We couldn't simply expand the [current target] market. If that's all we try to do, slowly this industry will die. It is our responsibility to make games for all skill levels. …. The idea is Wii doesn't follow the conventional path of game systems. That's what we're about; disruptive technologies, new ways to think about the market place, and driving the industry forward."*(Source: Sousa, 2006)

A recent press report reflects Nintendo's market-making outcomes,

> *"Japanese women have overtaken their male counterparts to become the biggest users of Nintendo's Wii and DS machines in a seismic shift that the company said would "transform the video games industry"….If the change repeats itself around the globe, said analysts, it could force a complete change of business model for many of the world's largest games makers."* (Lewis 2007)

Compare the product features of Sony's, Microsoft's and Nintendo's latest consoles (Figure 3). The Wii has not been developed as a superior technology; it does not intend to be a best-of-breed video game console. Nintendo is trying to bring new and non-core gamers back to gaming with new technologies incorporated in the Wii. Wii doesn't set out to equal video games but Wii aims at (comparatively) low cost and interactive 'fun'.

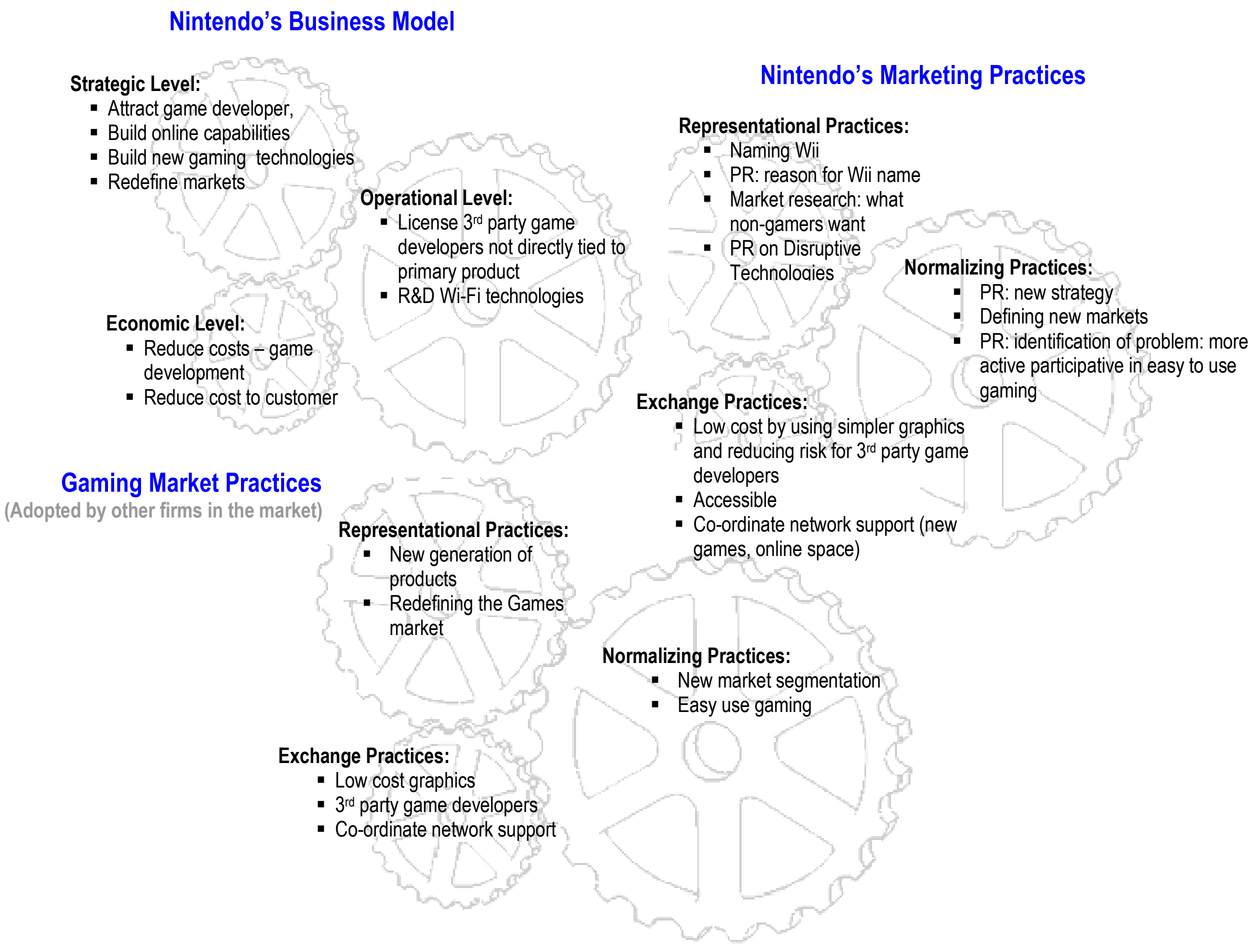
Figure 3. Competitor Analysis of Value and Product Features for NintendoWii

Product Features

Source:

The iterative process between the exploration of market and technological opportunities together with an understanding of the business network resources, the capabilities of the Nintendo and the marketing - and broader market practices at each of the multiple levels at which market practices occur, allowed Nintendo to develop a business model that reshaped and redefined the gaming market and thus shape the broadly adopted 'market practices' that begin to proliferated within the industry. The interactions and translations between the business model (as a developing frame and representation of what the organization wanted and needed to do), and the market practices that supported the business model at each level, are summarized in Figure 4. While it is recognized that Figure 4 does not capture the complexity or the dynamic nature of the business model and all the sets of market practices that supported it at each of the various stages throughout its development, it provides us with some initial ideas for how business models are developed and in doing so, how markets are made. In this regard, the marketing practices of Nintendo can be understood as the key drivers of the market practices that are later more widely accepted and the gaming market as it evolves. Thus marketing practices can be understood as a subset of broader and subsequent market practices.

Figure 4. Nintendo's Business Model, Marketing Practices and Market Practices



Tentative Conclusions

This papers explores the use of business models in market-making through an assimilation of the market-making and business model literatures and the examination of an illustrative case heralded in the media as the 'way forward for market making' – the case of Nintendo. We have argued that in –order to frame market-making practices to achieve firm growth, organisations are using business models. The discussion offers three potential contributions to the way we think about market-making and the growth of the firm.

The first contribution of this paper relates to our understanding of market-making (Araujo, 2007). Specifically, we suggest the use of business models has an impact on the way organisations map and manipulate their markets in three ways. Business models frame and hold the potential to provide a degree of transparency both for firms themselves and for the wider network (Knorr Cetina, 2006). This transparency allows for the sharing of information and visibility in the development of market knowledge. In this sense, business models offer a representational frame of time and space within which network actors can identify and explore markets within their own organisation and with other business network actors. In this sense, business models appear to be more than the sum of their parts and a useful lens through which to explore the market-making process. It recognises the distinction between the network approach, which does not distinguish between socially constructed market but recognises a single connected network with no boundaries; and the idea of markets and defined and targeted, bounded networks which form the focus of the firms activities and practice.

The second contribution of this paper relates to the business model literature by helping to explicate the sets of marketing practices that underpin and 'realise' a business model at three distinct levels (Morris et al., 2005; Kjellberg and Helgesson, 2008). Inline with the work of Kjellberg and Helgesson, (2008), we suggest that the sets of market practices that support each level are interactive and interdependent and in this way, contributes to the conceptualisation of business models as dynamic constructs (*c.f.* Mason and Leek, 2008), rather than as static frameworks (*c.f.* Yip, 2004). This suggests that it might be more helpful for organisations to focus on the 'growth of the network' as they develop their strategies for success rather than 'the growth of the firm'. This relates directly to our third contribution.

The third contribution of this paper relates to Richardson's (1972) observation of the need to remove the divide between markets and firms. This paper provides some tentative insights into how business models might provide a useful lens through which organisations might seek to look beyond the traditional boundaries of the firm and into the wider business network as they try to develop not only new ways or *doing* things, but new ways of *seeing* things – specifically 'markets'(Araujo et al. 2003; Penrose 1959).

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