

Why Business Models Matter for CIOs

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Initiatives: [CIO Leadership of Innovation, Disruptive Trends and Emerging Practices](#)

The mission of every enterprise is to create, deliver and capture value. Business models provide the “blueprint” for accomplishing this mission. Digitalization brings new threats and opportunities. Top CIOs must master business models to define their ambitions and map their digital strategies.

Analysis

Business Models Provide an Enterprise’s “Blueprint” to Create, Deliver and Capture Value

Enterprises are not random collections of people and processes. They are designs architected by executives and leaders over time to perform against a chosen mission. Commercial enterprises are formed with a mission to generate value to stockholders by providing targeted customers with goods and services that fulfill specific needs. Noncommercial enterprises have a mission to provide services and support to citizens and stakeholders, again to address designated needs. To succeed, every enterprise needs a well-designed and -articulated business model indicating the decisions made by the executive team to:

- Establish the identified customers or citizens or constituents to target and to organize them into segments useful to developing the right value propositions.
- Indicate the value propositions the enterprise will deliver to meet the customers’, citizens and constituents most important and unserved needs.
- Provide the set of capabilities the enterprise will design, develop and operate to engage and support customers, citizens and constituents, and to produce and deliver the goods and services defined in the value propositions.
- Define the way the enterprise measures value, including:
 - Its approach to revenue generation
 - All dimensions of its financial model including pricing models for each customer segment and value proposition
 - Intended funding mechanisms

- Major elements of costs
- The metrics used to manage performance

In a public-sector organization, value may be expressed in terms of citizen/constituent needs as opposed to revenues.

All of these choices are shaped into the enterprise business model, as in, the blueprint to create, deliver and capture value. All choices must be taken into consideration to create a design for the business that will work together to create, deliver and capture value.

As every enterprise works to digitalize, CIOs must act to master all components and attributes of business model designs and contribute to business model innovation. CIOs who work to lead/contribute to this critical executive responsibility will be positioned and prepared to contribute to optimizing and transforming their enterprises.

Business model analysis and design centers around four components (see Figure 1):

- Customers
- Value propositions
- Capabilities
- Finance

Figure 1. Business Model Components

Business Model Components

1 Customer

Individuals and segments that purchase or use your products or services.

2 Value Proposition

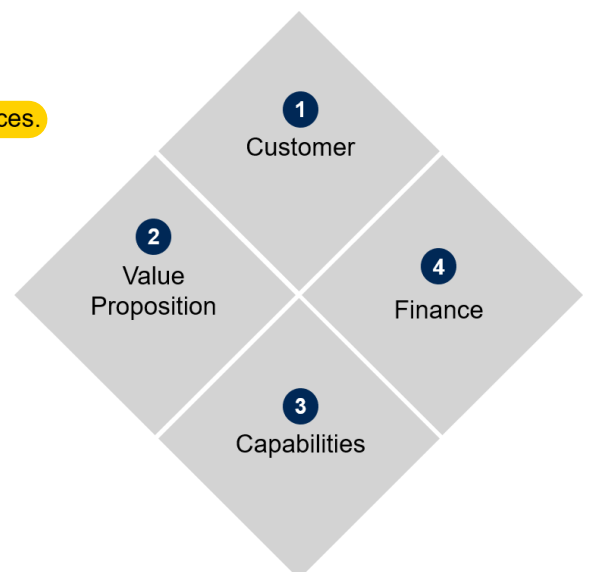
The implied promise a company makes to its customers regarding the value of products or services.

3 Capabilities

The resources combined across the organization to deliver customer-perceived value.

4 Finance

System for capturing value and turning excess value into profit and funding that can be reinvested into the business.



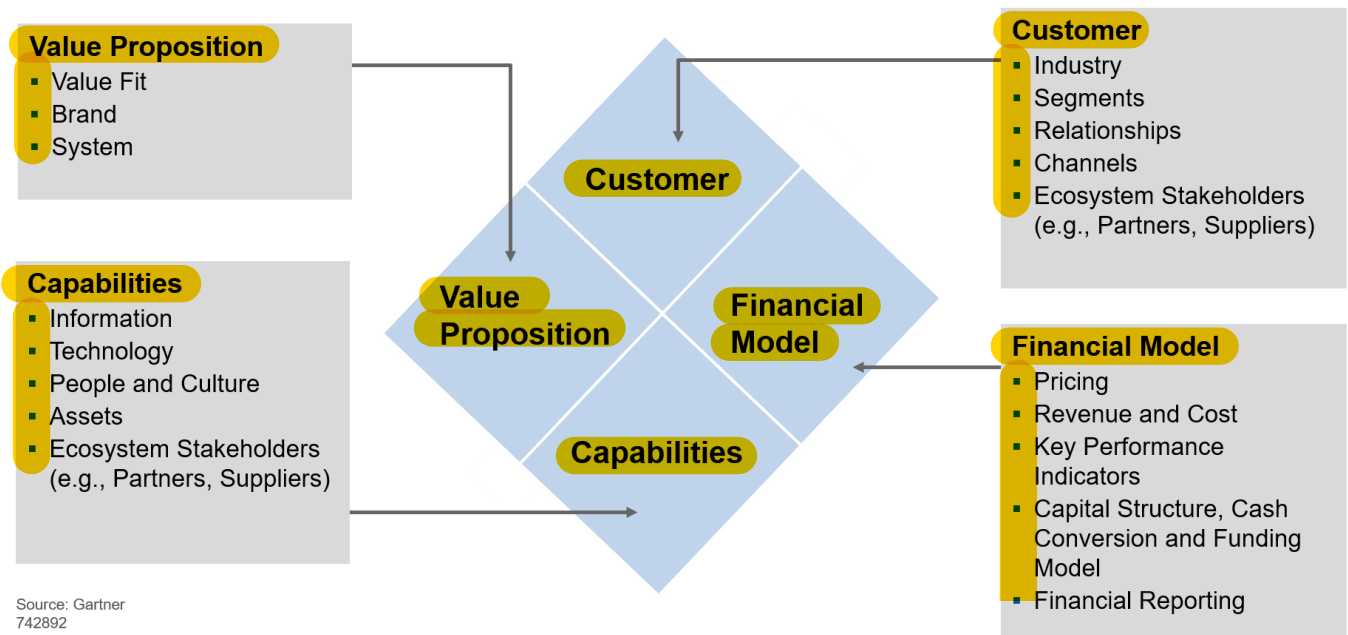
Source: Gartner
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Every component of the business model must have a determined alignment/integration with the other components. Customers are identified, segmented and analyzed to determine the value they need to produce for themselves. Value propositions represent the mechanisms, such as goods and services, customers use to create value for themselves (typically established in the form of goods and services). The capabilities of the business model provide the practical mechanisms by which both creation and delivery of value to customers and the enterprise is achieved. The finance component represents how the enterprise intends to recognize value captured, as in, will be compensated for goods and services and how it will fund the capabilities and measure costs associated with the identified capabilities.

To design a physical building, the architect will likely create multiple designs and explore each for its performance potential and client acceptance. The architect also produces detailed blueprints for all structural attributes, such as electrical, plumbing and physical design. Similar to a physical structure, every business model is composed of a set of key attributes (see Figure 2). These attributes represent more detailed design choices by executives to achieve the mission of the business/enterprise.

Figure 2. Business Model Component Attributes

Business Model Component Attributes



Just as a good building architect would, executives need to explore multiple business model designs to ensure they have the optimal design that will achieve their intended success. Business model innovation is the process used by executives to identify and test ideas and concepts for business model components and attributes (see [Demystify 'New' Businesses Through Business Model Innovation](#)). The process follows a basic flow, but is not a strict linear process. Business design must be iterated. When constraints are encountered in any business model attribute, this may necessitate changes in other attributes. Executives must design, test and adjust each attribute to best fit all other attributes. The basic flow of action is:

- Customer attributes are explored and defined. Customer choices determine needs that determine the required value propositions.
- Value propositions are established for each customer segment. Multiple value propositions are common.
- Capabilities are developed based on the value propositions. Digital technologies are applied to enhance capabilities and can enable unique attribute designs.
- Finance model choices are made – how the firm will:
 - Charge for its value, and recognize revenue and costs.
 - Measure performance of its capabilities.
- After initial designs for all attributes are established, the overall business design is examined and analyzed to ensure it holds together and is capable of achieving expectations.

The process does not have to begin with the customer attributes. For example, if new value propositions have been discovered via an innovation process, business model innovation can use those new product or service options to develop the overall business model. If there are new opportunities to significantly improve capabilities, these can be the starting point. Whatever serves as the starting point, the key is to execute complete attribute exploration and design – the model must “hold together.” As with an automobile engine, every part must be designed to work and complement other components of the engine and of the total vehicle. If a business model attribute is not designed to work with all of the others, the business model will not perform optimally and in some cases may fail.

As the business model is developed, executives will need to move back and forth, examining the impact of each attribute choice on other attributes. Business model innovation requires a comprehensive review and analysis of all attributes as a connected and cohesive design. Additionally, executives will need to ensure their attribute choices are tested to validate whether the model will work as intended. If they don't, the design must be adjusted and retested. Many iterations of design may be needed to produce the optimal business model. Throughout the process, executives will learn and find new and better options and reduce future performance risks.

Digitalization does not necessarily change the structure of a business model. Advanced digital technologies provide the executive team with new and significant attribute options. Executives must determine how and where to apply advanced information and technology to every business model attribute. If digital is applied only to certain business model attributes, executives must ensure all other attributes will still work cohesively as a complete model. Random or poorly designed digitalization may lead to problems and weaken the business design rather than strengthen it. Business model innovation provides an excellent process for executives to explore their digital ambitions. They can model how and where digital can improve their business design. In addition, executives can design completely new value propositions that include all of the needed attributes to support new value creation, delivery and capture.

Business model innovation informs the executive team to make better strategic choices, determines investment and improves risk management.

Business Model Components and Attributes

The real key to a solid business model is **to design the attributes of each of the four business model components**. The attributes represent the qualities and features of the ultimate design of a given business model.

Customer

All business models are designed **to create and deliver value to targeted customers** (or in the case of governments, citizens; or in the case of nonprofits, recipients). Any enterprise is established to **serve given sets of customers**, to provide them with **goods and services** they need to achieve their own value creation. **Every firm seeks to attract, acquire and retain customers**. To do so, it must establish relationships with targeted customers. **Enterprises typically segment customers** with similar **requirements (jobs, pains and gains)** and situations, and **design unique value propositions** for **each segment**.

The relationship attribute must be designed to fit the customer's needs and the value propositions provided. Relationships can be "heavy," with dedicated sales, service and support personnel assigned to work with each customer, or "light," where a self-service process is provided, almost always via technology.

To successfully **distribute and capture value**, firms must **establish channels to those customers**. These are the processes through which the enterprise interacts with customers **to raise awareness, demonstrate its goods and services, establish relationships, exchange information** and **negotiate agreements** between the firms. Channels **have many variants**, from **direct sales forces to digital commerce to external distributors**.

Finally, **every enterprise exists within an ecosystem of customers** and the **customer's customer**. The firm must determine the ecosystems in which it participates, or whether it wants to create and lead its own ecosystem.

Digitalization can supply enterprises with significant new abilities to reach new customer segments by providing new channels to market. Likewise, channel performance can be digitally enhanced to strengthen customer relationships, providing new and useful information about existing customers that the enterprise can leverage to increase value. Digitalization can develop the platforms needed to create ecosystems or allow enterprises to effectively operate within existing ecosystems.

Value Proposition

The value proposition is a **firm's implied promise to its customers** regarding the **value of products** or **services it can provide**. Each **value proposition consists of goods and services** designed **to create value** for each **customer's requirements**. Often, this is expressed as the "job" the customer needs done to

eliminate the “pains” (the challenges or constraints they face), and the “gains” (the opportunities they are pursuing or the achievement they seek). To succeed, value propositions must deliver on their key attributes, especially “value fit.” Value fit is determined by how complete the products or services delivered successfully execute the customer’s important jobs, resolve their key pains and/or achieve the expected gains. Winning value propositions have high value fit – they meet all or the majority of customer needs.

Other value dimensions are important for the customer to benefit from a firm’s value proposition, including the emotional experience that occurs when engaging with the firm’s goods and services. These are intrinsic to the brand and are critical to differentiate the firm’s offerings from other possible solutions the customer can acquire.

Finally, value propositions are created inclusive of value contributed by external partners who are ideally organized as a system to help drive and deliver the value proposition.

Digitalization can significantly impact value propositions. For example, goods and services can take the form of a data and analytics service enabled by algorithms and/or artificial intelligence. Physical products can be designed to become “smart,” interacting with customers and providing useful information or analysis. Services can likewise be enhanced or even provided digitally. Digitalization can be focused on improving the customer experience to improve the brand attribute of the value proposition.

Capabilities

To produce and distribute value, every enterprise must acquire or build and make effective use of capabilities. Capabilities include not only physical assets (plant, property and equipment, technology, systems and infrastructure) but also the people (including competencies and skills), culture, information sources, and strategic suppliers and partners needed to produce and distribute the value propositions.

Digitalization provides opportunities to significantly improve the performance of any or all business capabilities. By increasing automation and acquiring and analyzing new forms of data to improve decision making, digital technology can enhance performance – reducing cycle times and waste and offering improved customer experiences. Application of advanced technologies can also deliver completely new capabilities, which in turn may promote the creation of new value propositions. For example, implementing artificial intelligence capabilities to leverage existing data sources might support new services to offer existing and new customers. Applying digital technologies also allows enterprises to participate in external ecosystems, which add value from these new partners.

Digitalization requires new people capabilities – data science, anthropology, digital design and so on. Changes in culture may also be needed to apply and leverage new digital capabilities – such as a shift to new mindsets, and changes in the way goals and performance are set and measured.

Finance

Every enterprise must establish **how it will capture value** and **measure success** as well as **how it intends to fund its capabilities**. Value recognition is generally done through **pricing mechanisms** or **via taxes** and **fees**. Firms must **establish their revenue** and **cost models to determine economic viability**, and **comply with regulations for financial reporting and measurements**. To **perform optimally**, most firms establish **metrics** and **key performance indicators**. These attributes **must** support **all other attributes**; that is, the revenue recognition model, the customer relationship design, capability designs and so on.

All enterprises must fund the development of capabilities, with many new capabilities required for deploying digital initiatives, at scale. The business model includes choices for capital structure, cash management and funding.

Digitalization has a significant impact on selecting revenue models – **how** and **when** a firm recognizes revenue. New value propositions are increasingly provided on a **“pay per use”** basis. Another emerging option is that the firm’s compensation for its goods and services is captured when the customer achieves their value. Digitalization allows firms to rethink their traditional finance models to more effectively compete within evolving ecosystems.

Business Model Innovation Is Key to Establishing and Achieving Digital Ambitions

Every enterprise must actively establish their digital ambitions (see [Using Digital Business Narratives to Speed Digital Business Transformation](#) and [Initiate Your Digital Journey With a Digital Ambition Workshop](#)). **Business model innovation is the process of analyzing current models, challenging them with disruptive “digital” options, and designing, testing and iterating different possibilities**. It is a **disciplined approach to disaggregating, abstracting and evaluating every attribute of the business model before aggregating (often in different ways), investing and executing**.

Analyzing existing business designs and innovating to create and explore **new business models is not a massive or complicated process**. Similar to strategic planning, it requires a **disciplined program of information acquisition, ideation, analysis, exploration and testing of options, selection, decisions, documentation and communications**. It is a **“team sport”** requiring **senior leaders** and **experts** from the business to participate. The core elements of the process are:

- Identify and explore environmental forces and changes that might demand new business model designs, such as:
 - Macroeconomic forces, including capital markets and global market conditions
 - Major trends in regulations, society, the economy and technology
 - Industry forces, including competition (incumbents and new entrants), suppliers and partners
 - Market forces, including customer needs and perceptions, demand, and market stability

- **Holistically and rigorously, challenge, assess and determine if existing business model attributes are still relevant and effective.** Identify attributes that require optimization to maintain competitiveness (defense) or to produce new levels of value (offense).
- **Identify and explore new value proposition opportunities.** Seek unserved or underserved customers in existing markets. Identify new customers in adjacent or related markets. Explore ecosystems to determine if value can be produced or provided to partners as well as customers. Use this analysis to define and market-test new value propositions.
- Choose the **best business model options.** Once the executive has analyzed, explored and assessed new design options, choices must be made. Actions to test selected model design changes and/or new business models to be developed must be organized and executed. The testing process should be iterative. Validate choices and collect information to finalize business model designs and move into strategic planning.
- **Informed by test results,** executives can finalize the business model and progress into goal setting and strategic planning. Business model design change and the decision to develop new business models inform the strategic planning process. Strategic planning determines how the approved changes and new designs will be produced.
- The executives can use the results from the business model innovation process as a common and mutual language to communicate with all leaders, managers and personnel, as well as with strategic partners and customers. The business model design can serve to support myriad executive management processes, including:
 - **Improved customer understanding** – **intimate understanding of customers from a jobs, pains and gains perspective that informs ongoing development of goods and services.**
 - **Improved understanding of competition** – how does the **new design differentiate the enterprise** from key competitors?
 - **Guiding innovation programs** – focusing innovation investments and processes to support new business model designs including new value propositions, new capabilities, new channels to market and so on.
 - **Determining merger and acquisition (M&A) targets** – focusing acquisitions on enterprises who complement the new business design and/or those with attributes needed to achieve the objectives of the new design.

Although it is possible to create **high-growth businesses** without **mastery of business models**, execution of **business model innovation is the better approach to create clarity** and **higher precision**. Business model innovation also enables better **“in-flight adjustments,”** where **ambiguity** and **hidden assumptions** might **otherwise reign**. Firms that develop **digital business strategies** without **performing business model innovation** **are likely to focus on incremental and even superficial options**. They may act as late

responders to competitors' digital plays, create goods and services not supported by their customers, or fail to link the financial model with market conditions.

CIOs Should Master Business Model Design and Innovation

Every business has a "shelf life," and business models that delivered success in the past can become a trap when organizations cling to them despite disruptive shifts in competition and/or markets. Digitalization represents a seismic shift – altering competitive playing fields, providing for new forms of value, and changing how value is distributed and financially recognized. The impact of digital as a major threat and opportunity affords CIOs a powerful new executive leadership opportunity.

Unfortunately, many executive teams do not incorporate business model innovation into their routine strategy development, planning and management processes. Even worse, many executives are uncomfortable about making business model changes – they are stuck in the "if it isn't broke, don't fix it" mindset. All too often, they only examine their business models after major disruptions impact performance – a new competitive threat, a major failure in current strategies, or a downward shift in the economic environment. The business model exercise then becomes an autopsy where leaders look for what happened instead of focusing on which new designs are needed. When executives play business model defense, it is often too late, and the enterprise suffers against new competitors.

Gartner recommends executives play business model offense – proactively executing business model innovation. CIOs have a tremendous opportunity to promote and then contribute to the process and deliver high-impact leadership in the pursuit of digital ambitions.

CIOs can prepare for leadership, proactively collaborating with business executives, with teams like corporate strategy, and with external partners and advisors (see [Steps CIOs Can Take to Drive Business Model Innovation](#)). CIOs can leverage their digital acumen to devise new digital business model options that deliver value growth and financial returns.

CIOs can promote and lead business model innovation to:

- Gain clarity, strengthen business leader competency, and identify how specific threats (with a focus on disruptive technology) could impact enterprise performance and sustainability.
- Identify opportunities to apply digital technologies to strengthen and improve the established core business – digital optimization.
- Explore, discover and consider opportunities to use information and technology to create new value propositions – digital transformation.

Digitalization is real and immediate. Every business model must respect the threats and opportunities of digitalization. CIOs must choose to play offense – to prepare and execute leadership to determine the digital ambitions for their enterprise. CIOs who master business model innovations will be able to be more effective in this effort.

Research Highlights

These business model research notes provide guidance on how CIOs can act to position business model innovation in relationship to other management practices such as strategy, ecosystem analysis and financial management. Here, we summarize the latest Gartner business model research.

CIOs Must Leverage Both Business Models and Strategy

Business model design and strategic planning play different but complementary roles in determining how an enterprise will compete, grow and prosper. CIOs who master and leverage both will increase their executive influence and the perceived value of technology innovation. They will strengthen enterprise focus on what matters most. CIOs, CFOs, CEOs and enterprise leaders facing a multitude of competing requests can exploit business models (and new leading indicators) better to assess the trade-offs between competing investment options. The top consideration is whether a technology investment has a meaningful impact on the customer value and economic model propositions. Specifically, will the investment improve a product or service in a way that helps to delight customers and differentiate the product in the market? Will it improve the costs to deliver that value?

The answer to this question for many “urgent” but common requests for IT services is often “no,” especially when the focus is on internal process efficiency, although continuous optimization of internal processes and their costs is also a critical path.

Leverage Business Models to Guide Digital Business Transformation

Executive leaders tasked with driving digital business transformation must use business models to increase the odds of success by holistically identifying, evaluating and refining new value propositions, customer segments, capabilities and financial opportunities. Digital disruption, which will impact all enterprises (including governments and nonprofits), constitutes the single largest business context transformation over the last five years and will continue to be a key force into the future. Digitalization creates the opportunity to generate enormous economic value through business model innovation, yet poses existential threats to organizations that cling to old business models that served them well in the past but are increasingly marginalized by the market shifts driven by technology innovation.

8 Ways Ecosystems Supercharge Digital Business Models

Digital business is causing enterprises to rethink many aspects of their business models. Using ecosystem approaches to bolster or disrupt traditional business models is a vital element that executive leaders must master. Enterprises don't just become “digital.” They seek to create new products or services, enhance citizen and customer experiences, connect to new markets and constituents, or develop new business models. They have value propositions to execute. Any of these business pursuits can be fulfilled by digital business ecosystem approaches.

CIOs Should Exploit Financial Models to Become Better Business-Technology Executives

Stepping up digital business initiatives entails investment in and changes to the organization's business models, and the connecting tissue that enables development of strategy and execution, to achieve it. Well-designed business models succeed because they improve the finances and enterprise value of the organization. A **well-defined financial model** enables both **born-digital** and **brick-and-mortar entities** to adjust their **business models**, as market conditions change and competitors evolve.

How Executive Leaders Can Prompt Innovative Business Model Creation

Many organizations are aiming to create innovative business models, often by leveraging the latest developments in technology. However, while this is a popular ambition for organizations to have, not many are clear on how to do it. To provide clear guidance on business model innovation, we reached out to a group of executives, both business and IT, with real experience in business model innovation and asked them how they did it. This research discusses the results of our survey and provides guidance on business model innovation.

Demystify 'New' Businesses Through Business Model Innovation

Transforming from incumbent into new businesses is a process of **business model optimization** and **innovation**, and it can lead to **improved business performance**, including marketing and branding efficiency, improved customer experience, supply chain efficiency, and manufacturing capability. This research uses two "demystifying" examples to explain how companies can transform into new businesses by using new channels and new technologies, and how they can enhance their business performance through the transformation.

How CIOs Can Foster Business Model Innovation Through Workshops

Digital technologies such as AI and **IoT are central to business model change**. CIOs can leverage virtual or **in-person cross-functional workshops** to effectively help the organization imagine the possibilities of advanced technologies to achieve new value, sparking creativity and enabling comprehensive business model innovation. This research provides a best-practice-driven approach CIOs can adopt for their purposes to provide active leadership in the effort to innovate existing business models and pursue new business model options.

Evidence

Further reading:

- "Business Model Generation: A Handbook for Visionaries, Game Changers, and Challengers," John Wiley and Sons, 2010.
- "Value Proposition Design: How to Create Products and Services Customers Want," John Wiley and Sons, 2014.

- “Design a Better Business: New Tools, Skills and Mindset for Strategy and Innovation,” John Wiley and Sons, 2016.
- “Why Business Models Matter,” Harvard Business Review, May 2002.

Document Revision History

[Why Business Models Matter for CIOs - 30 January 2018](#)

Recommended by the Authors

[Leverage Business Models to Guide Digital Business Transformation](#)

[How to Drive Business Model Innovation by Adopting a Checklist Approach](#)

[Tell Your Business Model Story With Simple Building Blocks](#)

[Demystify ‘New’ Businesses Through Business Model Innovation](#)

[How CIOs Can Foster Business Model Innovation Through Workshops](#)

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