The Role of Business Model Innovation in the Emergence of Markets: A Missing Dimension of Entrepreneurial Strategy?

Samuel S. Holloway
University of Portland

Helder J. Sebastiao
University of San Diego

Current theorizing assumes business models are developed to match firm resources and capabilities to existing market conditions. Consequently, entrepreneurs who successfully introduce new business models that significantly alter existing market preferences and structures are viewed as an anomaly; their success attributed to the strategic failure of incumbents. In contrast, we attribute success to both a co-evolution of individual and collective interests and the entrepreneur's concerted efforts to align those interests with their strategic vision of a new business model and market. This process combines the experimental and iterative nature of effectuation with a strategic orientation that is fundamentally market driving.

EXECUTIVE SUMMARY

While the business model literature effectively explains how existing market conditions influence business model development and implementation, it does not seem to account for situations where a new business model actually influences market conditions. In addition, despite a rich literature describing the interactions among institutional entrepreneurs that shape new markets (Aldrich & Fiol, 1994; Fligstein, 2001), much less has been written about the specific role of individual actors in influencing and shaping emerging markets in their favor (Santos & Eisenhardt, 2005). Examining business model development and evolution in the emerging market context provides a critical link between the collective actions that facilitate new markets (Aldrich & Fiol, 1994; Fligstein, 2001) and individual firm actions seeking to co-opt market preferences, define firm and market boundaries, and control competitors, suppliers, and future outcomes (Santos & Eisenhardt, 2005). In other words, in the emerging market context the development and execution of a business model requires interaction and alignment between collective interests and those of the entrepreneur, which in turn influences market definition and structure.

This suggests that business models are a key dimension in developing and analyzing entrepreneurial strategy in emerging markets. While the preferences and structures of established markets are relatively fixed and difficult to change, thus constraining the extent and impact of business model innovation, this is not the case in emerging markets. In emerging markets, competing business models are a primary source of innovation that significantly influences market structure and preferences. Through a process that combines the experimental and iterative nature of effectuation with a strategic orientation that is fundamentally market driving, self- and collective interests are aligned to forge actions that result in a predominant (e.g. market defining) business model.

INTRODUCTION

Current business model definitions make the same fundamental assumption: business models are a strategic response to clearly identified market opportunities and delineated market boundaries determined through competitor analysis (Porter, 1980) and market research (Narver & Slater, 1990). Business models must either maximize production and transaction efficiency or facilitate new transaction mechanisms that connect previously unconnected parties (Zott & Amit, 2007). These accepted definitions rely upon existing market structures, known customer preferences, and established competitors to facilitate market research and analysis (Narver and Slater 1990). These requirements limit the application of the business model construct to emerging markets because *markets that don't exist can't be analyzed* (Christensen, 2003).

Business models play a pivotal role in emerging markets because they are a mechanism for integrating an individual firm's value chain (Porter, 1985) or value network (Shafer, et al., 2005; Voelpel, et al., 2004) within the larger business ecosystem (Leibold, et al., 2002). Successfully implementing a business model requires the integration of resources, partners, suppliers, customers and other agents into cooperative networks that evolve with market conditions (Leibold, et al., 2002; Sarasvathy & Dew, 2005; Voelpel, et al., 2004). In the emerging market context, these elements co-evolve and influence each other. Entrepreneurs in emerging markets experiment with business models through effectuation (Sarasvathy, 2001) and use market driving (Hills & Sarin, 2003; Jaworski, et al., 2000) to influence the collective action needed to construct a new market. Over time, these interactions enact an increasing level of stakeholder commitment and market constraints that transform market conditions around a (resulting) predominant business model (Sarasvathy & Dew, 2005). This process of simultaneous business model and market evolution highlights the critical role business models have in shaping emerging markets as a link between individual and collective action.

The co-evolution of the direct-to-consumer computer market and Michael Dell's business model illustrates this interdependence. Dell's ultimately successful business model required significant innovations in supply chain practices, which in turn required and resulted in significant changes in channel structures, processes, and supplier performance expectations in the manufacture of computers. Dell also needed to influence and alter consumer expectations related to researching, buying, and installing computers (Park, 2004). However, Dell gained these insights over time and through continuous refinements to his business model. Dell began building computers in his dorm room at the University of Texas, Austin, because he lacked the resources, supply chain relationships or retail outlets to compete via the existing business model for personal computer sales (Park, 2004). This mismatch between the existing model and Dell's resources and capabilities compelled him to experiment with new markets and customer segments, as well as new processes for the manufacture and distribution of personal computers. Through this process, Dell realized that a new business model based on an innovative supply chain strategy was his key to success. He then proceed to line up key suppliers and convince buyers of the efficacy (semi-customization and value) and ease (intuitive ordering system) of buying computers direct – influencing both market structure and preferences to align with the Dell business model.

We proceed with a review of the business model literature, highlighting the need for greater insight on the role of business models in influencing market definition and structure in an emerging market context. This is followed by a review of the literature on market creation, which indicates an opportunity for connecting social and institutional theory to literature that emphasizes the role of individual firms in catalyzing markets through the development and execution of their business models. This link is explained by describing how effectuation leads entrepreneurs to engage in an experimentation-driven process of market hypothesizing and business model refinement. These entrepreneurs then adopt a fundamentally market driving strategic orientation to influence market structure and preferences in alignment with their business model. We believe this is a compelling theoretical foundation for explaining how business models and markets co-evolve through the simultaneous pursuit of individual self-interest and collective action. We offer propositions that link business model evolution, effectuation, and market driving to market emergence and conclude with potential implications for practitioners and scholars.

LITERATURE REVIEW

Examining the Co-Evolution of Business Models and Emerging Markets

Existing conceptualizations define business models as a firm's strategic response to their environment (Amit & Zott, 2001; Chesbrough & Rosenbloom, 2002; Klein, 2007; Lichtenstein & Brush, 2001; Mahadevan, 2000; Morris, et al., 2005; Sandberg & Hofer, 1987; Voelpel, et al., 2004; Zott & Amit, 2007). Business models seek to achieve an optimal arrangement of a firm's resources with those of its value chain (Morris, et al., 2005; Porter, 1985; Shafer, et al., 2005; Zott & Amit, 2007) in order to achieve and sustain competitive advantage. Existing theory and conceptualizations accurately describe business model development and implementation under conditions where critical business model components and market structures are well established and widely accepted.

The assumption of known market rules, norms, and structures and established firm and value chain components is consistent with transaction cost economics theory (TCE) and is a foundation for nearly all business model definitions (for detailed reviews, see Shafer, et al. 2005; Morris, et al. 2005). Under TCE tenets, business models are designed to economize transaction costs by establishing boundaries between firms and value chain partners that maximize transaction efficiency. For example, Amit and Zott (2001: 511) define a business model as "the content, structure, and governance of transactions so as to create value through the exploitation of business opportunities." Similarly, Morris et al. (2005: 727) state: "A business model is a concise representation of how an interrelated set of decision variables in the areas of venture strategy, architecture, and economics are addressed to create sustainable competitive advantage in defined markets." These definitions have been the impetus for empirical studies that elucidate the optimal arrangement of business model components in defined markets (Zott & Amit, 2007), but these studies have missed a critical element of business model development – the stages prior to the establishment of clearly and widely understood market norms, rules, and boundaries.

This gap in the literature is troubling in light of recent research on business model development and entrepreneurial action in emerging markets (Sarasvathy & Dew, 2005). Early in their development, business models are not fully formed or committed; they represent the entrepreneur's initial hypothesis of the future and only after repeated refinements and the incorporation of new information do business model components solidify into more permanent structures (Winter & Szulanski, 2001). Johnson, Christensen, and Kagermann (2008, p. 59) note that "successful new businesses typically revise their business models four times or so on the road to profitability," and rules, norms, and metrics "are often the last element to emerge in a developing business model" (Johnson, et al., 2008, p. 56). Studies of decision making in emerging markets indicate that entrepreneurs eschew transaction efficiency for strategic flexibility when developing business models. For example, Santos and Eisenhardt (2005) found that entrepreneurs treat firm boundaries as fluid (versus fixed) and take actions that seek to claim, demarcate and control competitors, suppliers and market conditions. Sarasvathy and Dew (2005) note that while making small, incremental resource commitments is not always the most efficient strategy, entrepreneurs prefer such an approach because it enables them to refine their business model in pursuit of increasing stakeholder commitment as a hypothesized market gains increasing clarity. Thus, business models emerge through the interactions of stakeholders seeking to influence one another (Sarasvathy & Dew, 2005; Sebastiao & Golicic, 2008).

In emerging markets, where both the environment and potential outcomes are highly uncertain, the firm (or entrepreneur) engages in business model experimentation through a process of effectuation (Sarasvathy, 2001). Firms develop one or multiple *hypothesized* business models and work individually and collectively to define and develop the strategic actions that enable them to create value (Morris, et al., 2005). Over time, this iterative process creates stakeholder commitments and market constraints that determine the structure of the business model (Sarasvathy & Dew, 2005). In other words, in the emerging market context a business model is the product of stakeholder interactions seeking to clarify market boundaries as opposed to being a discrete strategic response to established boundaries. Only after these boundaries are established and widely accepted by stakeholders can existing theorizing and definitions of business models be applied.

The next section reviews the literature on entrepreneurial action in emerging markets and describes how the iterative process of developing, testing, and refining business models coalesces collective action with individual self-interest. The following sections offer propositions which explain the role of effectuation (Sarasvathy, 2001) and market driving (Hills & Sarin, 2003; Jaworski, et al., 2000) in the process of the co-evolution of business models and new markets.

Entrepreneurial Action and Emerging Markets

Most discussions of strategy assume organizations operate exogenous to their environment. This implies the organization operates within an industry defined by an accumulation of discrete boundary choices between firms (Santos & Eisenhardt, 2005). Assuming these boundaries exist as hypothesized, then transaction cost economics (Williamson, 1981) and agency theory (Fama & Jensen, 1983) are the dominant theories for explaining a firm's strategic choices within established market structures (Fligstein, 2001). However, in emerging markets boundaries are poorly defined, so identifying efficient transactions and ideal principal-agent relationships is difficult at best and likely to be premature (Santos and Eisenhardt, 2005). During this stage of market emergence, achieving survival is far more important than attempting to optimize outcomes as the primary strategic objective. Firms that survive in emerging markets seek to effect change by any means possible, focusing on effective rather than efficient strategies (Fligstein, 2001).

An increasingly popular view of emerging markets is they are socially constructed (Fligstein, 2001; White, 1981) between entities as competing firms develop a "conception of control" (Fligstein, 2001). Fligstein (2001, p. 22) offers a thorough discussion of necessary conditions for the social construction of markets, including property rights that facilitate exchange, governing entities that enforce stability, and multiple firms with embedded interests to continue. We agree that market creation contains many of these elements, but we disagree with Fligstein (2001) on his requirement of multiple firm interactions as the primary catalyst. We believe as few as one entrepreneur can catalyze a market by developing a revolutionary business model; subsequent interactions with multiple stakeholders serve to align the entrepreneur's self-interests with those of the collective. For example, Apple developed the business model that inextricably linked the iPod and iTunes on its own, but once conceptualized, the firm worked on aligning the interests of content providers with those of Apple and its customers. Otherwise, actors in emerging markets behave in ways consistent with sociological viewpoints of market construction.

Santos and Eisenhardt (2005) appear to share this perspective. They focus on entrepreneurial firms operating in markets where the industry structure is ambiguous and still evolving, where there are vague product conceptions and technological change is unpredictable, and where there are few widely accepted business models. Santos and Eisenhardt (2005, p. 3) argue that most theories of markets and firms assume an existing industry structure and established organizations operating within that industry's boundaries, but "market boundaries in particular are not exogenous but rather shaped by entrepreneurial actions." In emerging markets "organizational and market boundaries are intertwined and co-constructed" and entrepreneurs are "not entering a new market" or "discovering a hidden market" (Santos & Eisenhardt, 2005, p. 3), "rather they are trying to make their conception of the emerging market socially understood and accepted" (Santos & Eisenhardt, 2005, p. 16). Thus entrepreneurs actively co-construct and define market boundaries (Santos & Eisenhardt, 2005, p. 16).

A third viewpoint for the emergence and construction of markets comes from the institutional entrepreneurship literature. Institutional entrepreneurship scholars believe that a new product or technology requires a defined space with norms and rules governing the production, distribution and consumption of the product or technology (Van de Ven & Garud, 1994). The central tenet of institutional entrepreneurship is that institutions influence whether, how, and the extent to which new products and services are adopted, therefore entrepreneurs should work to gain sociopolitical legitimacy (Aldrich &

Fiol, 1994). Entrepreneurs / individual actors typically seek legitimacy by working collectively on the establishment of rules and norms and accommodating each other's needs to influence institutions (Aldrich & Fiol, 1994). While some level of collective action is required to align the interests of individual actors with those of the collective, we believe there are individual actors who engage in aggressive efforts to dominate the shaping of market rules and norms via a market driving strategy (Jaworski, et al., 2000). These entrepreneurs seek to simultaneously create legitimacy for both their business model and the market. We discuss market driving in further detail in the Proposition Development section.

In summary, these three perspectives assume the relationship between individual and collective action in the emergence of markets is *either* (a) only required for the coordination of discrete transactions, (b) central to catalyzing the construction of markets, or (c) a mechanism for coordinating strategies that achieve market legitimacy and establish norms. We believe the relationship between individual and collective action is more nuanced and iterative, as outlined in Sarasvathy and Dew (2005). However, we extend and amend their theoretical argument to explain instances where entrepreneurs proactively seek to influence the collective construction of markets in order to achieve a dominant position via their business model. Table 1 (see appendix) provides a summary of each of these four perspectives, highlighting their differences and the need for a new perspective on market creation that acknowledges the role individual entrepreneurs and their business models have in shaping new markets.

The next section begins with a review of recent work (Sarasvathy, 2001; Sarasvathy and Dew, 2005) that links effectuation with new market creation when market conditions are highly uncertain and ambiguous. Next, we extend and amend their work by explaining the co-evolution of business models and emerging markets as a process of aligning the interests of individual entrepreneurs and their stakeholder networks via both effectuation and market driving.

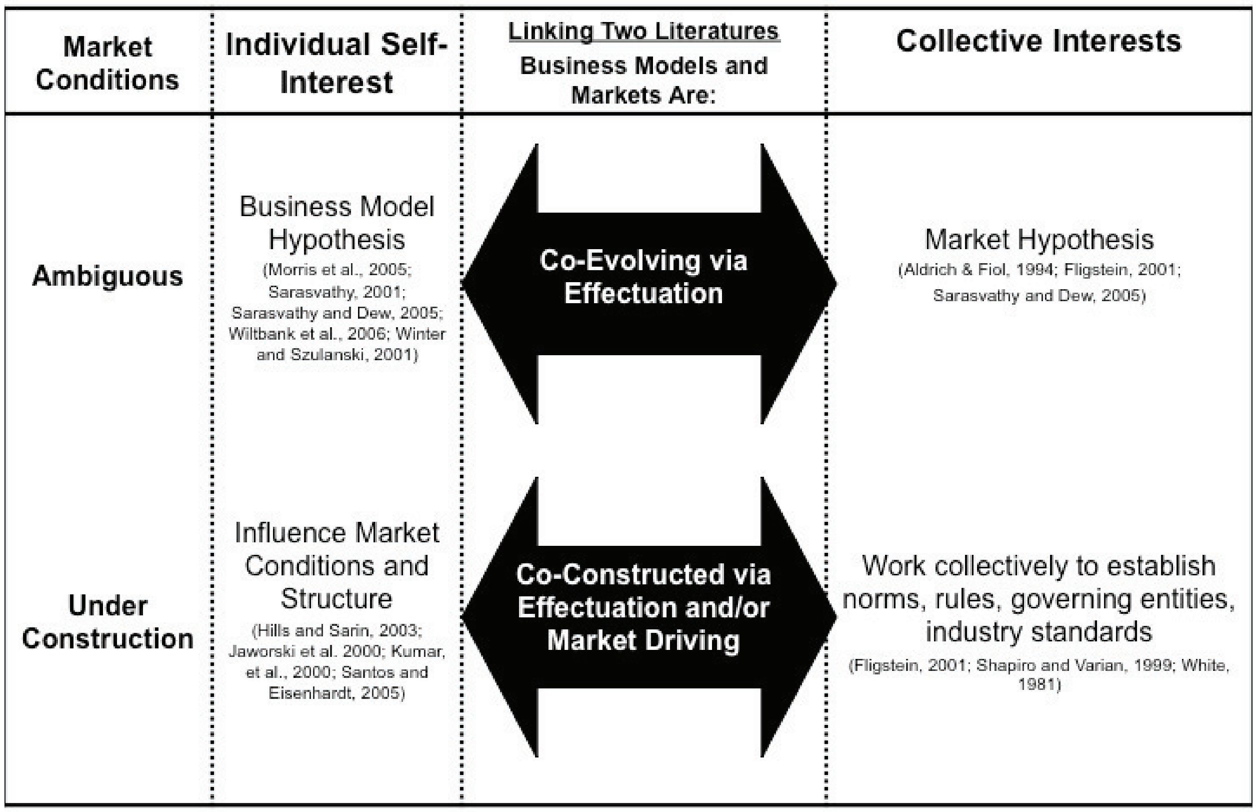
CONCEPTUAL MODEL

How Business Models and Markets Co-Evolve Through BOTH Effectuation and Market Driving

As Christensen (2003) notes, emerging markets do not contain enough structure or discernable information to facilitate traditional analysis of market potential; clearly we also cannot accurately determine the optimal strategies for exploiting this uncertain potential. Sarasvathy (2001) and Sarasvathy and Dew (2005) offer an alternative explanation of how entrepreneurs develop business models and markets under conditions of high uncertainty and insufficient information. Sarasvathy and Dew (2005) suggest market creation is the result of entrepreneurs experimenting with business models through effectuation[1]. The basic premise of effectuation is that entrepreneurs eschew analyzing expected returns based upon estimated levels of risk and investment and instead choose between possible effects they can create with their given means (Sarasvathy 2001). When new markets are emerging, it is impossible for entrepreneurs to analyze all possible resource arrangements and market opportunities because they are cognitively bounded and have idiosyncratic motivations (Sarasvathy & Dew, 2005). Flooded by a multitude of opportunities, entrepreneurs set out with an initial hypothesis of the market and develop a business model in alignment with that hypothesis. Through multiple entrepreneurs engaging in an iterative process of market hypothesis testing and with their network of stakeholders, order emerges and business models are crystallized while new markets are created. Through this process "those (firms) who come on board, and what they commit to the enterprise, together with other contingencies that occur along the way, determine what opportunity gets created" (Sarasvathy & Dew, 2005, p. 543).

Figure 1 summarizes how self-interest and collective interest in emerging markets are aligned via business model evolution (effectuation) and construction (effectuation and market driving). In the next section, we describe how effectuation and isotropy interact to influence business model and market co-evolution. We conclude this section with propositions (1-4), which outline the role of effectuation in the co-evolution of business models and markets. To conclude proposition development, we complement and extend Sarasvathy and Dew (2005) by identifying explicit and intentional actions entrepreneurs take to pursue market dominance via a fundamentally market driving strategy (Hills & Sarin, 2003; Jaworski, et al., 2000). Propositions 5-10 identify the conditions under which entrepreneurs will likely engage in market driving behaviors -- and be most likely to succeed.

FIGURE 1 –HOW SELF- AND COLLECTIVE INTERESTS IN EMERGING MARKETS ARE ALIGNED VIA BUSINESS MODEL EVOLUTION / CONSTRUCTION



PROPOSITION DEVELOPMENT

Effectuation -- Making Sense of Emerging Markets through Business Model Experimentation

As previously noted, entrepreneurs developing business models in emerging markets begin with a joint hypothesis of a market and a business model that offers the best chance for survival. These entrepreneurs adopt an effectuation strategy (Sarasvathy, 2001) that involves the simultaneous and iterative testing and promotion of these hypotheses (Wiltbank, et al., 2006). This approach is referred to as the strategy of *affordable loss*, where the entrepreneur avoids making a single large investment in favor of incremental investments so that resources are set aside for downstream refinements or iterations to offerings based on market feedback (Sarasvathy, 2001). The entrepreneur may also enter markets through alliances and other cooperative strategies that spread risk and facilitate market experimentation {Sarasvathy, 2001 #33}. What the firm learns through interactions with these various stakeholders provides critical input to strategic decisions about the business model, such as pursuing additional or different stakeholder relationships and alliances, revising the product or service offering, and refining the target market. This process expands both firm know-how (skills and ability to adopt contingencies) and whom they know (networks of partners, supporters, suppliers, customers).

Effectuation can play a role in the emergence of business models that become de facto new industry standards (Sarasvathy & Kotha, 2001). The literature on the emergence of industry standards (e.g.

Anderson and Tushman, 1990; Hill, 1997; Shapiro and Varian, 1999) identifies two key strategies that are consistent with effectuation: seeking to develop and leverage partnerships and alliances with key / influential industry stakeholders, and seeking to quickly build an installed base of customers. Sarasvathy and Kotha's case study analysis of the evolution of Real Networks (2001) illustrates how engaging in this process radically altered the founder's initial vision of product offering, target market, and value proposition. Several rounds of partner and customer feedback led the firm to become the market leader in the online delivery of audio programming.

The role of effectuation in the co-evolution of business models and markets is summarized in the following propositions:

Proposition 1a: *In emerging markets, entrepreneurs develop an initial hypothesis of the market and their business model*

Proposition 1b: *In emerging markets, entrepreneurs expect both their definition of the market and their business model to change via a process of experimentation*

Proposition 2: *In emerging markets, entrepreneurs make incremental commitments of resources to their business model as it evolves*

Proposition 3: *In emerging markets, entrepreneurs, their stakeholders, and their competitors make incremental commitments to adopting collective market standards, norms, and rules as the market evolves*

Proposition 4: *In emerging markets, as entrepreneurs, their stakeholders, and their competitors make incremental commitments to adopting collective market standards, norms, and rules as the market evolves; their business models converge around these standards, norms, and rules*

Thus, effectuation helps explain the general evolution of markets from hypothesized and competing business models to the emergence of standards, norms, and rules that define and demarcate them. However, we believe the emergence of dominant business models requires more than collective stakeholder reliance on the iterative and somewhat serendipitous nature of effectuation. Individual actors within the collective who seek to dominate markets must also possess a fundamentally market driving orientation to influence market preferences and structure to their advantage. In other words, while effectuation facilitates the refinement of business models and market standards, norms, and rules, market driving facilitates (and in some cases accelerates, e.g., Apple's iPod and iTunes, Dell) the establishment of a dominant market position. Market dominance is achieved by having a business model that is most closely aligned with the standards, norms, and rules of the market.

Market Driving: How Entrepreneurs Shape Market Preferences and Structure to Align with Their Business Model

Market driving is a critical theoretical linkage between the individual self-interests of the entrepreneur and the collective action needed for a business model to effectively define the preferences and structure of a market. Market driving (Hills & Sarin, 2003; Kumar, et al., 2000) or driving markets (Jaworski, et al., 2000) is a calculated and logical strategic process for producing desired outcomes. Market driving consists of a set of behaviors by which firms seek to fundamentally shape market preferences and structures -- referred to as "the rules" by Kumar, Sheer, and Kotler (2000) -- to their advantage. Instead of assessing and reacting to competitor movements, market driving firms engage in the proactive shaping of stakeholder expectations as they relate to the new business model. Similar to effectuation, stakeholder reactions to these efforts shape future efforts at molding expectations. Market driving similarly involves incremental market experimentation to test and refine markets, product offerings, and value propositions (Gatignon & Xuereb, 1997; Hill, 1997). Firms seek to shape market structure via premeditated and deliberate actions aimed at altering the competitive landscape (Jaworski, et al., 2000; Santos & Eisenhardt, 2005) and influencing industry standards (Hills & Sarin, 2003; Jaworski, et al., 2000).

While the differences between effectuation and market driving are somewhat nuanced in terms of influencing market preferences, there is a distinct difference in the approach to influencing market structure. While effectuation emphasizes the co-opting of competitors, entrepreneurs engaging in market driving seek to circumvent or eliminate the competition as well. Three perspectives of market driving, by Kumar, Scheer, and Kotler (2000), Hills and Sarin (2003), and Jaworski, Kohli, and Sahay (2000), are summarized on the following pages. The section concludes with the Santos and Eisenhardt (2005) perspective on market construction that outlines strategies which are essentially market driving in terms of influencing market structure. Propositions related to the objectives and actions of market driving entrepreneurs follow each summary.

Altering Preferences

Kumar, Scheer, and Kotler (2000) believe that firms who engage in market driving create, shape, and accelerate, rather than predict or respond to, potential market or industry movements. Instead of strictly focusing on customer needs, firms that are market driving also seek to shape the evolution of the marketplace. These firms seek to alter the *rules of the game* to their advantage, not simply make the best moves under the current set of rules. They redefine markets and trigger dramatic changes in customer expectations, value propositions, and business processes. Market driving is often done by new entrants who revolutionize an industry by delivering a substantial leap in customer value through either a breakthrough technology or marketing system made possible by a unique business process (Kumar, et al., 2000). The authors cite IKEA as an example of influencing market preferences: the company used a combination of logic (lower prices) and irreverence (don't be afraid) in their communications to convince customers of the benefits of buying quality furniture that you must assemble yourself (Kumar, et al., 2000). They cite Dell as an example of a company that created a new market structure by ushering in dramatic changes in the way personal computers were made, sold, and distributed. Kumar et al.'s (2000) definition of market driving suggests that the probability of creating a dominant new business model depends on the degree to which the business model is different from current market conventions and solutions. This leads to the following proposition:

> *Proposition 5: Entrepreneurs adopt market driving strategies when they develop business models that radically alter the price-performance frontier of existing markets*

Catalyzing a Market

Hills and Sarin (2003) focus on market driving by firms in high tech industries which exhibit a high degree of technological and market uncertainty and rapid product innovation and obsolescence. Hills and Sarin (2003) believe organizations that engage in market driving serve as change agents or catalysts that actively engage in creating shifts in attitudes, behaviors, and market structures. Market driving requires entrepreneurs to be market leaders who compel others to follow them. The primary objective is to influence the evolution of the market in a direction that is most favorable to the firm in achieving long-term advantage. For example, a clear motivation for Steve Jobs in pursuing the development of iTunes was his belief that if Apple could be the catalyst bringing order to a chaotic online-music market, Apple would be rewarded with a dominant market position. This leads to the following proposition:

> *Proposition 6: Entrepreneurs adopt market driving strategies when they believe their business model is a catalyst for defining / shaping market standards, rules, and norms*

Influencing Market Structure

Jaworski, Kohli, and Sahay (2000) use the terms market driving and driving markets interchangeably. The amount and magnitude of market driving behaviors adopted is a function of the degree to which a firm believes it can influence the definition or structure of a market and / or the behavior of market stakeholders to the firm's advantage. Jaworski, Kohli, and Sahay (2000) believe markets are driven in three ways: market deconstruction, market construction, and functional modification. Deconstruction involves eliminating market players through the reshaping or flattening of channels and changing the parameters of supplier relationships, or through acquiring, forming joint ventures or merging with, or similarly outflanking competitors. For example, Dell and Amazon.com have each changed the channel structure within their markets. Market construction involves building a new or modified network of players in a market, while functional modification requires changing the functions performed by existing stakeholders. For example E-Bay's business model facilitated the creation of new networks of buyers and sellers that previously had no means to effectively connecting with one another, while IKEA made the customer a co-producer of their product experience.

According to Jaworski, Kohli, and Sahay (2000), actions that attempt to directly influence market preferences include seeking out and collaborating with providers of complementary products and services, building (e.g. increasing switching costs) or removing (e.g. expanding channels of distribution) customer constraints, and seeking to constrain competitor actions (e.g. locking up key suppliers). Collaborative efforts to drive industry standards are one variation of this strategy that is prevalent in industries driven by technological advances and network externalities (Arthur, 1990), such as consumer electronics, software, and information technology (Hill, 1997; Shapiro & Varian, 1999). For example, the success of the VHS format for VCR machines facilitated the development and expansion of new business models and markets in the entertainment industry. The telecommunications industry provides an example where competing standards for products and services such as wireless data and voice transmission have sometimes hampered their evolution.

Therefore the ability to effectively shape market structure requires that the entrepreneur's business model has the potential to create new and innovative channel relationships and/or serve as the foundation for new industry standards.

> *Proposition 7: Entrepreneurs adopt market driving strategies when they believe their business model significantly alters existing channel relationships / conventions*

> *Proposition 8: Entrepreneurs adopt market driving strategies to influence industry standards that legitimize their business model*

Constructing Market Boundaries

While Santos and Eisenhardt (2005) do not specifically address market driving, their research on emerging markets is quite relevant to this discussion. Firms operating in emerging markets initially focus on legitimacy and survival, and they proactively seek to create market boundaries rather than treat them as environmental constraints: "executives spend considerable effort to shape market structure to their advantage" (Santos & Eisenhardt, 2005, p. 35). The mechanisms used are claiming, demarcating, and controlling. The objective of claiming is to become the cognitive referent in a market space, proactively defining the firm and the market as synonymous. The process is "more about sense-giving than sense-making" (Santos & Eisenhardt, 2005, p. 17) with respect to potential customers. The objective of demarcating is shaping an "advantageous industry structure of suppliers, buyers, and complementers" (Santos & Eisenhardt, 2005, p. 25) through "co-optation" alliances with established players to extend the firm's sphere of influence and limit competition through creating switching costs. Control is achieved through the acquisition of entrepreneurial rivals with the intent to eliminate them, destroy their resources, or thwart the entry of other competitors. The objective is not to just beat the competition, but to minimize it (Santos & Eisenhardt, 2005). These strategies for proactively demarcating market boundaries in line with the entrepreneur's business model are consistent with the strategies for influencing market structure outlined in Jaworski, Kohli, and Sahay (2000).

Both E-Bay and Amazon.com have adopted many of the strategies outlined by Santos and Eisenhardt (2005). Each is synonymous with their category (online auctions and e-commerce). In addition, they have co-opted potential rivals by allowing others to sell through their service. For example, Amazon.com manages the Target and Toys R Us e-commerce sites and E-Bay provides training to firms selling via their service. These firms have also made strategic acquisitions, such as E-Bay's purchase of Pay Pal (Kane, 2002). Finally, Microsoft's ascent was in part facilitated by engaging in aggressive efforts to thwart competitive incursions via co-opting and acquisition, and by erecting barriers that ultimately were deemed anti-competitive (Kawamoto, 1997).

From both Santos and Eisenhardt (2005) and Jaworski, Kohli, and Sahay (2000) it appears that successful market driving requires the entrepreneur to engage in activities that create both perceptual and physical barriers to potential challengers. This leads to the following propositions:

> *Proposition 9: Entrepreneurs seeking a dominant market position adopt market driving strategies that position their business model as the cognitive referent in the market*

> *Proposition 10: Entrepreneurs seeking a dominant market position adopt market driving strategies that include co-opting and/or acquiring potential competitors*

Table 2 summarizes each proposition and its theoretical foundation.

TABLE 2 – SUMMARY OF PROPOSITIONS

Proposition	Theoretical Foundation	Examples
P1a: In emerging markets, entrepreneurs develop an initial hypothesis of the market and their business model ***P1b:*** In emerging markets, entrepreneurs expect both their definition of the market and their business model to change via a process of experimentation	**Effectuation** (Sarasvathy 2001) (Sarasvathy & Dew, 2005) (Wiltbank, et al., 2006)	Johnson, Christensen, and Kagermann (2008, p. 59): "successful new businesses typically revise their business models four times or so on the road to profitability"
P2: In emerging markets, entrepreneurs make incremental commitments of resources to their business model as it evolves	**Effectuation** (Sarasvathy, 2001) (Sarasvathy & Dew, 2005)	Michael Dell begins in his dorm room at the University of Texas and continually experiments with his business model. (Park 2004)
P3: In emerging markets, entrepreneurs, their stakeholders, and their competitors make incremental commitments to adopting collective market standards, norms, and rules as the market evolves	**Effectuation** (Sarasvathy & Dew, 2005) (Wiltbank, et al., 2006)	The evolution of Real Networks. (Sarasvathy & Kotha, 2001)
P4: In emerging markets, as entrepreneurs, their stakeholders, and their competitors make incremental commitments to adopting collective market standards, norms, and rules as	**Effectuation** (Sarasvathy & Dew, 2005) (Wiltbank, et al., 2006)	Michael Dell's successive refinements to his business model leads to major supply chain innovations and widespread customer

the market evolves; their business models converge around these standards, norms, and rules		acceptance of a new model for purchasing computers.
P5: Entrepreneurs adopt market driving strategies when they develop business models that radically alter the price-performance frontier of existing markets	**Market Driving** (Hills & Sarin, 2003; Kumar, et al., 2000)	IKEA and Amazon.com; Southwest Airlines
P6: Entrepreneurs adopt market driving strategies when they believe their business model is a catalyst for defining / shaping market standards, rules, and norms	**Market Driving** (Hills & Sarin, 2003)	Apple: iTunes
P7: Entrepreneurs adopt market driving strategies when they believe their business model significantly alters existing channel relationships / conventions	**Market Driving** (Jaworski, et al., 2000)	E-Bay and Dell
P8: Entrepreneurs adopt market driving strategies to influence industry standards that legitimize their business model	(Jaworski, et al., 2000)	Apple: iTunes
P9: Entrepreneurs seeking a dominant market position adopt market driving strategies that position their business model as the cognitive referent in the market	**Market Driving and Market Creation** (Jaworski, Kohli, and Sahay, (2000) (Santos and Eisenhardt, 2005)	Apple: iPod *and* iTunes;
P10: Entrepreneurs seeking a dominant market position adopt market driving strategies that include co-opting and/or acquiring potential competitors	**Market Driving and Market Creation** (Jaworski, Kohli, and Sahay, (2000) (Santos and Eisenhardt, 2005)	Microsoft, E-Bay, Amazon.com

DISCUSSION AND CONCLUSION

Both business model innovation in the emerging market context, and the co-evolution of business models and markets in this context, have important implications for entrepreneurs whose success depends on fundamentally altering existing market preferences or structures. The adoption of an incremental investment philosophy with the goal of iterative and relatively small-scale market experimentation allows entrepreneurs to economize on resources at a fraction of the investment suggested by traditional market entry strategies. Rather than developing a business model through rigorous market research and then marshalling resources for a major market launch, the approach outlined here suggests entrepreneurs start with a hypothesized business model and throw it into competition with other business models in order to generate insights that lead to further refinement. This process of business model refinement leads to additional customer, supplier, and distributor commitments, which forges an increasingly shared strategic vision. The entrepreneur only commits to expending large amounts of resources when the business model is refined to a point where it can be positioned as an industry standard. During the dot-com bubble, many new ventures wasted millions of dollars on some ill conceived business models in part because they received too much money too soon. Many of these ventures could have benefited from the incremental investment/commitment approach detailed here. The resources conserved and market insights gained from this approach could have sustained their economic viability long enough to create an attractive market and viable business model.

Linking effectuation to market driving in the co-evolution of markets and business models offers a new and potentially powerful theoretical foundation for examining how individual entrepreneurs influence collective action. Effectuation seems to influence the general evolution of markets from hypothesized and competing business models to the emergence of standards, norms, and rules that define and demarcate them. However, we believe the emergence of dominant business models requires individual actors within the collective to adopt a market driving orientation to influence market preferences and structure to their advantage. In other words, while effectuation facilitates the refinement of business models and market standards, norms, and rules; market driving facilitates (and in some cases accelerates, e.g. Apple's iPod and iTunes, Dell) the establishment of a dominant market position. Market dominance is achieved by having a business model that is most closely aligned with the resulting standards, norms, and rules of the market. However, a business model can only be dominant if has the potential to radically alter existing market conventions *and* the entrepreneur adopts a market driving strategic orientation to pursue a dominant market position.

Another significant contribution of this paper is a compelling argument for scholars to incorporate the emerging market context in future definitions and studies of business model development. Specifically, there is an opportunity for generating new insights by examining the co-evolution of business models with market structures, rules, and norms in the emerging market context. Business models are the end-product of strategic actions, resources, and capabilities that collectively enable the firm to create value. Entrepreneurs in emerging markets select opportunities perceived to be a match with their existing resources and capabilities, develop and deploy strategies that uniquely organize those resources and capabilities into an initial business model, then experiment and ultimately refine the business model as more information, resources, capabilities, and opportunities are realized. We argue that past studies, which have focused ontechnology-driven innovation, order of entry, firm age and differences in resources have not sufficiently addressed the role of business models, or why a particular firm achieves (or does not achieve) market dominance. For example, Anderson and Tushman (1990) suggest a major limitation of their study of technology lifecycles and dominant designs is that their findings do little to inform when a dominant design does not emerge (Anderson & Tushman, 1990, p. 629). Competing business models may be the most salient unit of analysis for examining the emergence and dominance of firms in emerging markets.

Future Research

A promising but challenging direction for future research would be tracking the adoption of specific effectuation and market driving strategies by multiple firms in an emerging industry. This would require a concerted longitudinal research effort. Scholars may also gain further insights from previous studies of standards wars and the dominant design literature by re-examining those studies using competing business models (rather than individual firms or technology platforms) as a unit of analysis. Another potentially interesting line of inquiry is to re-examine the origins of existing markets to determine to what extent firms adopted relatively flexible versus rigid business models in the early stages of the market's evolution. While it would be a significant challenge to capture these nuances from existing data, interviews with key informants from early market entrants could provide fresh insights.

Of course, any study of emerging markets poses formidable challenges in developing and empirically testing relevant models of emergence. As previously noted, the overwhelming majority of research on business models, strategy development, and market evolution has been firmly grounded in existing markets. This focus has left us with incomplete and in some cases inaccurate frameworks, models, and studies of these phenomena. Creating frameworks that clearly define business models, market emergence, and the co-evolution outlined in this paper should be a priority for researchers interested in this area of study.

ENDNOTES

1. Sarasvathy and Dew (2005:539) define markets created through effectuation as the outcome of "isotropic interactions." Isotropy refers to the fact "that in decisions and actions involving uncertain future consequences it is not always clear ex ante which pieces of information are worth paying attention to and which not … in other words a phenomenon that looks ex post like an exploration of all possible markets … may instead be the result of a series of (effectuation-based) transformations on the original reality"

REFERENCES

Aldrich, H.E., & Fiol, C.M. (1994). Fools Rush In? The Institutional Context of Industry Creation. *Academy of Management Review,* 19(4), 645-670.

Amit, R., & Zott, C. (2001). Value Creation in E-Business. *Strategic Management Journal,* 22(6/7), 493.

Anderson, P., & Tushman, M.L. (1990). Technological Discontinuities and Dominant Designs: A Cyclical Model of Technological Change. *Administrative Science Quarterly,* 35(4), 604-633.

Arthur, W.B. (1990). Positive Feedbacks in the Economy. *Scientific American,* 262(2), 92.

Chesbrough, H., & Rosenbloom, R.S. (2002). The Role of the Business Model in Capturing Value from Innovation: Evidence from Xerox Corporation's Technology Spin-Off Companies. *Industrial & Corporate Change,* 11(3), 529-555.

Christensen, C.M. (2003). *The Innovator's Dilemma: The Revolutionary Book That Will Change the Way You Do Business*. New York: HarperCollins Publishers, Inc.

Fama, E.F., & Jensen, M.C. (1983). Separation of Ownership and Control. *Jornal of Law and Economics,* XXVI(June), 301-325.

Fligstein, N. (2001). *The Architecture of Markets: An Economic Sociology of Twenty-First-Century Capitalist Societies*.Princeton, NJ: Princeton University Press.

Gatignon, H., & Xuereb, J.-M. (1997). Strategic Orientation of the Firm and New Product Performance. *Journal of Marketing Research (JMR),* 34(1), 77-90.

Hill, C.W.L. (1997). Establishing a Standard: Competitive Strategy and Technological Standards in Winner-Take-All Industries. *Academy of Management Executive,* 11(2), 7-25.

Hills, S.B., & Sarin, S. (2003). From Market Driven to Market Driving: An Alternative Paradigm for Marketing in High Technology Industries. *Journal of Marketing Theory & Practice,* 11(3), 13-24.

Jaworski, B., Kohli, A.K., & Sahay, A. (2000). Market-Driven Versus Driving Markets. *Journal of the Academy of Marketing Science,* 28(1), 45-54.

Johnson, M.W., Christensen, C.M., & Kagermann, H. (2008). Reinventing Your Business Model. (Cover Story). *Harvard Business Review,* 86(12), 50-59.

Kane, M. (2002). Ebay Picks up Paypal for $1.5 Billion Retrieved February 16, 2009, from http://news.cnet.com/2100-1017-941964.html

Kawamoto, D. (1997). Microsoft Antitrust File Grows Retrieved Februrary 16, 2009, from http://news.cnet.com/2100-1001-280006.html

Klein, M.H. (2007). The Business Model Concept: A Strategic Management Approach. Unpublished Dissertation. Erasmus University of Rotterdam.

Kumar, N., Scheer, L., & Kotler, P. (2000). From Market Driven to Market Driving. *European Management Journal,* 18(2), 129-142.

Leibold, M., Probst, G., & Gibbert, M. (2002). *Strategic Management in the Knowledge Economy: New Approaches and Business Applications*. New York.

Lichtenstein, B.M.B., & Brush, C.G. (2001). How Do "Resource Bundles" Develop and Change in New Ventures? A Dynamic Model and Longitudinal Exploration. *Entrepreneurship: Theory & Practice,* 25(3), 37-58.

Mahadevan, B. (2000). Business Models for Internet-Based E-Commerce: An Anatomy. *California Management Review,* 42(4), 55-69.

Morris, M., Schindehutte, M., & Allen, J. (2005). The Entrepreneur's Business Model: Toward a Unified Perspective. *Journal of Business Research,* 58(6), 726-735.

Narver, J.C., & Slater, S.F. (1990). The Effect of a Market Orientation on Business Profitability. *Journal of Marketing,* 54(4), 20-35.

Park, A. (2004). Michael Dell: Thinking out of the Box. *The Great Innovators* Retrieved January 4, 2007, from http://www.businessweek.com/magazine/content/04_47/b3909024_mz072.htm

Porter, M. (1980). *Competitive Strategy*. New York: Free Press.

Porter, M.E. (1985). *Competitive Advantage : Creating and Sustaining Superior Performance*. New York: Free Press.

Sandberg, W.R., & Hofer, C.W. (1987). Improving New Venture Performance: The Role of Strategy, Industry Structure, and the Entrepreneur. *Journal of Business Venturing,* 2(1), 5-28.

Santos, F.M., & Eisenhardt, K.M. (2005). *Constructing Markets and Organizing Boundaries: Entrepreneurial Actions in Nascent Fields*.Unpublished manuscript, Seattle.

Sarasvathy, S.D. (2001). Causation and Effectuation: Toward a Theoretical Shift from Economic Inevitability to Entrepreneurial Contingency. *Academy of Management Review,* 26(2), 243-263.

Sarasvathy, S.D., & Dew, N. (2005). New Market Creation through Transformation. *Journal of Evolutionary Economics,* 15, 533-565.

Sarasvathy, S.D., & Kotha, S. (2001). Dealing with Knightian Uncertainty in the New Economy: The Real Networks Case *Research on Management and Entrepreneurship* (Vol. 1, pp. 31-62). Greenwich, CT: IAP, Inc.

Sebastiao, H., & Golicic, S. (2008). Supply Chain Strategy for Nascent Firms in Emerging Technology Markets. *Journal of Business Logistics,* 29(1), 75-91.

Shafer, S.M., Smith, H.J., & Linder, J.C. (2005). The Power of Business Models. *Business Horizons,* 48(3), 199-207.

Shapiro, C., & Varian, H.R. (1999). The Art of Standards Wars. *California Management Review,* 41(2), 8-32.

Van de Ven, A.H., & Garud, R. (1994). The Coevolution of Technical and Institutional Events in the Development of an Innovation. In J. Baum & J. Singh (Eds.), *Evolutionary Dynamics of Organizations* (pp. 425-443). New York: Oxford University Press.

Voelpel, S.C., Leibold, M., & Eden, B.T. (2004). The Wheel of Business Model Reinvention: How to Reshape Your Business Model to Leapfrog Competitors. *Journal of Change Management,* 4(3), 259-276.

White, H.C. (1981). Where Do Markets Come From? *The American Journal of Sociology,* 87(3), 517-547.

Williamson, O.E. (1981). The Economics of Organization: The Transaction Cost Approach. *The American Journal of Sociology,* 87(3), 548-577.

Wiltbank, R., Dew, N., Read, S., & Sarasvathy, S.D. (2006). What to Do Next? The Case for Non-Predictive Strategy. *Strategic Management Journal,* 27(10), 981-998.

Winter, S.G., & Szulanski, G. (2001). Replication as Strategy. *Organization Science,* 12(6), 730-743.

Zott, C., & Amit, R. (2007). Business Model Design and the Performance of Entrepreneurial Firms. *Organization Science,* 18(2), 181-199.

APPENDIX: TABLE 1 – COMPARISON OF THEORETICAL EXPLANATIONS OF MARKET CREATION

Theory	**Firm Strategic Focus**	**Market and Firm Boundaries**	**Business Model Development and Establishment**	**How The Market Emerges: Individual & Collective Interests & Actions**
Economics Williamson, 1981 Fama and Jensen, 1983	Transaction Efficiency	**Well understood** by all stakeholders; must achieve **efficient exchange**	Firm develops appropriate **strategic response** to established market boundaries and norms	Via **coordinating transactions** that seek to minimize cost, establishing and enforcing property rights, monitoring managers/agents
Social Construction Fligstein, 2001 White, 1981	**Survival** via increasing social commitment among stakeholders	**Emerging**; developed to facilitate **sense-making and exchange** between stakeholders; must achieve broad social understanding	Business model is **constructed** to align with sense-making and exchange efforts in the market	Via **multiple firms engaged in co-constructing the social structure of the market**: control mechanisms, property rights, governing entities, etc.
Institutional Entrepreneur-ship Aldrich and Fiol, 1994 Van de Ven and Garud, 1994	**Survival** via increasing collective understanding among stakeholders	**Emerging**; developed to facilitate **legitimacy** with key stakeholders; must achieve collective norms, rules, and customer expectations	Business model is **shaped** by desire for sociopolitical legitimacy; adjusted to align with norms, rules, and standards	Via **pursuing sociopolitical legitimacy**; adopting norms, rules, and standards accepted by key institutions
Effectuation and Market Driving Sarasvathy and Dew, 2005 Jaworski, Kohli and Sahay, 2000 Hills and Sarin, 2003 Santos and Eisenhardt, 2005	**Survival** via social commitment, then **Dominance** via increasing stakeholder commitments	**Emerging**; actively **constructed** to facilitate **sense-giving;** must achieve competitive advantage	Business model is constructed and **co-evolves with the market** via successive interactions with stakeholders; **dominant** models emerge via **market driving**	Via the entrepreneur **actively co-opting, persuading, or controlling stakeholders** to align their vision, norms, and rules with those of the entrepreneur