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Challenges in the business models of creative professional service firms

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Abstract

Recent studies have shown that professionals in the built environment need new or improved business strategies to survive in increasingly dynamic and competitive environments. To gain insight into how professional businesses can be successfully reshaped, a profound understanding of their business models is necessary. So far, business model research in project-based organisations has focused on large companies that are primarily profit-oriented. Work that addresses the business challenges of small, creative service firms is extremely limited. This study aims to develop knowledge around the business models of architectural firms by focusing on their value propositions, value creation and value capture. Iterating between business model literature and empirical data from 41 semi-structured interviews with Dutch architects and clients, architectural firms' business models were systematically examined regarding their configurations and outcomes. This resulted in an overview of key business model components, their interrelationships and accompanying challenges for architectural firms. The study contributes to theory and practice by the development of a strategic decision making framework that specifically addresses the business model challenges of small creative service firms. The framework helps practitioners to enhance their business strategies and to develop new or improved business models with increased benefits.

Keywords: architectural firms, business model, strategy, value creation

Introduction

Professional service firms (PSFs) within the built environment are challenged to alter or replace their existing business models as they transform in response to ongoing societal and industry-level changes (Hughes and Hughes, 2013). Some firms take on innovative roles for which they have to develop entirely new business models. Others try to stay competitive on the basis of established roles. These firms have to redesign their traditional business models as their ways of doing business are increasingly questioned by other industry actors or the public (Vough *et al.*, 2013).

Although academics are interested in the fact that PSFs increasingly adopt the logic and structures of business corporations (Suddaby and Muzio, 2015), explorations of how PSFs conduct their businesses remain extremely scarce. So far, efforts to develop more insight into the business challenges of creative professional service firms (CPSFs) have been primarily undertaken from a practice-oriented perspective (van AnDEL and Vandenbempt, 2012). A detailed understanding of the business models of CPSFs and the challenges that they involve is, however, crucial for firms that wish to develop new or alternative ways of doing business.

In this research, we use business model theory (e.g. Zott *et al.*, 2011) to analyse the design and challenges of the business models that CPSFs employ. We specifically focus on the business models of Dutch architectural firms. In the Netherlands, many architectural firms struggle to uphold viable business models as the sector suffered severely from the global economic recession. Between 2008 and 2015, firms saw their turnover decrease by nearly 50% (Vogels, 2016). Many of the surviving firms now look for ways to regain or enhance their competitive advantage and to become more sustainable.

The research contributes to the literature on CPSFs and architectural firms by providing a detailed understanding of the key components, their interrelations and accompanying challenges in the business models of CPSFs. It concludes with the proposal of a strategic decision making framework for sustainable value creation and capture in creative projects. The framework helps firms to improve their business strategies from the viewpoints of the own organisation and the other actors that are involved. This is especially relevant for professionals who wish to develop more competitive and sustainable organisations.

The business model concept

A business model describes the rationale of how an organisation creates, delivers, and captures value in relationship with a network of exchange partners (Afuah and Tucci, 2001; Osterwalder and Pigneur, 2010). Business models help organisations to exploit business opportunities by creating value for the parties that are involved, while generating profits for the firm and its partners. They need continuous adaptation to secure the firm's competitiveness over time (Teece, 2010). The abstract nature of the business model concept has proved extremely valuable to both academia and practice. Strategy researchers, for example, use the business model as a new unit of analysis to study how firms create and capture value (Zott and Amit, 2013; Zott *et al.*, 2011). Strategists and practitioners are especially interested in the opportunity to develop and increase competitive advantage through the operationalisation of the business model concept (Grozdanic, 2016).

Many scholars conceptualise the business model as a configuration of different sub-constructs, which are often referred to as components (Shafer *et al.*, 2005). From his literature review, Clauss (2016) recognises three overarching dimensions that explain a

firm's business model, namely the value proposition, value creation and value capture. The value proposition represents the solutions that firms offer to their customers to solve their problems or fulfil their needs (Osterwalder and Pigneur, 2010). Value creation refers to how and by what means firms create value along the value chain. Value capture explains how value propositions are converted into revenues (Clauss, 2016).

Each business model revolves around a few key components that detail the organisation's value proposition, creation and capture. Resources seem a particularly important component for any organisation's business model. They represent the firm's primary source of competitive advantage and thus define its ability to create and capture value. Resources are the tangible or intangible assets that are tied to a firm (Wernerfelt, 1984), such as physical, human or organisational capital (Barney, 1991). Capabilities are firm-specific, organisationally embedded resources that are built by a firm to handle its combined resources in the pursuit of a desired goal (Makadok, 2001). This type of resource is crucial for successful value creation and capture over time as they enable the organisation to adapt to its environment (Achtenhagen *et al.*, 2013).

Business models of project-based firms

Empirical evidence in existing literature demonstrates that many organizations use multiple business models simultaneously (Aversa *et al.*, 2015). Combining different business models in a business model portfolio can be beneficial as it helps firms to pursue different business opportunities at the same time (Sabatier *et al.*, 2010). Business model portfolios are at the core of how project-based firms work. As each project is unique, project-based firms typically use

(slightly) different business models in their projects. Kujala *et al.* (2010) argue that in project-based firms, business models thus exist at the firm level and the project level. Although project-level business models are often derived from firm-level business models, projects also create autonomous business models that may in turn influence firm business models (Mutka and Aaltonen, 2013).

The lack of knowledge on business models of CPSFs

Scholars are currently expanding the knowledge around the variety of business models that project-based firms use (Wikström *et al.*, 2010) and the impact of project-level business models on project-based firms (Mutka and Aaltonen, 2013). However, research remains characterised by a focus on large organisations that are primarily driven by the aim to generate profit. Existing research, for example, paid attention to the influence of servitization on the business models of capital goods supplier firms (Kujala *et al.*, 2010). The challenges that such organisations encounter in their business models are very different from the ones that small organisations, organised around service delivery and driven by multiple strategic goals have to deal with (Lu and Sexton, 2006). For many CPSFs, profit is not a main driver. Firms especially aim for customer, user and/or societal value by delivering service quality (DeFillippi *et al.*, 2007; Ravasi *et al.*, 2012), professional value, such as the development of a reputation or the generation of work pleasure (Bos-de Vos *et al.*, 2016) and organisational continuity. These goals are also expressed in how CPSFs compete for work (Manzoni and Volker, 2017). Figure 1 shows the theoretical framework that was used in our study.

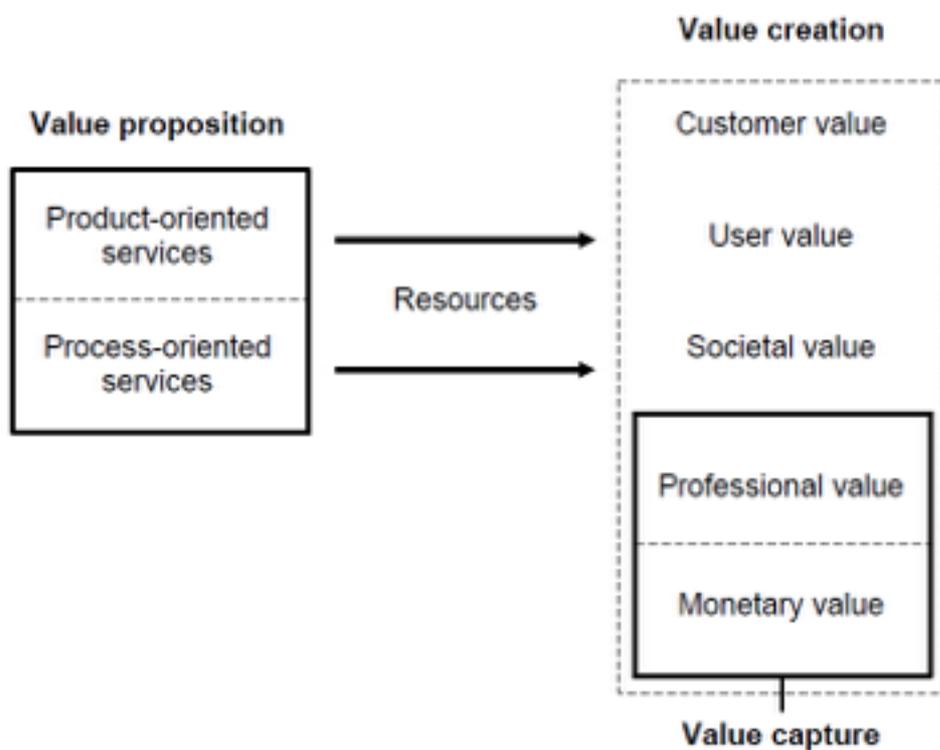


Figure 1: Theoretical framework for business models of CPSFs

Research approach and methods

We used a qualitative research approach (Miles and Huberman, 1994) to develop a profound understanding of the challenges in the business model designs of small creative service firms. From January 2014 until January 2015, we collected data from 41 face-to-face interviews with representatives of 24 Dutch architectural firms and 16 Dutch client organisations. Our sample consists of architectural firms with different age, size and strategic orientation (Coxe *et al.*, 2005; Mintzberg, 1979) and includes public, semi-public and private clients, such as governmental agencies, hospitals, housing corporations, contractors and developers.

The interviews were conducted in three rounds that each had a specific focus. First, we used exploratory interviews to develop an understanding of the contemporary business challenges of architectural firms. Two important themes that emerged from this first round of interviews each formed the

basis of an additional round of in-depth interviews: the valuation of the architectural firm's activities and the coordination of the inter-organisational collaboration. We chose to use a semi-structured interview protocol in the three interview rounds to address the topics of our theoretical framework, while leaving room for the respondents to come up with additional themes. The interviews lasted 45 – 120 minutes, were fully recorded and transcribed verbatim. The transcripts were checked and approved by the interviewees. Additionally, we studied archival documents and organised 8 interactive discussion groups with practitioners. The purpose was to validate the findings of our study and to gain additional insights.

The data analysis consisted of several iterative steps, which we repeated for each round of interviews. In a first step, the interviews were thoroughly analysed with the help of software program MAXQDA. A list of codes was developed and discussed among the authors. Specific attention was

given to the business related tensions that emerged within architectural firms and in their interaction with the client. In a second step, the findings were visualised in a framework that integrated key themes and their interrelationships. Third, the findings were compared to literature, which resulted in an update of the framework. The findings and framework were discussed and updated monthly in group meetings with the involved researchers, and validated in the interactive discussion sessions with practitioners.

Challenges in the business models of CPSFs

Our data reveal three key challenges that small CPSFs face in their business models.

First, we recognise clear gaps between the value propositions of firms and the value that they wish to capture. We found that firms often made or agreed with offers that did not align with their own organisational goals. The data show that architectural firms pursued professional goals that were not included in the value proposition and aimed for many different goals without having clear priorities. We found examples in which the value proposition was based on the client's desire to have a limited involvement of the architectural firm, while the value capture aims of this architectural firm were much broader. This, for instance, occurred when firms needed the work, but were also passionately driven by their professional urge to deliver the best work possible. Architectural firms delivered additional activities or spent more hours than offered to make sure that their desired level of quality was met. Several clients argued that these extra activities or hours are simply redundant. This suggests that firms would benefit from a more conscious decision on whether or not to engage in a certain project. If a project does not contribute to or is even harmful to the professional goals of the firm, it may be wise to reject it. If it is decided to participate in the project, the

business model should be designed accordingly. This means that the activities and costs should be fitting to the proposition that was made to the client.

Second, the data show that the value capture of architectural firms is hindered by the firms' high level of resource dependence. The firms in our sample needed partners to create value due to their own size and limited financial resources. However, they did not always end up collaborating with partners that were striving for mutual benefits. We found examples in which the partner was unwilling to go along with an appropriate fee for activities that are typically not performed by an architect, such as the development of a business case. We also found instances in which the partner did not value the input of an architect, for example in the engineering stage. This suggests that architectural firms and partner organisations often differ in opinion on what activities the architectural firm should perform and what these activities are worth. The difference seems largely related to risks. Contractors argued that it is because of their own risk-taking behaviour, that they want to keep things within their own control. They expected that architectural firms, who are typically not responsible for the construction of a project, would come up with different designs and technical solutions once they are held accountable for the construction flaws that might come up. It suggests that if architectural firms wish to be involved in activities that go beyond the scope of their partner's support, it might be beneficial to take on more risks, either in close collaboration or alone.

Third, we found that the value propositions of firms are difficult to translate into money at the beginning of a project. The architects in our sample considered it their professional duty to look beyond the things that the client asked for or expected. Their ability to look further than the original assignment was also highly valued by the clients in our sample. This shows that the third business challenge is not

about preventing or downplaying the hours that are spend on this particular kind of additional work, but about findings ways to get sufficiently paid for it. The interviewees argued that the exact opportunities of a project are often not clear in the beginning. It therefore seems difficult to agree on a price without knowing the value that might be created in the end. This suggests that the business models of architectural firms may benefit from a revenue model that allows a reconsideration of the price in a later stage of the project.

A decision making framework for successful value creation in creative projects

We translated the business model challenges of CPSFs into a framework for strategic decision making, which we are currently improving and validating with the help of practitioners. A draft version of the framework is presented in figure 2. The framework helps professionals and firms to identify the key components and interdependencies of their project-level business models and to handle the tensions that come up within these business models and in relation to the firm's business model. It is subdivided into three steps to guide the user/users towards more conscious strategic choices. The first two steps are designed to roughly map the wishes of the firm. The third step aims to translate these wishes into a pragmatic approach for value creation and value capture.

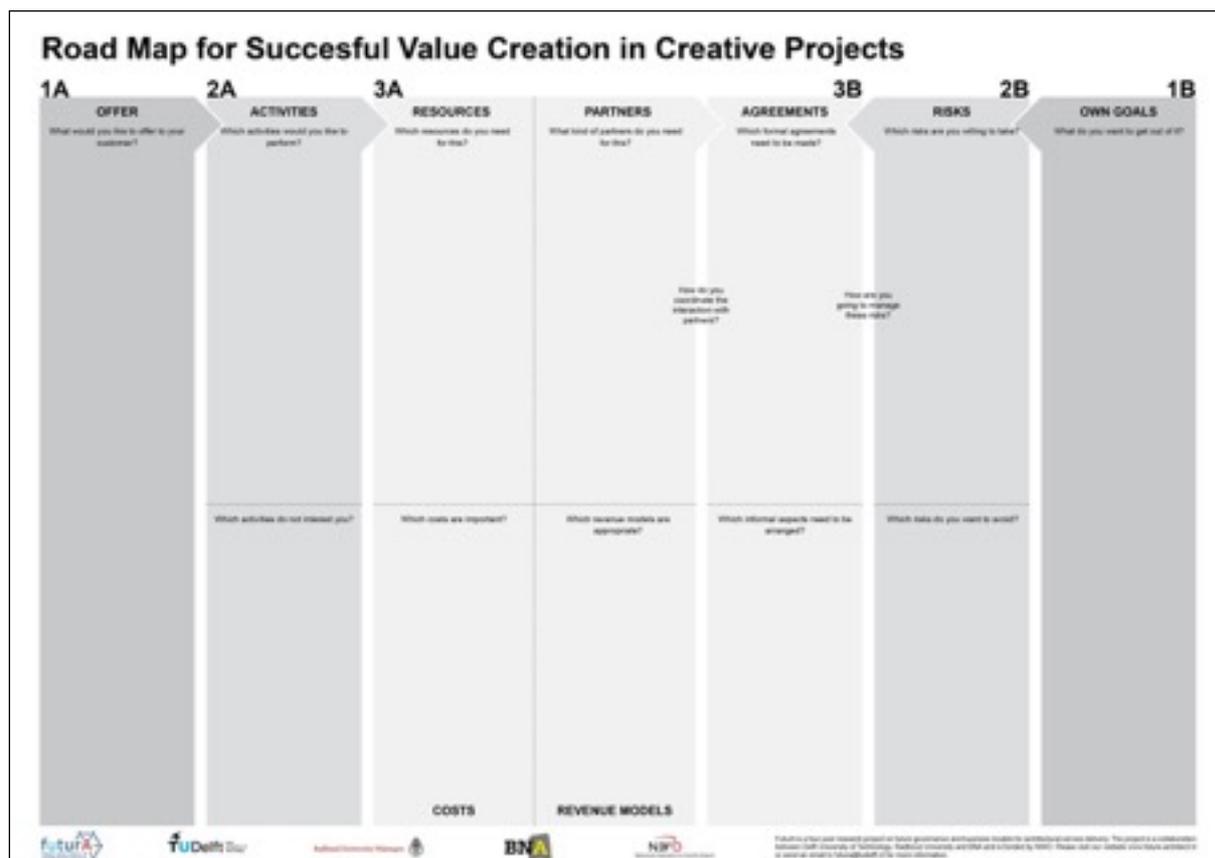


Figure 2: Strategic decision making framework for successful value creation in creative projects

In the first step, questions are asked regarding the firm's value proposition and value capture goals. What would the firm like to propose to the client and what does it wish to get out of it? By filling in both ends of the framework, the user is automatically triggered to think about the relation between the proposition and the value capture goals. Do they match each other or is the firm aiming for goals that are not included in the proposition to the customer?

The second step involves the desired activities and risks by the firm. What activities does the firm wish to perform and what risk is the firm willing to take? This step is designed to make a clear connection between the proposition and the activities to enable the prioritisation of certain activities. Are all activities necessary for the proposition to the customer? The second step also connects the value capture goals with risks. This helps to evaluate if the goals are realistic.

In the third step, the user is asked to fill in the resources, partners, costs, revenue model and agreements that are needed or already given. This step specifically aims to translate the rather abstract wishes of the firm into practical solutions. It is a crucial step in the decision making process of firms as it helps to identify the essential difficulties in the project and seduces the user to think in alternative solutions. It also aims to convince the user to rethink the wishes of the first two steps to arrive at a clear and realistic approach that really matches the ambitions and organisational identity of the firm.

Discussion

This study contributes to the literature on CPSFs and architectural firms by highlighting the challenges in the business models of small CPSFs. The findings of our study offer architectural firms and other CPSFs both knowledge and tools to improve their business strategies. With the development of a decision making framework for successful value creation in creative projects, the study specifically adds to the fields of construction management and project management and helps CPSFs within the built environment to improve their strategizing activities in order to enhance financial and professional performance.

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