DOI: 10.17747/2618-947X-2024-4-368-372

Transformation of business models through dynamic organisational capabilities

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Abstract

In this paper we look at the application of the theory and practice of dynamic capabilities of companies that adapt their current resources and competences. We review the Concept of Dynamic Capabilities that is developed by D.J. Teece, and discuss the context of the resource-based view and the Concept of Key Capabilities. In the article we highlight the three main components of dynamic capabilities: the sensory capabilities, the capacity to learn and strategic agility.

The main part of the work includes an illustrative case of *Netflix's* business transformation and the decline of *Blockbuster Video*. We take a closer look at the development of *Netflix* – its key business innovations in 'delivering' content to the customer and the collapse of *Blockbuster Video* – the reasons for its inability to sense the changing business environment.

The conclusions of the cases are discussed through the prism of the three components of dynamic capabilities. We highlight which of these enabled the company to transform, develop new key capabilities and build competitive advantage.

Keywords: dynamic abilities of the company, business model, resource approach, key competencies.

For citation:

Semenov P.O. (2024). Transformation of business models through dynamic organisational capabilities. *Strategic Decisions and Risk Management,* 15(4): 368-372. DOI: 10.17747/2618-947X-2024-4-368-372. (In Russ.)

通过组织动态能力业务模式的转变

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简介

文章论述了企业应用动态能力以调整其现有资源和能力的理论与实践。文章考虑了基于 D.J. Teece著作的动态能力概念，概述了基于资源方法和关键能力概念的动态能力背景。强调了动态能力的三个重要组成部分：感觉能力、学习能力和战略灵活性。文章的主要部分包括对 Netflix 公司业务转型和 Blockbuster Video 公司衰落的案例分析。文章分别讨论了 Netflix 在向客户 "提供 "内容业务方面的主要创新历程和Blockbuster Video的衰落，阐述了该公司忽视商业环境明显变化的原因。

我们从动态能力的三个组成部分的角度总结了这些案例的成果，指出哪些能力促成了业务转型、开发了新的核心竞争力并建立了竞争优势。

关键词: 公司的动态能力、业务模式、资源方法、关键能力。

供引用:

Semenov P.O. (2024). 通过组织动态能力业务模式的转变。战略决策和风险管理, 15(4): 368–372. DOI: 10.17747/2618-947X-2024-4-368-372. (俄文)

Modern companies are faced with the need to adapt to changing market conditions, which requires the transformation of traditional business models. Those that have failed to adapt have either lost their business altogether or are still struggling. By definition, dynamic capabilities enable an organisation to remain flexible and change both strategically and operationally. The key issue for companies is therefore to have the necessary resources and capabilities to maintain or even gain a competitive advantage at the time of the next market change. At its core, the concept of dynamic capabilities should answer the question of how a company can remain flexible and adapt to change.

The article uses the illustrative case of *Netflix* and Blockbuster Video from 2005 to 2015, primarily to qualitatively tell the story of how dynamic capabilities - their presence or absence - allow you to adapt and transform your business model in the digital era, which changes the conditions and environment of doing business. *Netflix* and *Blockbuster Video* are striking examples of companies with radically different strategies in the context of the digital revolution. The current state of these companies also reflects their ability to survive changes in the business environment.

Netflix's flexibility and willingness to innovate enabled it to take a leading position in the video rental market. Blockbuster, on the other hand, demonstrated a lack of willingness to change, resulting in a significant loss of market share. The company focused on traditional business methods and failed to move to digital platforms in time.

A key element of *Netflix's* success has been its use of user preference data to create personalised recommendations and develop its own content.

Blockbuster's reluctance to change and its conservative approach meant that it lost a significant proportion of its audience and was forced to close most of its stores. The company failed to take advantage of the opportunities offered by new technologies.

Netflix's success demonstrates the importance of dynamic capabilities and the willingness to transform in a rapidly changing market. Companies that can respond quickly to change and adopt new technologies are more likely to succeed. The key question is how to recognise that a company has dynamic capabilities and knows how to develop and apply them.

The concept of dynamic capabilities was popularised by D.J. Teece et al. in 1997 in their article 'Dynamic Capabilities and Strategic Management', which describes dynamic capabilities as the ability of a firm to integrate and exploit external and internal capabilities to conduct business in a rapidly changing environment [Teece et al., 1997]. Dynamic capabilities therefore enable new innovative forms of competitive advantage. The concept of dynamic capabilities originates from one of the classic and recognised approaches in the study of business strategy - the resource-based approach of R. Grant [Grant, 1991]. G. Hamel and K.K. Prahalad [Hamel, Prahalad, 1989; 1993] were also interested in the strategic analysis of companies and further developed the concept of the resource-based approach by introducing the concept of core competencies. Key competencies characterise a company in the marketplace and determine its place in the industry. A company's core competencies are the fundamental 'skills', business processes and business practices that are primarily associated with the company's success in the marketplace. The concept of dynamic capabilities does not abolish the basic resource approach and the concept of key competences - on the contrary, it becomes the next stage, defining those capabilities of the firm that allow the firm's key competences to be updated and adapted to the realities of a changing environment.

Dynamic capabilities are the ability of an organisation to identify and assess changes in the environment and then to adapt quickly and effectively to these changes using available resources and competencies. These capabilities include the ability to anticipate future challenges, develop and implement new strategies, and change existing business processes and structures to achieve sustainable competitive advantage.

Dynamic capabilities differ from static capabilities in that they involve continuous updating and improvement of the organisation's internal processes and external interactions. They help organisations not only to survive in uncertain times, but also to thrive by capturing new markets and creating unique offerings for customers.

Based on the existing literature, the author identified several key components of dynamic capabilities [Teece et al., 1997; Eisenhardt, Martin, 2000; Zollo, Winter, 2002]:

- sensory abilities:
  - the company's ability to gather and analyse information on changes in the environment (technological innovations, changes in consumer behaviour, changes in legislation, etc.),
  - effective use of monitoring and analysis systems to identify key trends and threats;
- learning abilities:
  - continuous improvement of knowledge and skills of employees through training and sharing of experience,
  - quick adaptation to new technologies and working methods;
- strategic flexibility:
  - the possibility of reviewing and adjusting the long-term strategy according to current conditions,
  - adaptive management of resources and priorities.

Let's look at the business practices of the two companies chosen for the case study: *Netflix* and Blockbuster Video, after which we can determine which components of dynamic capabilities *Netflix* used in practice and how *Blockbuster Video* ignored them.

Netflix originally started as a DVD rental by mail service, a business model that allowed customers to order films without having to visit a store. However, the company's management realised that the future belonged to digital technologies and streaming [Hastings, 2020]. The transition to the streaming format began in 2007 when *Netflix* launched its first online video streaming service. Initially, users could watch a limited selection of movies and TV shows, but the content library was gradually expanded. This was a risky move as it required significant investment in infrastructure and content licences, but it has proved extremely successful. With the rapid development of the internet and the rise of smartphones and tablets, *Netflix's* streaming platform has become incredibly popular. This article shows how this strategy has affected Netflix's financial and operational performance.

One of the key elements of *Netflix's* success has been its personalisation and recommendation algorithms. The company has begun to actively use data on user preferences to create customised offers. Each customer receives recommendations based on the movies and TV shows they have watched, ratings and other behavioural parameters [Hastings, 2020]. *Netflix's* algorithms are based on complex mathematical models and artificial intelligence. They analyse a huge amount of data to understand which genres, actors, directors and plots each individual user likes. This allows customers to receive the most relevant recommendations, increasing their satisfaction with the service and time spent on the platform. *Netflix* also uses A/B testing to improve the interface and functionality of its website and apps. This allows the company to continually improve the user experience and increase conversion to views, which drives revenue.

Creating original content was the next step in *Netflix's* evolution. The company realised that relying on third-party producers could limit its options, so it decided to start producing its own shows and films. The first major success was the series House of Cards, released in 2013. It received numerous awards and positive reviews from critics, confirming the correctness of the strategy chosen. After that, *Netflix* began investing heavily in the creation of original projects such as 'Stranger Things', 'The Crown' and many others.

Original content has allowed *Netflix* to differentiate itself from its competitors and attract new subscribers. It has also given the company full control of the rights to these projects, allowing it to monetise them in a variety of ways, including international sales and licensing.

Table
Financial performance of *Netflix* and *Blockbuster*, 2005–2015 (mln USD)

Годы	*Netflix*	*Blockbuster Video*
	Revenue	
2005	682	5.720
2006	997	5.530
2007	1.205	5.150
2008	1.365	4.970
2009	1.670	4.050
2010	2.163	3.240
2011	3.205	2.820
2012	3.609	N/A
2013	4.374	N/A
2014	5.505	N/A
2015	6.779	N/A
	Net profit	
2005	49	520
2006	67	50
2007	83	–37
2008	116	–101
2009	115	–518
2010	161	–128
2011	226	N/A
2012	–39	N/A
2013	112	N/A
2014	267	N/A
2015	123	N/A

Sources: Blockbuster Inc SEC Filing 10-K Annual reports, 2005-2011: https://last10k.com/sec-filings/bliaq/0001193125-10-058339.htm; Netflix Inc SEC Filing 10-K Annual report, 2005-2015: https://ir.netflix.net/financials/sec-filings/default.aspx.

The shift from DVD rental to streaming, the development of personalisation and the creation of original content have become key elements in the successful transformation of Netflix's business model.

Blockbuster Video, the leader in the video rental market in the 1990s and early 2000s, focused on the physical rental of videocassettes and DVDs through its network of stores. The company had a large number of stores across the United States and enjoyed great popularity among people who preferred to rent films rather than buy them.

Blockbuster stuck to its guns even when streaming came along and the internet became ubiquitous. The company relied on its proven business model, believing that a significant proportion of its customers preferred to go to a store, choose films in person and interact with staff.

Beyond its supposed understanding of the market, *Blockbuster Video* maintained its focus on physical rentals for other, more rational reasons. Physical rentals were highly profitable, largely due to late fees. Going digital would require significant investment in IT infrastructure, marketing and operating model changes.

Despite the obvious changes in media consumption, *Blockbuster* has been slow to embrace digital services. The company considered launching an online platform but delayed the process, fearing that the shift to online rentals would reduce sales in physical stores.

In addition, *Blockbuster* has traditionally specialised in retail sales and did not have the necessary skills and knowledge to quickly master digital technologies. Either way, the company tried to enter a new market when it became clear that the world was moving to digital platforms, but it was too late. *Blockbuster* tried to adapt by launching its Total Access online service in 2004, but it failed to seriously compete with *Netflix*. Total Access offered a hybrid model combining online viewing and physical rental, which proved inconvenient for many users.

High debt and declining physical rental revenues left the company in financial trouble, making it difficult to invest in new technology. Blockbuster's conservative approach eventually led to bankruptcy in 2011[1]. The company failed to adapt to market changes in a timely manner and lost its leadership to more agile and innovative competitors such as Netflix.

To get the full picture, let us turn to the actual financial indicators of the two companies, as shown in the table.

Until 2010, *Blockbuster's* revenues were significantly higher than *Netflix's*. But *Netflix* saw steady revenue growth each year; the gap narrowed each year until *Netflix* overtook its rival in 2010. Blockbuster experienced a sharp decline in sales in 2010 and stopped publishing financial statements after going bankrupt in 2011[2]. *Netflix* has been consistently profitable since 2005, unlike Blockbuster, which started making losses in 2007.

These data clearly show how *Netflix* was able to adapt effectively to new market conditions and strengthen its position, while Blockbuster was unable to cope with the challenges of the digital age and collapsed.

So we can see how dynamic *Netflix's* capabilities were and how stagnant Blockbuster Video's capabilities were. Returning to the theoretical basis, let's look at what the components of Netflix's dynamic capabilities were and how they manifested themselves.

The ability to clearly see the trend towards the digitalisation of society, which began in the mid to late 2010s, speaks to the company's sensory capabilities. *Netflix's* management was able to identify the gradual shift in consumer behaviour from 'physical' to 'digital' and began to rapidly develop IT capabilities. The company also kept abreast of the technological innovations of the time and understood that the spread of the internet to all segments of the population in developed countries, as well as the increasing availability of personal devices, was opening up a new way of consuming content.

According to the company's management, in particular *Netflix* co-founder and CEO R. Hastings, the company would not have been successful without the ability of almost all *Netflix* employees to learn. In his book 'No Rules Rules', Hastings states that a company's ability to learn as a whole depends on its ability to listen and take feedback from customers. All decisions are made on the basis of what is most convenient and beneficial for users. As mentioned earlier, the company is constantly experimenting, testing new things and getting feedback from customers. In this way, *Netflix* not only learns but also keeps its finger on the pulse of the market, which has allowed it to move to a new business model from the very beginning.

If we develop the idea of learning, we should note separately the most important competence of the company - working with customer data, which allows it to implement technological solutions that enable it to provide customers with appropriate content. This means that the company not only learns itself, but also trains its systems and algorithms. This is one of the company's key competencies.

The final important component of dynamic capabilities, as mentioned earlier, is strategic flexibility. This capability is clearly demonstrated by *Netflix's* decision to move to in-house content production. The company's overall flexibility, ability to identify market trends and organisational learning has enabled it to implement its own video content production processes, allowing it to become more strategically independent of

[1] Ash A. (2012). How Blockbuster went from dominating the video business to bankruptcy. Business Insider.

[2] A timeline: The Blockbuster life cycle (2012). https://www.forbes.com/2010/05/18/blockbuster-netflix-coinstar-markets-bankruptcy-coinstar_slide.html.

content providers. In this way, the company became not only a platform but also a production structure. It also opened up new revenue streams for the company.

Thus, the combination of key competencies in the form of working with customer data and creating original content based on the same data about customer preferences creates a strong competitive advantage. However, the author believes that all of this is built on a strong foundation of the company's dynamic capabilities.

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The article was submitted on 03.12.2024; revised on 21.12.2024 and accepted for publication on 22.12.2024. The author read and approved the final version of the manuscript.
文章于 03.12.2024 提交给编辑。文章于 21.12.2024 已审稿。之后于 22.12.2024 接受发表。作者已经阅读并批准了手稿的最终版本。