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Business Model Innovation: The Role of Enterprise Risk Management and Strategic Agility

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ABSTRACT
Changing business environment create uncertainty and risks to the companies. In the such situation, companies need to innovate their business model innovation to enhance their competitive advantage and increase their financial performance. Business model innovation is an important key for companies to respond the changes in the business environment. Enterprise risk management and strategic agility have important role to business model innovation in the companies in the changing business environment. This paper will elaborate and describe the relationship between enterprise risk management, strategic agility, business model innovation and financial performance especially in the changing business environment. The study conducted through literature review. Based on the literature review, the result shows that in the uncertain and risky business environment, enterprise risk management has positive influence to strategic agility and business model innovation, strategic agility has positive influence to business model innovation, and then business model innovation creates positive impact to the company financial performance.

Keywords: *Business Environment, Business Model Innovation, Enterprise Risk Management, Strategic Agility, Financial Performance.*

1. INTRODUCTION

Digital technology disruption, regulatory changes, new business models and new competitors create rapid changes and increase uncertainty in the business environment [1]. Shocks and ‘black swans’ become the norm, especially when fundamental technological breakthroughs occur and when economic and monetary policies begin to reach uncharted territory [2].

Environmental uncertainty refers to the condition that reflects the lack of accurate information and difficulty to understand about the changes of micro and macro factors of the company in business environment [3]. There are three types of uncertainty, those are uncertainty about the environment changes, uncertainty about the impact of the changes to the company position in the market, and uncertainty about what actions the company should do [4].

The uncertain, complex and difficult to predict business environment is known as VUCA. The term VUCA refers to volatile, uncertain, complex and ambiguous world, with turbulence in financial market, commodities and geopolitical instability [5]. The environmental turbulence at a high level can disrupt the company operation, whereas turbulence consists of uncertainty and risks faced by the company [6].

These things lead organizations to look for new techniques to maintain and improve competitive capabilities and then survive and perform in the business environment [7]. Companies capability to make improvement will be the important factor to survive and achieve the bright future [5].

The escalation of globalization in the business environment [8] or the development in technology and behavioral aspect [9] are factors that drive companies to make innovation of their established business models [10]. Established business model does not guarantee companies to survive and perform in the rapid and massive business environment changes and tight competition [10]. To respond uncertainty and volatility in the changing business environment, business model innovation has been acknowledged as an important way for companies to enhance their performance [11]. Companies need to review and renew their business model continuously to maintain and increase their competitive advantage [12].

Implementation of enterprise risk management and company strategic agility are also important keys for the company to face the changing and uncertain business environment. Enterprise risk management is a structured and integrated method for management to manage uncertainty and business risks [13]. Meanwhile, strategic agility is the ability of the company to respond the changes by using the resources and knowledge through innovative solutions and ensure short-term and long-term competitiveness through constant business model renewal [14].

This paper will elaborate and describe the relationship between enterprise risk management, strategic agility, business model innovation, and financial performance, especially how is the role of enterprise risk management and strategic agility to business model innovation and the impact of business model innovation to company financial performance. The analysis conducted through review on previous literatures or studies about enterprise risk management, strategic agility, business model innovation, and financial performance, and the relationship among them.

Understanding their role and relationship is relevant and important because currently companies in the world including in Indonesia are facing various changes in the business environment that caused by digital technology developments and the widespread of covid-19 pandemic that could create negative impacts to the company's operations and performance, especially financial performance.

2. LITERATURE REVIEW

2.1. Enterprise Risk Management

Risk, based on ISO 31000, is the effect of uncertainty on objectives [15]. While enterprise risk is a level where the results of the company's corporate strategy can differ from what is stated in corporate objectives, or the level at which the company does not succeed in achieving the stated goals [16].

In today's highly competitive business environment, companies are faced with uncertainty that include risks and opportunities when they have to struggle to achieve intended performance [17]. By adopting a systematic and integrated approach, it is expected that company risks can be managed in an integrated manner so that they do not interfere with the achievement of overall company performance. Enterprise Risk Management encourages companies to manage their overall risks in comprehensive way, rather than managing them separately [18]. Management of each risk group in separate silo creates inefficiency because of lack of coordination between the various risk management departments [19].

Companies in their business operation face various risks, such as financial risk, strategic risk and operational risk [20]. Financial risk is potential loss as impact of economic conditions such as foreign exchange rates, derivatives, liquidity risk and credit risk [20]. Strategic risk is losses due to uncertainty faced by the organization and the losses can be related to profit or non-profit [21]. Strategic risks can arise from regulations, political barriers or technological innovation [20]. Meanwhile, operational risk is more related to problems in company business operation, such as employee fraud, company leadership, job development, information risk and product defects [20].

Risk management is an important business practice in today rapid developing and changing business environment. Companies need to take holistic and integrated approach in risk management instead of silo-based approach. Enterprise risk management is management of all risks faced by companies in systematic and integrated approach [16]. In other literature, enterprise risk management described as a management process that requires company management to identify and carry out a collective risk assessment that affects firm value and apply a company-wide strategy to manage these risks with the aim of creating an effective risk management strategy [22].

Amid various definition of enterprise risk management, there is consensus on the enterprise risk management main elements. First, managing the risks of company comprehensively is more efficient than managing the risks separately. Second, enterprise risk management covers both traditional risks and strategic risks. Third, in risk management, companies should seek competitive advantage from managing risk instead of just see risk as a problem to mitigate [18].

Both external and internal factors can cause a company fails to achieve intended corporate objectives. The example of external factors are marketplace condition, new competitors in the market, the shift of consumer tastes or incoming of new product. Other external factors are the economy condition, capital, financial market condition, and also business environment changes such as political, legal, technological, demographic and other business environments. Internal factors also can cause company fails to achieve the intended objective such as human error, fraud, systems failure, disruption of production and so on [16].

2.2. Strategic Agility

Strategic agility is a concept that can be applied in various businesses [23]. Agility emerged as an interesting key area because of the assumption that the best performing organizations are those that agile and quick to respond to changes in the external environment

[24]. Building strategic agility in a company is a way to manage invisible changes and risks faced by companies [6].

Strategic agility is a systematic approach of dynamic capabilities in achieving variation related to the composition of firm's product, process and service in the business model [25]. Strategic agility is defined as the organization's ability to look ahead, act and respond proactively to matters relating to strategy against internal weaknesses or external opportunities and threats faced by the organization [26].

There are three dimensions of strategic agility, those are strategic sensitivity, leadership unity and resource fluidity [27]. Strategic sensitivity is company ability to detect changes in business environment and to observe the incoming threats and opportunities for the company, leadership unity is company ability to make actions whereas the entire top management team support the actions, and resource fluidity is ability to orchestrate and recombine resources, knowledge, and capabilities of companies to achieve the intended results [27].

There is an objective or subjective matter whereas the objective business model refers to the contractual relationship between the company and its partners, while the subjective business model refers about where the company is related to its environment [27]. In the 21st century where the globalization, technology, innovation and diverse products make the economy borderless, companies without strategic agility will result in competitive disadvantage and declining of company performance [28].

2.3. Business Model Innovation

Business model is a means by which companies create and sustain profits or growth [29]. There is a consensus from academics that the business model consists of three interrelated dimensions, about value proposition, value creation and the value captured [30]. The value proposition explain about how the new product or service is designed and developed [31]. Value creation explain how value of product or service is created and developed in the internal company and outside of the company with customers and suppliers [30]. Meanwhile the value capture dimension refers about how companies make money [31].

Business model innovation is an approach that support companies in facing dynamic and fierce global competition [32]. Business model innovation described as the development of the new business model that is very different from the previous business model [33]. In other literature, business model innovation also defined as innovation of business model that creates new markets or disrupts the competitive advantage of competitors [29]. Then, business model innovation also described as a design about how the value developed and delivered to customers by the companies [34].

Capability of the company to recognize and anticipate relevant developments in a constantly changing environment timely and effectively is prerequisite in developing of business model innovation [11]. Business model is unlike product and service innovation because business model innovation refers to different innovation activities of the company such as processes, structures, delivery and interactions that facilitate the achievement of sustainable competitive advantages and superior performance [35]. Deeper understanding of the drivers of change is needed and companies must have capability to recognize the opportunity of innovation to their business model [10].

Business model innovation that is carried out on an ongoing basis will help companies become more successful. There are two points of view related to implementation of business model in the company. First, business model innovation that is carried out on an ongoing basis will drive company to the intended performance, because a sustainable business model innovation can create more advantages and sizes for the company, and second, it will be a disadvantage competitive position for a company to compete with competitors who continuously innovate their business model [36].

2.4. Financial Performance

Firm performance is a common term in strategic management field and in the research model is often positioned as a dependent variable. Although the term is often used in the academic literatures, it is very difficult to get a consensus about definition and measurement. The definition of the concept of firm performance may be abstract, general, and lacking or clearly defined [37].

A clear conceptualization of firm performance and the consensus about dimensions and measures is needed in the field of strategic management for better measurement of firm performance [38]. Through measurement, people can create simple numerical concepts from complex realities to facilitate communication and action [39].

Firm performance is one of the most relevant constructs in the field of strategic management [40]. 238 empirical studies using 56 different indicators related to firm performance. In general, financial performance is widely used (82%), with accounting measures of profitability being the most common choice (52%) [41].

Firm performance consists of seven facets, those are growth, profitability, market value, customer satisfaction, employee satisfaction, social performance and environmental performance [42]. Three of those facets can be classified into financial performance, those are profitability performance, growth performance, and market value performance [38]. In other literature, financial performance refers to the performance of an organization such as profitability, return on equity, return on investment, return on asset, and so on [43].

3. THE RELATIONSHIP BETWEEN VARIABLES

The relationship between the variables of enterprise risk management, strategic agility, business model innovation, and firm performance described through the conceptual model as follows :

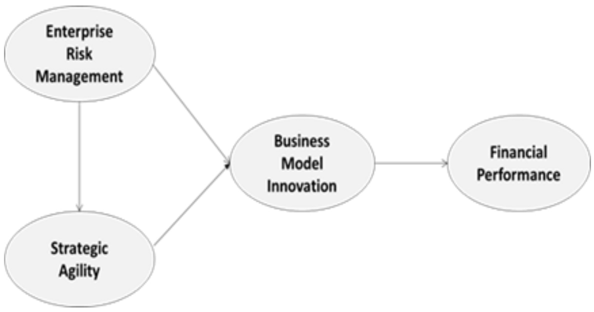

Figure 1 Conceptual Model

The conceptual model shows the relationship between enterprise risk management, strategic agility, business model innovation, and financial performance that described below.

3.1. Enterprise Risk Management and Business Model Innovation

Enterprise risk management is a structured and integrated method for management to manage uncertainty and business risks [13]. Business model innovation needs high investment whereas the investment is risky and the result is uncertain [30]. Implementation of risk management minimize the risks due to uncertainty condition in the innovation process of development and implementation of a new business model [44]. Based on the result of the previous study, enterprise risk management has positive influence to business model innovation in organizations [43].

3.2. Enterprise Risk Management and Strategic Agility

Enterprise risk management is management of all risks faced by companies in systematic and integrated approach [16]. The literature describes that organizational macro conditions has influence to risk approach in a company, related to the quantity and profitability [18]. Enterprise risk management has ability to decrease risks and then improve the company performance and subsequently increase the company value because enterprise management is an approach that systematically and consistently facilitate process to mitigate all risks of the company [45]. Based on the result of the previous study, enterprise risk management has a positive influence to strategic agility [46].

3.3. Strategic Agility and Business Model Innovation

Strategic agility is a capability in achieving continuous variations related to the composition of firm's product, process and service in the business model [25]. Strategic agility facilitates the rise of ability to create and develop the new business model [27]. Based on the result of the previous study, strategic agility has positive influence to business model innovation [30].

3.4. Business Model Innovation and Financial Performance

Business model innovation facilitates companies to develop their ideas, resources and products and then commercialize them in the new ways [47]. An effective business model innovation create opportunity for companies to generate high profit and return rather than previous established business model [48]. It facilitates companies to enhance profitability [49].

Creation of an effective business model is needed for companies to increase their competitive advantage and subsequently achieve high financial performance [35]. Based on the result of the previous study, business model innovation has positive impact to the financial performance [43].

4. CONCLUSION

Business model innovation is the important key for the companies to respond the uncertain and volatility business environment. To maintain and increase the company financial performance, companies must improve and innovate their business model continuously although they already have established business model.

Based on previous studies, enterprise risk management has positive influence to business model innovation. Enterprise risk management also has positive influence to strategic agility and strategic agility has positive influence on business model innovation. Subsequently, business model innovation has positive influence on company financial performance.

The above description underlines that enterprise risk management and strategic agility have important role to business model innovation. Enterprise risk management help company to minimize risks due to uncertainty of the investment related to business model innovation.

Enterprise risk management also support company strategic agility by mitigation of risks that disrupt company business operation to create value. Then, strategic agility increases company ability to create and develop new business model, and subsequently the new business model facilitates company to enhance financial performance.

The role of enterprise risk management and strategic agility in creating and developing business model innovation is very relevant and important for companies amid current changing business environment due to digital technology development and covid-19 pandemic. In such condition, business model innovation facilitates companies to survive and achieve the superior financial performance.

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