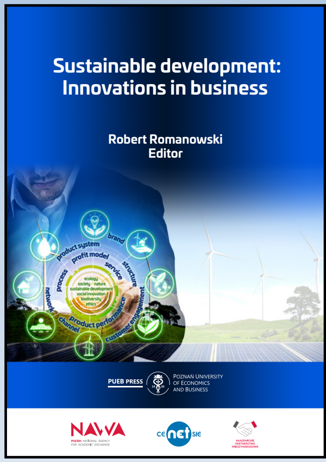

Sustainable development: Innovations in business

Robert Romanowski
Editor

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1.

BUSINESS MODEL AS AN INNOVATION

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Abstract: Business model is the way in which an organization develops relationships with their market environment and converts products into cashflow. The chapter focuses on business model as a type of economic innovation. This chapter provides a case study on CD Projekt Red company, the publisher of the *Witcher* games series. The case of the game covers three types of innovations, i.e., business model, product performance and customer engagement, and is an example of multidimensional innovation process.

The case is related to both innovation types: business models and customer experience ones. The aim of this chapter is to diagnose business model innovations on the basis of *The Witcher 3: Wild Hunt* game created by CD Projekt Red.

Keywords: business model, CD Projekt Red, customer experience, product performance, sustainability.

1.1. Introduction

“Differentiate or Die” says a slogan which is well-known among marketers and that sounds like an easy recipe for success, but in practice it becomes more and more difficult to differentiate from competitors. Market is saturated and globalisation caused that almost all companies need to compete not only with local competitors, but also global rivals. However, competition is the reason why companies are still trying to develop and to be better than others. Development is driven by competition. At the same time companies try to achieve a competitive advantage, which can be understood as a better position on the market in relation to the competitors. When a company has a competitive advantage, it can be assumed that the company does something better, which allows to achieve better results (Godziszewska, 2001). A competitive advantage can have its source inside the company—when the company is cost leader, or outside the company when it is a result of specific properties, which provide the customer with greater value (Mruk, Pilarczyk, & Sławińska, 2015). The biggest challenge for companies is that, not all companies can be the leader offering the lowest prices. Just a few of them can be cost leaders, the others need to focus on outside advantages and differentiation strategy. While differentiation strategy refers to how to be unique among the companies in the industry, the development strategy reflects the plan showing how the company will achieve that goal (Mruk et al., 2015). Both strategies are reflected in business model. Business model is a concept which links the idea and the ways of putting it into practice. Comparing business models of different companies from the same industry can give researchers knowledge about the properties that are really important and guarantee success in specific business. The aim of this chapter is to diagnose business model innovations on the basis of *The Witcher 3*: *Wild Hunt* game created by CD Projekt Red.

1.2. Theoretical background

Every company has a business model, whether that model is explicitly articulated or not (Chesbrough, 2006). Companies mention their business model in financial statements and claim that innovative business model helps achieve success. Apple, Facebook and Google are companies which are believed to be successful because of innovative business model. Also, fast fashion company Zara is considered a company which achieved success because of new business model it developed.

Although the business model concept is widely used, there is no one generally accepted definition of the term “business model”. One of the first definition was formulated by Timmers (1998), who described business model as an architecture for the product, service and information flows, including a description of various business actors and their roles; a description of the potential benefits for various business actors; and a description of the sources of revenues.

A very simple definition was introduced by Stewart and Zhao (2000), who approach the business model as “a statement of how a firm will make money and sustain its profit stream over time”. Chesbrough in his definition states that the core of the business model are two functions: creating and capturing values. A very similar definition was introduced by Osterwalder and Pigneur (2010): a business model describes the rationale of how an organization creates, delivers, and captures value. Cyfert and Krzakiewicz (2011) suggested that business model denotes an optimal way of creating value in the specific context of the organization’s functioning, and it allows to answer the questions: who the client of the company is, what kind of values are expected to be delivered and what the costs and revenues of the business are.

Morris, Schindehutte, and Allen (2005) stated that “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”. The definition by Morris et al. seems to be most useful to describe business model in fashion industry. It not only highlights the meaning of the strategy and the fact that competitive advantage is crucial, but also mentions that competitive advantage needs to be sustainable. A short term profit is no longer a value in fashion business; what really matters for the future of the company is the ability to create a long term value.

The quoted definitions can be divided into three group. The first group treats business model as a way of earning money, while the second can be described as value concerned approach. The last type of definition treats business model as a tool to create sustainable competitive advantage. Osterwalder and Pigneur (2010) not only define the business model phenomena, but also name nine blocks which create business model. They include customer segment, value proposition, channels, customer relationships, revenue stream, key resources, key activities, key partners, cost structure. A big advantage of this concept is highlighting connection between key resources in the company.

After analysing 30 definitions of business model, Morris et al. (2005) identified three kinds of business model definitions: financial, operational and strategic. Each of the three types is associated with a different area of decision taken in companies. Financial definitions define a business model as an economic model, showing how the company generates profits. In operational definitions, the emphasis is on the internal processes that enable the company to create values and decisions related to the architecture and configuration of these processes. Strategic definitions indicate aspects related to the company’s positioning, cooperation with other entities and opportunities for its development. According to Morris et al. (2005), a business model should lead to the creation of a sustainable competitive advantage of a company on a given market and take into account decision variables relating to each of the three aspects mentioned: strategic, operational and financial.

In the literature, one can find not only plenty of definitions describing what should be understood by business model, but also its many classifications. Baden-Fuller and Morgan (2010) introduced generic approach, which distinguishes four types of business model: scale models, role models, scientific models and success recipe models. Scale models accurately reproduce the objects represented, which work analogously to the original, but on a smaller scale. Role models play the role of the "original" in specific business. They emphasize the sense and idea of functioning of a given object or its location. Scientific models help to analyse similarities and differences in characteristics of the examined object. They provide the opportunity to identify, analyse and solve problems, forecast future events and reconstruct relationships between components of the business model. Success recipe models show how to run a business, its principles and the necessary components to perform tasks.

Osterwalder and Pigneur (2010) distinguished five general types of business models: unbundling, long tail, multi-sided platforms, "free" concept and open business models. Unbundling business models are divided into separate but complementary models relating to infrastructure management, creation of product innovations and shaping relationships with customers. Long tail ones are a new or additional value proposition targeted at a large number of niche customer segments that collectively generate significant profit, although serving only one of them would not be profitable. Multi-sided platforms are providing existing customers with a value proposition "providing access". In the free business model at least one substantial customer segment is able to continuously benefit from a free-of-charge offer. Different patterns make the free offer possible. Non-paying customers are financed by another part of the business model or by another customer segment.

Finally, open business models help to obtain the results of research and development works from external sources.

Moreover, the authors (Osterwalder & Pigneur, 2010) proposed the scheme, that is commonly used in defining the way in which an organization may operate on the market (Figure 1.1).

The Customer Segments Building Block defines different groups of people or organizations an enterprise aims to reach and serve (Osterwalder & Pigneur, 2010). The Value Propositions Building Block describes the bundle of goods and services that create value for a specific Customer Segment. This part of business model gives opportunity to develop sustainable attitude towards customers. The Channels Building Block describes the way in which a company communicates with, and reaches its Customer Segments to deliver a Value Proposition. The Customer Relationships Building Block describes the types of relationships a company establishes with specific Customer Segments.

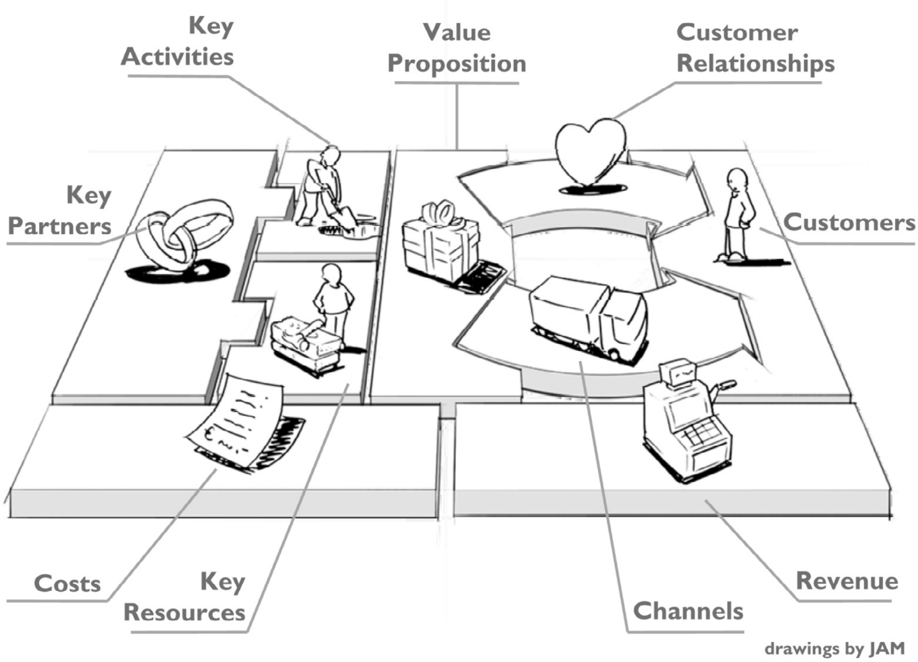

Figure 1.1. Canvas model scheme

Source: (Osterwalder & Pigneur, 2010, p. 40).

The Revenue Streams Building Block represents the cash a company generates from each Customer Segment (costs must be subtracted from revenues to create earnings). The Key Resources Building Block describes the most important assets required to make a business model work. The Key Activities Building Block describes the most important things a company must do to make its business model work. The Key Partnerships Building Block describes the network of suppliers and partners that make the business model work. The last building block, related to the Cost Structure, describes all costs incurred to operate a business model.

Although business model is clearly linked to strategy, the two concepts have some differences. Strategy research has traditionally placed emphasis on competition, value capture and competitive advantage, whereas business model studies focus more on cooperation, partnerships and joint value creation (Magretta, 2002; Mansfield & Fourie, 2004; Seppänen & Mäkinen, 2007).

1.3. Business models in gaming industry

Gaming industry is treated as cultural and creative one. Cultural and creative industries (henceforth CCIs) are defined as "those industries which have their origin in individual creativity, skill and talent and which have a potential for wealth and job creation through the generation and exploitation of intellectual property" (DMCS UK, 2001, p. 4). These industries are increasingly acknowledged as crucial to both social and economic development (Henry, 2007; KEA European Affairs, 2008; UNCTAD, 2008) and have attracted the growing interest of management scholars due to their idiosyncratic characteristics, which determine specific challenges to their management and their ability to compete (Peltoniemi, 2015).

Cultural and creative firms use multiple business models to serve different markets segments, sell different products, engage with multi-sided markets, or use different business models over time (Landoni et al., 2020). CCIs are not only a significant engine of economic growth, job creation, and social cohesion (Pratt & Jeffcutt, 2009), but also a peculiar setting characterized by new business models and able to stimulate innovation and entrepreneurship in other sectors of economy (Lampel & Germain, 2016; Messeni Petruzzelli & Savino, 2015).

Figure 1.2 shows the evolution of the video-game industry business model ecosystem based on their most recent common ancestor. The figure also depicts the evolution of characters over time. Business models are grouped together into two broad categories or families: 1) the Platform Manufacturing and Publishing, and 2) Video-game Developing. The relations among these archetypes were examined, and the focus was put on the analysis through the prism of two-sided market economics, as part of the networking literature that focuses on the intermediaries of the market (Rysman, 2009).

The business model archetypes (or species), related to video game industry, under the general name of *Electronics Manufacturing* could be grouped into two broad categories or families, i.e., the Platform Manufacturing and Publishing, and Video-game Developing, and then divided into 10 types: 1) Arcade games manufacturing, 2) Console manufacturing, 3) Console manufacturing-sales-at-a-loss, 4) Publishing, 5) Freemium-game publishing, 6) Independent game-developing, 7) Third-party game-developing, 8) In-house game-developing, 9) Second-party game-developing, and 10) Crowd-funded game-developing (Goumagias et al., 2014).

Arcade games manufacturing business model is focused on manufacturing platforms dedicated to a single game. The enterprises characterized by this business model were combining characteristics of both publishing and manufacturing in an all-in-one approach. The key partners were entertainment hubs and public houses which were the main target group of coin-operated machines similar to pinballs. Due to the increased manufacturing costs and the technological limitation, vertical disintegration was impossible during the early days of the industry (Johns, 2006).

The vertical disintegration of this family of business models set the foundations of the video-game market transformation into a two-sided one.

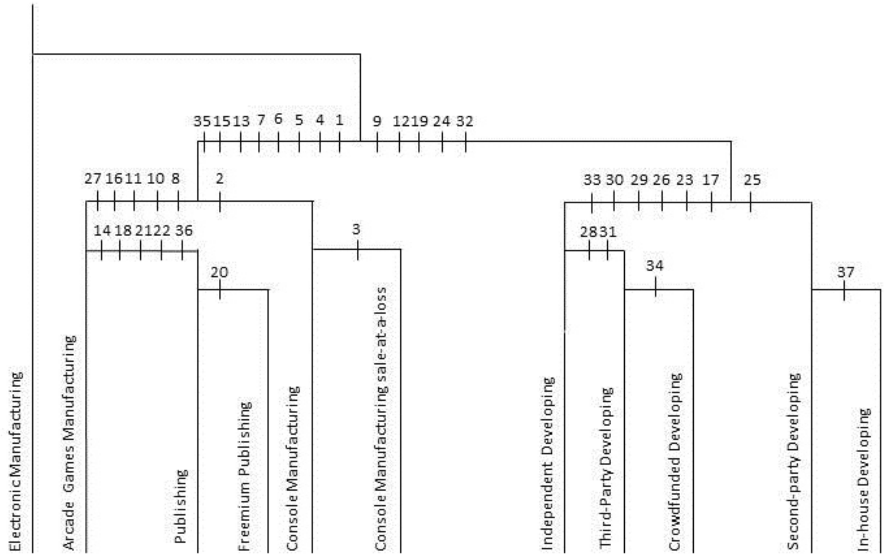

Figure 1.2. The Video-game Industry Cladogram: Business model archetypes are grouped together based on their most recent ancestor. Numbers represent the characters that have been inherited or developed through the evolutionary process.

Source: (Goumagias et al., 2014, p. 290).

Console manufacturing business model, with the advent of new technological advances that allowed for lower manufacturing costs of the new platforms, no longer dedicated to a single game, were produced. Console manufacturing business model is focused on maximizing the console sales, which is supported by games developed specifically for a given platform preventing cross-platform compatibility.

This interdependence between publishing hit-driven titles and player-base maximization was responsible for another business model (*sale-at-a-loss*), also known as *razor-blade*, which effectively entails that console manufacturing business model focuses on market infiltration maximization instead of profits (Hagiu & Lee, 2011; Evans, Hagiu & Schmalensee, 2006).

To achieve that, the business model needs to establish networks (Johns, 2006) with another business model, namely *publishing*, operating in a form of two-sided market (Rysman, 2009). It is safe to argue at this point that multi-sided markets determined the emergence of a symbiotic relationship between more than one business models (Sabatier, Mangematin, & Rouselle, 2010). This business model archetype acts as the intermediary between publishing/developing business models on the one hand and customers on the other.

The *publishing* business model is focused on revenue and profit maximization through video-game sales (physically or digitally), following a risk-averse strategy (Johns, 2006) that skews the publishing decision making heavily towards hit-driven titles. The apomorphic event took place when the business model discarded the manufacturing character and focused instead on monetisation strategies of physical and digital copies of video games (Haddon, 1999). This business model acts as the major revenue source and financially supports the console manufacturing business models in a symbiotic relationship, and the major source of funding for the Video-game developing business models. Consequently, intellectual property (IP) acquisition and creation, internally via *in-house development*, is very important for the sustainability of this business model (Johns, 2006). A specific aspect of two-sided market, which publishers currently operate in, led many publishers to follow a price-discrimination strategy, usually called *Freemium* business model (Rysman, 2009).

Video-game developing family of business models focuses on the development of original or licensed titles creating new video games for all platforms. The group consists of *Independent developing*, *Crowdfunded developing*, *Third-party developing*, *Second-party developing* and *In-house developing* business models. Their evolutionary trajectory is heavily affected by the relationship they develop against publishing business models which act as their major partners for financing and revenue streams. The major goal is survivability maximisation through production costs minimisation. To overcome these challenges, developing business models focus on the production process and key resources when it comes to business model innovation. Independent developing operates usually under the radar (Haelfiger, Jäger, & von Krogh, 2010). They employ digital distribution channels to directly sell the products to consumers, or via online markets (GoG, Steam, etc.). *Third-party developing* business models are focused on creating original titles or entering a contract with a publisher. The challenges that developing-studios face during project financing has led to the emergence of a new business model, namely *crowdfunded-developing*, which aims to attract funding directly from customers. This has initiated a series of domino effects on the production and monetization process of the games and is heavily based on the loyalty of the customer base, which is placed at the centre of production process for feedback and word-of-mouth marketing strategy.

Economies of scale usually lead *Publishing* and *developing* business models to merge or acquire competitors (Johns, 2006). *Second-party developing* business models are focused on engaging in dedicated contracts with a single publisher who acts as the financier of the project, and the final customer. The studios operating under this business model rarely enjoy production independence and are focused on a hit-driven development strategy.

Finally, *in-house development* studios are effectively owned by publishers in a strategically driven strategy to fuel IP creation, but usually they operate in a relatively more autonomous way.

Business model as an innovation is based on the way in which product could be capitalised and all the resources used to generate profit. Cultural and creative industries base on four features, that influence their profits (Landoni et al., 2020). First, it emerges the renowned tension between artistic ambition and financial gain, where in many cases the conflict is internal as many artists prefer wide distribution to profit. Second, the unique management tensions are also linked to the need to grant considerable autonomy to the creatives for the creation of new products, while at the same time preserving a clear strategic orientation of the company. Third, CCFs face significant resource constraints, as they have to manage creative processes, production processes and complex value chain relationships. Fourth, the highly symbolic content of the cultural and creative products creates other idiosyncratic difficulties and tensions: the features and characteristics of traditional goods and services can be easily demonstrated and evaluated by customers prior to sale, whereas cultural and creative products are typically experience or credence goods. The above-mentioned challenges tend to be also exacerbated by the so-called digital transformation, which is significantly reshaping the boundary of competition. These challenges were smartly undertaken by Polish game producer CD Projekt Red.

1.4. Implementing business models in gaming industry—the case of *The Witcher* series by CD Projekt Red

CD Projekt Red is a game development studio founded in 2002. Videogames, a dynamically growing branch of digital entertainment, are its main area of activity. The firm creates cutting-edge innovative entertainment and, thanks to its proprietary distribution platform, it provides gamers from around the world with access to a vast pool of releases, free of cumbersome DRM restrictions.

In order to maintain trust and acclaim among gamers CD Projekt Red pursues a diligent, open and honest communication policy, which results in sustainable products. They earn the respect of our customers through devotion and continuous personal engagement—in their private lives the owners and their employees consume electronic entertainment in the same way as those who play their games. It develops and publishes video games for personal computers and video game consoles. The studio's flagship titles include *The Witcher series of games*, *Thronebreaker: The Witcher Tales*, *GWENT: The Witcher Card Game* and the futuristic AAA role-playing game—*Cyberpunk 2077*. The enterprise business rests upon a strong dual foundation: development of videogames, carried out by CD Projekt Red, and global digital distribution, which is the domain of GOG.com. Untill the end of June 2019, over 50 million copies of *The Witcher, The Witcher 2: Assassins* *of Kings* and *The Witcher 3: Wild Hunt* were sold worldwide. Untill the end of 2020 the firm sold more than 50 000 000 copies of *The Witcher games*, achieved over 250 GOTY awards for *The Witcher 3* and over 800 awards for *The Witcher 3* (Figure 1.3).

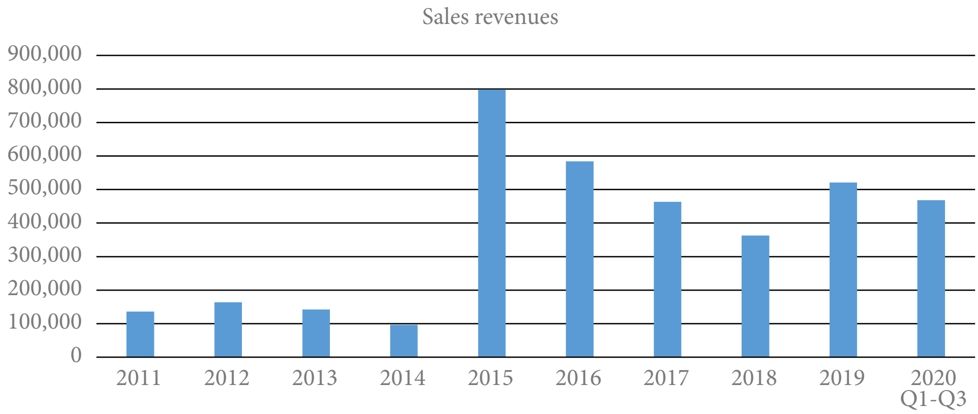

Figure 1.3. CD Projekt Red annual revenues (in thousand PLN)

Source: Own elaboration based on file taken from (CDPR, 2020).

The business philosophy of the CD PROJEKT Capital Group rests upon two pillars: uncompromising dedication to quality in the videogame and service development process, and retention of financial and creative independence. The Board regards these factors as decisive in ensuring success on the competitive global digital entertainment market.

CD Projekt Red stands apart from other major videogame developers and publishers as it emphasizes control over every stage of the game development and marketing process—from initial design, through work on technological solutions, publishing activities, promotion and distribution, all the way to community relations. This model is implemented by operating a proprietary digital distribution and online gaming platform—a part of a broad user-friendly and player-centric ecosystem (Figure 1.4).

As already mentioned, the studio's flagship title is *The Witcher* trilogy set in Andrzej Sapkowski's fantasy world. The Studio's most popular videogame—*The Witcher 3: Wild Hunt*—debuted on 19 May 2015. The game is not just a regular game, but also a sustainable product, especially in content and the way in which the firm is building the relationships with customers.

The success and endurance of *The Witcher 3* may be boiled down to a single sentence from Polygon's original review: "*The Witcher 3* makes what should have been a terrifying risk look like the most natural evolution in the world" (Gies, 2015).

Figure 1.4. Videogame development business model at CD Projekt Red

Source: https://www.cdprojekt.com/en/capital-group/business-model/

As a reaction of many players from previous *The Witcher* versions, the main goal of *The Witcher 3* was to combine the design philosophy of previous *Witcher* games, which was to create a complex and mature story that has choices and consequences, with an open world" (Maher, 2020). The firm decided to create open-world game, which is often seen as a trade-off, where the price of all that freedom is the tight storytelling from more linear games. This was a fallacy that *The Witcher 3*'s developers would try to put to rest by using the series' non-open-world roots to rework the entire open-world formula. The game holds up, five years later (Maher, 2020), so it seems like they did a pretty good job.

In order to populate these open-world environments with the narrative strength of a more restricted area—like what you'd find in the first two *Witcher* game CD Projekt Red had to think outside the box. Or perhaps it is more accurate to say the designers had to go back *inside* the box, and draw inspiration from the small but hard-hitting stories they were already known and respected for (Maher, 2020). What is unique, quests, which are usually linear in other games, could take you across the map, and can be completed in whatever order you want, across tens, if not hundreds, of hours. However, they still tie into each other, and even themselves, depend on where the player entered them. The team saw its inability to control the player as a strength, not a weakness, and leaned into it. What is important, every quest or event in the game is supported by stylish music, composed by Marcin Przybyłowicz, Mikołaj Stroiński and Percival group, and realistic nature typical for Central Europe, giving a Slavic touch in fantasy world, which is rather rare in current popculture. This kind of novelty in gaming industry could be treated as product performance type of innovation, which gives superior offering that dominates market share or earn a substantial premium.

Previously the all-time highest concurrent player count for *The Witcher 3* came at launch, on May 19, 2015. That is when SteamCharts says some 92,268 players logged in. As of publication, the new all-time high is 94,601, which was set within the last two days of December 2019. The role-playing game has also cracked Steam's top 10, coming in as the eighth most-played game (Hall, 2019) at the time of publication.

Other titles in *The Witcher* series are also seeing a bump. *The Witcher: Enhanced Edition*, the 2008 revision of the original game in the series, also cracked the top 100 most-played games on Steam according to SteamCharts. It is also at an all-time concurrent peak player count, with 12386 players in December 2019 and 12627 in January 2020 (SC, 2020), which was fuelled by the popularity of Netflix's *The Witcher* series (Nelson, 2019) starring Henry Cavill (*Man of Steel*, *Justice League*). The spike in players also coincides with Steam's winter sale, which has *The Witcher 3: Wild Hunt — Game of the Year Edition* marked down to USD 14.99 (SSP, 2019). Full price was normally USD 49.99. Using the uniqueness of Sapkowski's world and the game structure in Netflix series could be treated as storytelling strategy, increasing the customer engagement, which is described in another chapter of the book.

The price policy is the way, in which CD Projekt Red builds the relationships with customers. What is innovative, is that the firm's representatives prefer to organize revenue streams by single purchase, rather than variety of streams based on freemium business model, micropayments or other diversified sources of turnover, observed in competitor's offers. What is more, when building good relationships with customers, as in *The Witcher* games, players are often asked to make plenty of tough choices on their journey (Savage, 2018). Local disputes rarely have a clear-cut answer, and the people who wrong you, often have what is—in their minds—a good reason. You are often under pressure to do the wrong thing for the right reasons, but even doing the right thing rarely leads to a happy outcome, at least in terms of the story you are being told. The story is captivating. What is more, Sapkowski created the story based on strong men, like Geralt of Rivia, and strong women, like Ciri or Yennefer of Vengerberg, that is why many players can find themselves in proposed characters.

These are the reasons why the game is so successful and the key blocks of business model became the pattern of open-world games for single players (Table 1.1).

Table 1.1. CD Projekt Red business model for the *Witcher 3: Wild Hunt*

Business model block	Description
Customer segment	Gamers playing on platforms Win, PS4, Xbox One
Value proposition	Open world, Slavic culture with enormous nature and music, strong men and women characters, non-linear quests, no compromise for quality and details
Channels	Microsoft XBOX; Sony Interactive Entertainment; Spike Chunsoft Co., Ltd.; GOG; Valve; Cenega S.A.; Bandai Namco Entertainment; Warner Bros. Interactive Entertainment and others
Customer relationships	Relatively low price for high quality, The game was organized with some customers' advice coming from the experience of previous parts, any decision is important and can change the played scenario completely
Revenue stream	Single purchase, premiere day's sales covered the costs of production and promotion
Key resources	Sapkowski's books, Percival music, money invested
Key activities	Production based on previous game edition, enriched with motion capture technology, artificial intelligence of Geralt's opponents and open world solutions; promotion started in 2013 on Microsoft conference during E3 Fair Trade, based mainly on word-of-mouth (virus marketing) and PR
Key partners	CD Projekt Red; Spike Chunsoft Co., Ltd.; Microsoft XBOX; Sony Interactive Entertainment
Cost structure	Costs of production (lasted 3,5 years)—32 mln USD, Promotion—35 mln USD

Source: Own elaboration based on (Lewicki, 2020; Ostrowski, 2015).

The Witcher 3: Wild Hunt by CD Projekt Red was released on May 19, 2015, almost four years after *The Witcher 2* had first hit PC. By the end of summer, it had sold more than six million copies across PC and consoles. That was only a little surprising, because *The Witcher 3* is an incredible game—it was good enough, and big enough, to lure in players who had never touched the series before. The case of the game covers three types of innovations, i.e., business model, product performance as well as customer engagement, and is an example of multidimensional innovation process. The same business model was proposed to the most wanted game during Covid-19, which is *Cyberpunk 77*. But the game is not as successful as *The Witcher 3* was. But it is quite a different story.

Questions / tasks

1. Do you think this profit innovation based on price reduction in comparison to main competitors was necessary? Where do you see the main innovations?
2. Can you describe the process of innovation? Steps taken, results gained.
3. Where do you see other potential innovation possibilities for CD Projekt Red?
4. "Was it a radical innovation or an incremental innovation?" Discuss your opinion.
5. Was it sustaining or disruptive innovation? Discuss your opinion.

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