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DEVELOPING UNIQUE BUSINESS MODELS: GOING BEYOND SERVICES/SOLUTIONS

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"If I hear the call to 'innovate' one more time..."

"Innovate! Innovate! Innovate!" It's become a numbing mantra. Your company strives to innovate and differentiate, but do you have a sneaking suspicion that your buyers see less and less meaningful differentiation between your offer and that of your competitors? Is your pricing power eroding?

Take solace: you are not alone. This experience is becoming increasingly common as competitors replicate one another's product value propositions more and more quickly.

Moving from products to services might help but might not be enough

Many firms across industries are beginning to realize that they cannot maintain significant product differentiation. Any product differentiation is quickly noted and matched by competitors.

So, companies are looking for salvation from product commoditization hell in "services" or, even better, "solutions."

The move to services/solutions has its benefits. First, it provides a company with relational and informational advantages in terms of its customers. It enables a supplier to better understand and meet its customers' needs. Second, establishing deep and efficient service/solution relationships takes time and effort for both parties, thus creating switching costs for customers. Both of these advantages are essentially defensive in nature. They are a way of holding on to existing customers, a way of locking in the status quo.

A third benefit of moving to services and solutions is that it provides a longer-lasting source of competitive advantage (both for gaining and retaining customers). Successfully moving from a product-focused organization to a services/solutions organization requires a very different business model. Since business models involve every central aspect of organizational design and often require a new organizational culture, they are even harder to replicate than products or even individual firm competencies. As a result, companies' value propositions will be meaningfully and sustainably differentiated from those of competitors that are operating with a product-focused business model.

Thus, if you are looking to gain market share, ostensibly, moving to services and solutions will be especially advantageous only when fewer competitors are playing in that space. Unfortunately, many companies across a wide swath of industries are moving simultaneously from products to services/solutions. In many industries the initial profit potential of services/solutions will be reduced as businesses make this difficult transition.

An old rule in competitive strategy is: If everyone is "zigging," try "zagging." This goes for business model innovation as well. The most sustainable competitive advantage will come from unique "zagging" business models. This is not to say that the move to services/solutions is a bad idea, many firms are indeed seeing higher profit margins in this part of their business. But why not try to look for radically unique business models.

A different business model yields a more sustainable competitive advantage

Let's look at an example of a more radical business model adopted by Desso, a mid-sized European carpet tile manufacturer.

C2C is a concept of designing products made of pure subcomponents to allow for easy disassembly and endless recycling without loss of quality. It requires and offers an entirely different way of doing business.

Carpet tiles are not sexy. And when Stef Kranendijk took over, the industry as a whole was only moderately attractive. Desso was seeing very modest 1% EBITA margins on its 15% market share. Most of the players had similar business models – selling weakly differentiated carpet tiles to contractors and often competing heavily on price.

Stef decided to completely transform the business model of the firm around Cradle-to-Cradle (C2C) design. C2C is a concept of designing products made of pure subcomponents to allow for easy disassembly and endless recycling without loss of quality. It requires and offers an entirely different way of doing business.

Business model components[1]	Old business model	New business model
Target market	• Industrial contractors	• Architects • Interior designers
Value proposition	• Similar to competition • Focus on price	• More differentiated design • Health benefits • Sustainability benefits • Taking up of old carpet and new carpet at end of life • Higher end-of-life value
Key activities	• Industry-comparable manufacturing, marketing, R&D, production, sales.	• C2C production processes • Higher R&D • Deeper marketing • Advanced production processes • Deeper customer service
Key resources or competencies	• Undifferentiated	• Unique understanding of C2C implementation • Strong co-design with suppliers and customers
Key partners	• None	• Deep co-design with suppliers • Certifying organization • Co-design with architects and interior designers
Customer relationships	• Transactional	• Ongoing, with product replacement and end-of-use product pick-up
Distribution channels	• Contractors	• Architects • Interior designers
Revenue streams	• Sale of carpet	• Sale of carpet • Rental of carpet • Paid by customers to take used carpet

All of these changes required a transformation along most of the dimensions of the organization's design, from core organizational processes (e.g., deeper co-design of inputs with suppliers, tighter integration of the R&D and marketing departments; a fundamentally new design of the production processes), to new skill requirements across R&D, production, marketing and sales.[2]

The wholesale transformation of the organization and its relationships with suppliers and customers around a single design principle was, as one would expect, difficult. Internally, vested interests, established habits, skills-gaps, cynicism and a simple product-push culture all had to be overcome. Externally, relationships with existing suppliers were tested (sometimes to the limit) as higher purity standards were demanded of them, new customer relationships needed to be formed with designers and architects, who needed to be educated and inspired about a very different value proposition.

The transformation was also risky. It was an "all-in" strategic leap. There was no question of half measures; it was a bet-the-company move. There was the risk of poor or incomplete implementation. But even if it was successful, it was an untested value proposition.

The story turned out to have a happy ending. From 2007 to 2011, Desso grew its 1% profit margin to over 9% and increased its 15% market share to 23%. It is seen as an industry leader in design.

But what is perhaps the most indicative of its success is that smart college graduates are fighting to work for Desso, seeing it as an innovative, fit-for-the future and yes, sexy company in this decidedly unsexy carpet tile industry.

No competitor has pursued a similar strategy of designing an entire business model around the C2C design standard. One reason for this might be that a me-too strategy would, by reducing differentiation, effectively ruin the anticipated profit margins.

But perhaps even more critically, the preconditions for the successful transformation of a business model needed to be just right for Desso's success. For instance, the private equity owners gave Stef greater freedom to pursue a risky and long-term strategy than might have been possible in a publicly held company. And Stef himself is a pretty unique resource. He is a tireless evangelist and salesperson of C2C and Desso and has the hardheaded business acumen and experience to inspire and provide confidence in his organization. It is quite possible that another firm simply would not have the preconditions necessary for such a successful business model transformation.

Looking for a Unique Business Model

Moving to a new business model – such as from a product focus to a service/solution focus – will not provide a significant sustainable advantage if many competitors are all moving to that business model. The key for a sustainable competitive advantage is to move to a relatively unique business model in your industry.

It could be an enlightening and creative exercise to work on imagining new business models with your team. But how does one go about identifying radical new business models? The following examples from different industries could provide some inspiration:

- **Google: Non-paying users**. The advertiser-pays model is being tried in a wider range of industries. Can you develop a business model starting with the assumption that your end user will not be the one who pays?

- **Apple: Ecosystem competition**. Only the computer, the iPhone, iTunes and the huge app developer community together can create the powerful value proposition of Apple. Could you create a more fully integrated ecosystem – either through tighter integration across the value chain or by more effectively fostering and bundling complementary products? Note: This strategy works for dominant industry players; small players end up in ecosystem ghettos.

- **easyJet and Southwest Airlines: Radical yield management**. It seemed impossible until it was done. Could your firm incorporate yield management to approach 100% asset utilization?

- **REI: Customers as owners**. Employee-owned cooperatives increase performance by increasing the loyalty of the key stakeholders. Research suggests that employee-owned firms, contrary to common assumptions, generate greater total value than capital-owned firms. Could your firm evolve its ownership structure? Could you take an intermediary step of customer capital investment and profit-sharing as a kind of super-charged loyalty program? Could you add employee or customer representatives to the board?

- **NetJets: Fractional ownership.** Having a percentage share of costly assets such as small jets, cars and real estate can offer a less expensive value proposition to customers/owners. Variations of this model are spreading across a number of industries. What would fractional ownership look like in your industry?

- **Skype: Freemium offering – network effects**. When network effects are critical, it is particularly important to build a user base, perhaps by giving away your basic offering for free and then charging for additional services. Can you imagine such a model in your industry?

- **Mobility CarSharing: Automated customer interface**. Airlines, hotels, car rentals, travel agencies, insurance, grocery stores, container shipping and many other industries are seeing the rise of this lower-cost and sometimes lower-hassle value proposition. This model is spreading across industries. Has it reached yours? Could you envision this being attractive to certain customer segments in your industry?

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Moving toward a unique business model within your industry can hold out promise for long-lasting sources of competitive advantage.

- **Intrade: Market-making – network effects**. Intrade is an internet-based betting system. It builds a more liquid, lower transaction-cost, simplified market mechanism and takes a cut on every transaction. Can you identify incomplete or inefficient markets somewhere in your industry system that your firm could address?
- **P&G Children's Safe Drinking Water Program: Cross-sector collaboration.** This business model is especially interesting in bottom of the pyramid contexts where basic needs are going unmet because no single player can meet the need. Companies that can take the lead in building successful cross-sector partnerships can create markets for their products and services that would not have existed otherwise. Note: Building cross-sector partnerships is especially challenging, but is also extremely difficult to copy.
- **Holcim alternative fuels for cement manufacturing: Multiple revenue streams. Suppliers pay**. With the increasing cost of raw materials as well as the increasing cost of waste stream disposal, more and more companies across multiple industries are looking to get paid for taking other industries' waste streams and using them as a negative cost input to their own products. Try imagining a profitable business model in which your customers do not pay.

References

[1] Modified from Osterwalder, Alexander, Yves Pigneur, and Tim Clark. *Business Model Generation: A Handbook for Visionaries, Game Changers, and Challengers*. Hoboken, NJ: Wiley, 2010.

[2] For a fuller description of the key levers of organizational design see Galbraith, Jay R. *Designing Organizations: An Executive Briefing on Strategy, Structure, and Process*. San Francisco: Jossey-Bass Publishers, 1995.

In Summary

Simple product differentiation is increasingly short-lived and provides highly ephemeral pricing power. Differentiation based on a unique competency will last longer, until competitors match that competency or find a substitute; many of the moves to services and solutions are based on developing new "service" competencies within a historically "product" industry. And a move to a service/solution focus does indeed require a new business model. However, in many industries, multiple firms are all moving in the same direction and could well end up with similar business models and reduced profits as a result. Moving toward a unique business model within your industry can hold out promise for much longer-lasting sources of competitive advantage. The business model can simply be a better organizational design and culture to better fulfill a value proposition or a more radical business model as seen in the Desso case as well as some of the other examples given above.

Brainstorming new business models is relatively inexpensive and it can be highly energizing. So get creative and work with your team to try imagining how you could stretch these and other business models to fit your own industry. Then, if it looks promising and you think you can successfully transform your organization to this unique and profitable business model, consider taking the leap!