Business Model Innovation

Paths to Success: Three Ways to Innovate Your Business Model

March 2009
Richard Gleed, Associate Partner, IBM Global Business Services
richard.henry.gleed@uk.ibm.com
Agenda

- Changing Business Environment
  - Summary Findings from Business Model Innovation Study
  - Business Model Innovation Framework and Best Practices
  - Getting Started
Will UK companies meet the criteria of “The Enterprise of the Future”?

- Based on the 1,130 CEO interviews, IBM’s Global CEO Survey highlights five key traits of the “Enterprise of the Future”

Core Traits of the Enterprise of the Future

1. Hungry for change
2. Innovative beyond customer imagination
3. Globally integrated
4. Disruptive by nature
5. Genuine, not just generous

- The 61 interviews carried out in the UK¹ provide an opportunity to contrast the views of UK respondents with global views

¹The geographic area analysed here is in fact UKISA: 55 interviews were carried out in the UK, and 6 in South Africa; see Appendix for further details
The Enterprise of the Future is Hungry for Change

More CEOs than ever before – 8 in 10 – anticipate turbulent change, and plan bold moves in response

- In two years the gap between the ability to manage change and the challenge ahead has **tripled**
- The number of companies reporting limited or no success has surged 60%
- Outperforming organizations are significantly better than their peers at successfully navigating change

*Difference or ‘gap’ between expected level of change needed and past success in managing change

The Enterprise of the Future is Disruptive by Nature

More than two-thirds of CEOs strongly focused on the most sustainable form of innovation – business model transformation

- More than 2 in 5 pursue business models that are more externally collaborative
- More than 1 in 5 pursue an even more disruptive path: redefining their markets, moving into or creating wholly new industries
- More outperformers (28%) choose the most difficult transformation - disrupting industries - and more (49%) choose collaborative business models
Agenda

- Changing Business Environment

  - Summary Findings from Business Model Innovation Study

  - Business Model Innovation Framework and Best Practices

- Getting Started
Top-line findings from Business Model Innovation study

1. Business Model Innovation improves margins

2. There are three distinct paths for business model innovation

3. Each of these paths (or combination) can lead to financial success; the right strategy and execution are key

4. Enterprise model innovation through collaborative innovation is the most prominent model
Business Model Innovation improves margins

Operating Margin Growth in Excess of Peers

(Compound annual growth rate over 5 years)

Source: The Global CEO Study 2006: Expanding the Innovation Horizon
There are three distinct paths for Business Model Innovation

Based on literature research and 35 best practice cases (*), we define business model innovation along three dimensions:

**Industry model (IM) Innovation**
- Innovating the industry value chain by:
  - moving into new industries
  - redefining existing ones
  - or creating entirely new value chains

**Revenue Model (RM) Innovation**
- Innovating how revenue is generated through:
  - new value propositions
  - pricing models

**Enterprise model (EM) Innovation**
- Innovating value chain roles by:
  - changing the extended enterprise to be more integrated or specialized
  - transforming networks with employees, suppliers, customers, and others

What business am I in?
making fundamental choices
Within each path, organizations adopt a set of levers to innovate their business model

---

**Business Model Innovation**

**Industry model Innovation**

**INDUSTRY TRANSFORMATION**
- Apple transformed the music industry through a new way of connecting hardware with software to download music with iPods/iTunes product & service combination
- Dell redefined the PC value chain and industry model by using a direct to customer sales model

**HORIZONTAL MOVES**
- Moving from one value chain to another, leveraging its brand across industries including airline, media and telecoms

**Revenue model Innovation**

**PRICING / REVENUE MODEL**
- Gillette innovated the pricing model by giving away razors and making money on the blades
- Netflix shifted the revenue model from product / rental based to a subscription based annuity model

**VALUE PROPOSITION**
- Cirque du Soleil reconfigured offering and value elements to transform the circus experience

**Enterprise model Innovation**

**INTEGRATION**
- Zara’s Fast Fashion model is supported by a highly integrated business model along its value chain

**SPECIALIZATION**
- Bharti created a highly specialized Telco business model by focusing only on its key differentiators – marketing, sales and distribution – and partnering for everything else

**EXTERNAL COLLABORATION**
- P&G’s innovative R&D collaboration model “connect & develop”, sourcing over 50% of ideas externally

---

**What business am I in?**

‘making fundamental choices’
Two key findings of the Business Model Innovation research on 35 best practice cases

1. Each of these paths (or combination) can lead to financial success; the right strategy and execution are key.

2. Enterprise model innovation through collaborative innovation is the most prominent model.
Agenda

- Changing Business Environment
- Summary Findings from Business Model Innovation Study
- Business Model Innovation Framework and Best Practices
- Getting Started
Industry Model Innovation – Industry Transformation
New models are transforming traditional industry value chains

Value Chain Transformation
- Companies are changing the “rules of the game” by challenging traditional value chains through disintermediation
- Most significant advances were enabled through the internet as new “direct models” allowed cutting out the middle man

Example: The “Dell Direct” Model

1. Direct path to the customer
2. Single point of accountability
3. Build-to-Order
4. Low cost leadership
5. Standards-based technology
Industry Model Innovation – Horizontal moves
Companies leverage assets through horizontal moves

**Horizontal Moves**

- Companies are exporting differentiating expertise / experience / assets to a comparable part of another industry value chain
- Most prominent examples are leveraging brand assets to move aggressively from one value chain to another.

Example: Virgin horizontal moves

- Music Artist → Record Company → Retailer → Consumer (Music industry)
- Manufacturer → Agent → Airline → Consumer (Airline industry)
Revenue Model Innovation – Pricing/Revenue Models
Driving shifts in underlying pricing and revenue models

Revenue / Pricing Model Innovation

- Companies are transforming the “rules of the game” in their industry by driving fundamental shifts in the underlying pricing and revenue models.
- In several industries (e.g., Media and entertainment) digitization of content has created entirely new models, such as charging for different ring tones.

Examples: Distinct Pricing and Revenue Model Innovations

**Subscription Model**
- Replacing traditional pay per individual product models with selling periodic use or access to products and services.
- Example: Newspapers & Magazines, movie rental subscription, mobile phones, pay TV channels.

**Razor & Blade Model**
- The razor & blade model (also called “tied products model”) works by selling initial master product at a subsidized price or even at a loss, and making profit on high margin consumables that are essential.
- Examples: Gillette razor/blades, Computer printer/cartridge, mobile phone/air time.

**Product to Services Model**
- Many industries see a transition from a traditional product focus to service focus, often changing the traditional dichotomy of products vs service to a continuum and alignment.
- Examples: Electronics industry, e.g., IBM replacing traditional product focus through service led “business solutions”.
Revenue Model Innovation – Value Proposition
Innovating the value proposition through reconfiguration

Value Innovation. Creating Value while Reducing Costs

- Value Innovators open new, uncontested spaces, and generate a leap in customer value
- They reconfigure factors of competition and the value they bring to the customer
- Unprecedented value propositions and therefore create completely new markets

Example: Southwest Airlines

Enterprise Model Innovation – integration / specialization
Innovating along the integration / specialization continuum

Integration and Specialization

- Integrators play in and execute their business component map completely
- Specialized players concentrate on a limited number of differentiating ‘business components’ and partner on selected non-differentiating ‘business components’

Examples: Zara (Integration) and Bharti (Specialization)

Zara is owning/driving/executing and therefore integrating all components out of the Fashion component map

Telco players like Bharti are specializing on differentiating components (like marketing, sales, distribution)
Enterprise Model Innovation – Collaboration & Partnering
Companies are redefining the “extended enterprise”

**Collaboration and Partnering**

- **Collaborators** seek collaboration in a selected number of business areas/components
- **Partnerships** and collaboration range from supplier relationships to legal joint ventures, even leading to ‘value networks’

**Collaboration partnership continuum**

---

**Example: Illy Café**

Value Network Collaboration

Network role of offering output
- Brand
- Asset
- Service
- Network
Agenda

- Changing Business Environment
- Summary Findings from Business Model Innovation Study
- Business Model Innovation Framework and Best Practices

- Getting Started
Understand the constraints

Age of Company

- Depending on age and organizational legacy, companies are pursuing different business model innovation paths
- Understanding implications will set the framework for taking decisions on both type and degree of business model innovation

Industry

- Nature of business model innovation opportunities vary by industry, depending on unique characteristics and maturity in each industry
- Understanding the nature of opportunities within – and across – industries allows identification of incremental or radical innovations

Financial Performance

- Benchmarking performance against industry peers, especially financial opportunities created through business model innovation

Leveraging the results of IBM’s research on 35 best practice BMI cases
What kind of innovation best addresses these constraints?

**Current Position & Path Selection**

- How can you leverage new / emerging business models in your industries? From other industries?
- How does new/emerging technology change the parameters?
- Are you a leader of follower when it comes to industry change?

**Revenue Model**

- Are there ways to reconfigure / re-allocated sources of revenue in your business?
- How can you sell elements of your services / offerings differently?
- How can you reconfigure value elements in your business?

**Industry Model**

- How can you select and leverage unique assets & capabilities in your business that provide competitive differentiation?
- What should you do vs where should you partner for optimal value?

**Enterprise Model**

- How does new/emerging technology change the parameters?
- Are you a leader of follower when it comes to industry change?

**Degree of Innovation**

- How does the degree of innovation relate to your industry? How will it change in the future?
- Do you have the right balance?

**Timing of Innovation**

- Do you drive change in the industry, or is it imposed on you? Lead vs follow?
- What are the disruptive technologies or models emerging today?

**BMI Path**

- Which business model innovation paths are we / should you explore?
- Which ones are most aligned with our industry, capabilities, vision?
Enterprise Model Innovation: a component-based approach

An **Accountability Level** characterises the scope and intent of activity and decision-making. The three levels used are Direct, Control and Execute.

Columns are **Business Competencies**, defined as large business areas with characteristic skills and capabilities, for example card management or payment transaction processing.

A **Business Component** supplies a capability to an enterprise: it carries out activities, using resources, applications and infrastructure to do so. Each capability should be unique and only appear once (or on occasions twice) on the map.
Enterprise Model Innovation – high level design

3 weeks
Confirm strategic direction

Strategic Direction Statement

4 weeks
Baseline current model

Current Operating Model Assessment

7 weeks
Develop target model

An integrated Target Design to deliver BMI

2 weeks
Create Change Roadmap

Outline change case and roadmap

Total = 16 weeks

Ways of working: ongoing interactions with senior management team through: 1 to 1 interviews, establishment of “war room” to show gallery of deliverables, workshops to challenge hypotheses and agree priorities
Summary

- The drastically changing industry landscape is driving the emergence of new business models

- Our Business Model Innovation Research shows that:
  - Business Model Innovation improves margins
  - Different paths of business model innovation can lead to success – the right strategy and execution are key
  - Enterprise model innovation through collaborative innovation is the most prominent model

- Companies should get started by understanding their current position, the industry and competition, and by defining and selecting future opportunities
Business Model Innovation

*Paths to Success: Three Ways to Innovate Your Business Model*

March 2009
Richard Gleed, Associate Partner, IBM Global Business Services

*richard.henry.gleed@uk.ibm.com*