Why industrial companies need to lead business model innovation

(PART 1)

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Building a better working world

If manufacturers don't have a seat at the table, they risk letting others take control of their value chains.

In brief

- Manufacturers can and should become leaders in their value chains.
- New business models based on value creation are at the center of successful growth strategies.
- When value creation opportunities demand capabilities outside core competencies, manufacturers should consider building or joining an ecosystem.

Manufacturers seeking an edge cannot rely on product-centric innovation alone. They must also develop business models to create and capture value in new ways. Combining connected products, customer knowledge and the right ecosystem of relationships can place you in the most advantageous position in your value chain.

For decades, manufacturing business models have largely focused on incremental growth through product improvement or market expansion. However, stagnating growth, market disruptions and diminishing returns from process improvements are challenging manufacturers. In response, some leading firms are broadening their innovation efforts to include their own business models.

Business model innovation can occur on many fronts, including a company's customer base or relationship model; offerings (e.g., a manufacturer expanding into services or experiences); commercial and revenue models; and core competencies. At their core, successful innovations involve a significant change in the way a firm captures, creates and exchanges value. Value can be more than financial; it may also include intellectual property, data, customer access, human capital, brand permission or other elements related to a company's position in its value chain.

Manufacturers are in a powerful position to become leaders in their value chains.1 Connected products are generating data rich with potential insights that can drive new services and new business models. Every day, competitors from inside and outside the manufacturing sector are forming ecosystems to manage, and profit from, new ways to deliver customer value. To take their seat at the table, manufacturers must be ready to reinvent their business models – or watch from the sidelines as others take control of their value chains.

Chapter 1

The need for business model innovation has never been more urgent

Overlooking the potential for new business models can create opportunities for competitors.

While manufacturing leaders know that true innovation needs to extend beyond product reinvention, they are more likely in general to turn to digital transformation efforts rather than innovating business models. The EY CEO Imperative Survey finds 70% of manufacturing sector respondents see technology and digital innovation as a transformation driver for their companies, while only 30% said the same of new business models. Contrast this with the technology sector, which is leading the way with almost twice the focus on business model innovation – and receiving significant investor credit for it.

EY CEO Imperative Survey - Percent of respondents identifying new business models as a top 3 transformation driver in their industry

Implications of moving to "as a service" business model (subscription/consumption) in the technology sector

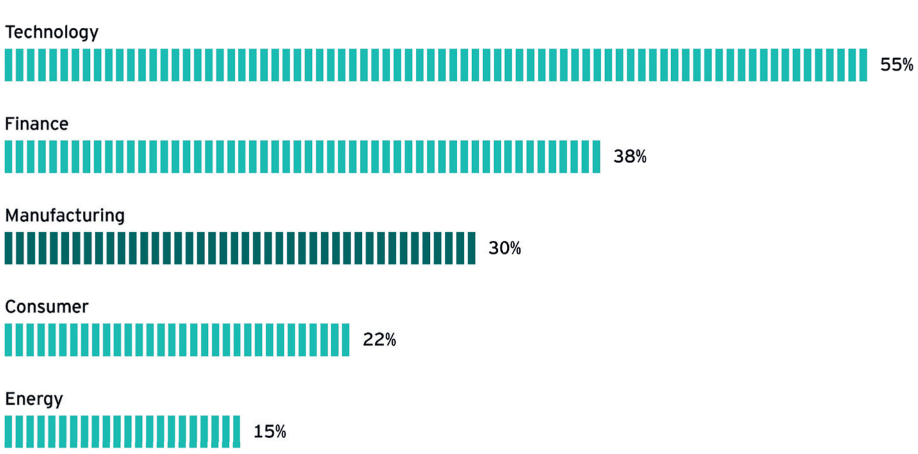
This disparity underscores a significant risk for manufacturing companies. Overlooking the potential for new business models can create opportunities for competitors from adjacent sectors. The risk is particularly acute when these new competitors are also able to capitalize on evolving customer and consumer (end user) expectations. The most successful industrial firms are already learning from consumer-oriented models in sectors such as technology and consumer.

The results of the recent EY CEO Imperative Survey, which looked at trends among "thrivers" (firms with growing revenues) and "survivors" (those with declining revenues), illustrate the importance of business model innovation and transformation more broadly to successful corporate strategy. Per the survey, 45% of manufacturing thrivers are planning business model change, compared with just 32% of survivors. Over the next three years, thrivers (45%) are almost twice as likely as survivors (25%) to be planning changes in their innovation processes. Within the same timeframe, 73% of thrivers plan to increase spending on general transformation initiatives, while only 32% of survivors indicated the same.■

(CONTINUED IN NEXT EDITION)

Figure 1

EY CEO Imperative Survey – Percent of respondents identifying new business models as a top 3 transformation driver in their industry

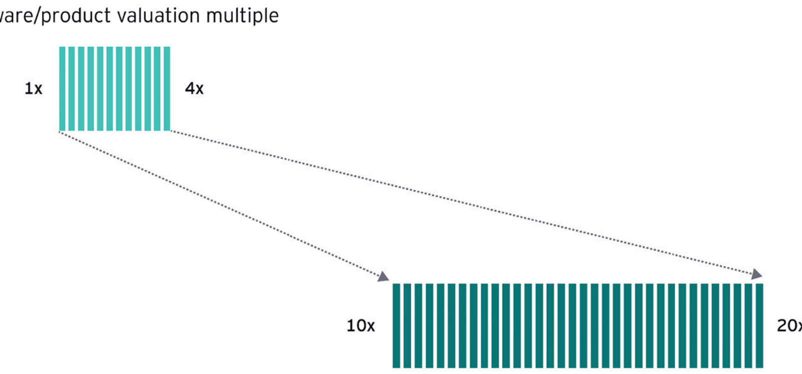


Source: EY CEO Imperative Survey

Figure 2

Implications of moving to "as a service" business model (subscription/consumption) in the technology sector

Hardware/product valuation multiple



Subscription valuation multiple

Source: EY analysis