Why industrial companies need to lead business model innovation

(PART 2)

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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.

(CONTINUED FROM PREVIOUS EDITION)

Chapter 2

Four ways to build, launch and grow an innovative business model

Manufacturers can thrive in a challenging growth environment by following these principles.

Manufacturers that want to shift from surviving to thriving need to turn their business model innovation intention into action, today. They can do so by building a foundation of innovation on four principles:

1. Strengthen relationships with customers and consumers throughout the value chain

Business model innovation begins with bringing a growth mindset to identifying, understanding and pursuing customers. While most manufacturers are naturally accustomed to considering both direct customers and consumers as key constituencies, leaders should assess all the links in their value chains to ensure a comprehensive understanding of who in the chain is creating the most value and how. Doing so helps leaders align strategic decisions and resources to the needs of constituencies that will ultimately drive revenue growth. This also helps leaders broaden their thinking beyond the immediate next link in the value chain to include a wider range of value creation opportunities.

Thriving manufacturing companies are

1.5x

more likely than survivors to identify changing customer expectations as a major market trend.

In broadening their thinking, manufacturing leaders should also transition from a product-delivery mindset to a value-generation mindset. Implementing these shifts within a company may require both structural and cultural adaptations to best generate value. Leaders must bring a fully open mind to the process of understanding their customers better — and be prepared to disrupt their own teams and structures to maximize value creation. Reorganization without full knowledge of customer needs, on the other hand, can take a company backwards in the value creation process.

Case study: Vehicle maker misses mark on new e-commerce model

A commercial vehicle manufacturer wanted to increase sales of aftermarket parts. To do so, it decided to introduce a new e-commerce business model that would sell parts directly to consumers, rather than through traditional distributor or dealership channels. The company believed that its knowledge of its own products and large base of equipment in the field would be sufficient to guarantee the new model's success. This confidence led the manufacturer to invest millions of dollars in a new digital platform to support the direct aftermarket model — yet it flopped, generating less than US$100,000 in sales in its first year.

What went wrong? While the firm's willingness to explore a new business model was commendable, it was undermined by two critical mistakes: 1) it did not fully evaluate the needs, preferences and habits of consumers (which strongly favored traditional players' broad, non-OEM-specific catalogs, personalized service and superior logistics), and 2) it did not have organizational structures and procedures in place to enable smaller, quicker business model innovation cycles. Manufacturers must know their customers well and be prepared to fail quickly for innovation to succeed.

2. Establish a presence in the value chain with the strongest market position

As threats from non-traditional competitors rise, manufacturing leaders need to focus their organizations on pursuing and owning value chain positions that offer the greatest opportunities for value creation over time — and embracing the business model innovations required to achieve these goals.

Risk of increasing competition from non-traditional competitors ranks at

#3

behind geopolitical risks and climate change, according to the EY CEO Outlook Survey.

Leaders must assess how their organization's capabilities and offerings align with the value being generated across the value chain. Reviewing one's activities through this lens can help identify whether the value being captured by the organization is properly aligned with the value created for consumers, or if there are untapped opportunities to create new value — and be recognized for it.

Many manufacturers have succeeded at business model innovation by evolving from a product-based model to a new service- or subscription-based model. These new models frequently draw on existing capabilities (e.g., aftermarket repairs and related ancillary services) while deepening or creating new customer or consumer relationships and providing unparalleled ongoing insights into how these constituencies define value.

Case study: Ball bearing company rolls into subscription services

A manufacturer of ball bearings wanted a stronger and more direct relationship with the consumers of its products — factory owners — to improve its value chain positioning. As components in large, highly complex systems, ball bearings can be undervalued as a commodity input. However, improper maintenance of ball bearings can lead to unplanned downtime from equipment failure. This disproportionate impact on what consumers valued most — uptime — helped the firm identify an opportunity for business model innovation.

The manufacturer developed a subscription-based model that positioned the company to sell a service based on the value of machinery performance rather than on the ball bearings alone. Its introduction repositioned the manufacturer in the value chain so that it could interact more directly with the consumer. This new position also afforded greater control over sales of the ball bearings, further enhancing the manufacturer's competitive position.

3. Shift revenue models from delivery of goods to delivery of value

The first two principles underscore how business model innovation can help firms rethink what value they are delivering and to whom. As the preceding case study also demonstrates, it is also critical for manufacturers to explore changes to the "how" — namely, revenue model shifts and tactics that enable them to capture their fair share of the additional value delivered to customers.

For companies to succeed at measuring and pricing value, they need access to data, supported by the right technology to capture, analyze and act on it. Connected products provide manufacturers with a prime opportunity to understand customer usage patterns and to build new offerings — and new business models — based on insights from this data. Digital transformation efforts undertaken by many manufacturers may create a foundation, but the insights that may foster real business model innovation require more than just the right toolkit. Leaders must be ready to reimagine all aspects of their business through the lens of what they know, via their own data, that the rest of the market doesn't.

Thriving manufacturing companies are

2.5x

more likely to prioritize investments in data and technology over cost reduction efforts.

When working with customer data, trust is essential. If manufacturers are to be paid based on value delivered versus units sold, customers must be willing to trust that data gathered via connected products and services will be used to their benefit as much, if not more so, than that of the manufacturer. Customers should be able to see an accounting of value generated and its alignment with prices or fees, ideally creating a virtuous cycle of openness with the manufacturer. Ongoing transparency makes it easier to identify opportunities that may be addressed by new business models.■

(CONTINUED IN NEXT EDITION)

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