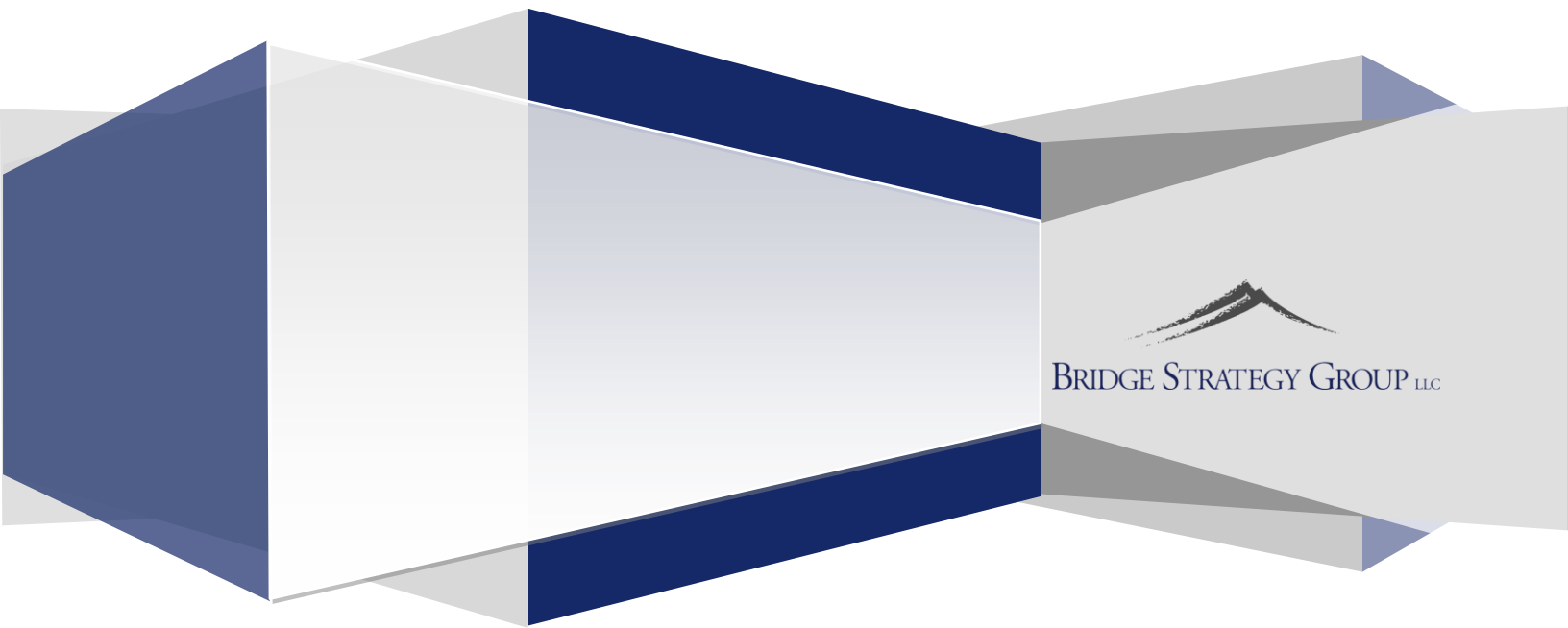


Value Creation Through Solutions

Capturing a Larger Share of the Value Chain




BRIDGE STRATEGY GROUP LLC

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Much has been written over the years about different aspects of solutions – what they are, how to organize around them, how to sell them. A critical area that clients sometimes overlook is an understanding of how solutions add value – to themselves and to their customers – and how that value is captured.

Companies that implement solutions effectively seek to reconstruct or expand their roles in the value chain and capture incremental value for themselves. Companies that don't do this well can end up creating solutions that add value for customers, but that don't add value to the company. Furthermore, a deep understanding of the mechanisms through which companies create value can help you to identify new solutions. In this article, we introduce some frameworks and questions that can assist you in your attempts to create solutions, and ensure that you are appropriately capturing your share of the value that is being created.

DRIVERS AND ENABLERS OF SOLUTION DEVELOPMENT

So why do solutions arise when they do? If the solution is such a great idea, why hasn't someone already brought it to market? It turns out that there are a few drivers and enablers that typically lead companies to create solutions. A quick review of these factors can be instructive thinking about how and when to look at solutions.

Commoditization/slowing growth: When successful new products and services emerge on the market, they are almost by definition fulfilling an unmet need, and therefore experience rapid growth. But over time, growth inevitably slows, accompanied by limited differentiation and lower profitability. Solutions can be a way to differentiate offerings and expand business with existing customers as well as broaden the potential customer base to reinvigorate profitable growth.

In the classical example of this, IBM anticipated continuing declines in hardware margins, and moved into consulting—expanding their served market to include more profitable business while deepening customer relationships. Providing enhanced value and potentially lower overall cost of ownership through consulting services helps to ensure a more effective deployment of the equipment that they are selling. More recently, Dell and HP have also made acquisitions to move into services, as they anticipate shrinking margins in the PC and server markets. GE has arguably recognized this in their medical imaging and railroad locomotive businesses, where rather than selling the product up front, they have



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created solutions that allow customers to pay on a per-use basis (per hour, per scan, etc.). By introducing these alternative financing “solutions,” GE has opened up the market for their equipment to customers that otherwise would not or could not purchase the product up front. Commoditization and slowing growth are nothing new – the long-term trend in any industry is toward commoditization. The key is to anticipate when commoditization will occur, and to proactively manage one’s response. *Do you understand the commoditization timeline in your industry, and are you proactively taking steps to counteract it?*

An important point to note is that new solutions are often not created by incumbent players. This is partly due to the entrenched thinking of the incumbents, and partly due to the realities of the business models that they must maintain to support the existing businesses. Take the case of Zipcar, which rents cars by the hour, primarily in urban settings. Prior to Zipcar, consumers could choose between taking a taxi or public transportation, renting a car for an entire day, or borrowing a car. Clearly there is a need for limited use of a car, but neither the car manufacturing companies, dealerships nor the incumbent rental firms figured this out. Any of these participants could have leveraged existing investments in inventory and physical location to offer cars by the hour, but they were unable or unwilling to think beyond their existing business models to try something different. *If you were attacking your business model as an outsider, where would you strike? From where are such attacks most likely to come? What companies in adjacent market spaces might enter your markets more directly?*

Technology: Technology can be both a driver of, and enabler for, solution development. One such example, TSMC, is a semiconductor foundry – they don’t design integrated circuits, but instead manufacture them to customer design specifications. It is a high fixed cost, volume-driven, volatile business. As technology advances, and geometries shrink, the ability to integrate the design process on the front end and the chip packaging process on the back end becomes increasingly important. Typically these steps are performed by separate vendors in the value chain. TSMC, however, is clearly moving to integrate these steps into its own value chain, thereby creating a higher-quality, higher-value added “solution” for its customers. While the physics (technology) of the semiconductors themselves drives a need for better integration, TSMC gains a competitive advantage through information technology, advanced simulation, and data-driven manufacturing process control enables that integration. The lesson here is that companies must actively be on the lookout for, and invest in, technological advancements that could disrupt their businesses and their role in the value chain. *What emerging technologies are most likely to disrupt your business? How can you leverage technology to improve your position in the value chain?*

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Environmental shocks: A third driver/enabler of solution development is a changing environment. This can take the form of regulation, price shocks (e.g., the price of oil or other inputs), political upheaval or other exogenous event. While occurrences such as additional regulations are often looked upon as stifling to business, many times they can actually create the opportunities. Ecolab, which historically sold cleaning products to places like restaurants, is a good example of this. In this case, health codes required restaurants to meet certain guidelines for cleanliness, as determined by the microbial count present in places like kitchens and bathrooms. Seeing an opportunity, Ecolab changed its business model from selling “cleaning products” to selling “cleanliness solutions.” Rather than paying for products, customers pay for a guaranteed maximum level of microbes, thus guaranteeing that they will meet the new health codes.

Similarly, Johnson Controls is able to take advantage of new regulations and grant money that is available to improve the energy efficiency of buildings like public schools. Although the schools are not able themselves to pay for infrastructure improvements, Johnson Controls can help them secure grants and loans to make such improvements by guaranteeing savings in energy. Johnson Controls has leveraged government policy and regulations to expand its role in the value chain to include financing, system integration and building operations. *How can environmental shifts, government policy and regulations create opportunities to expand your role in the value chain?*

5 WAYS YOU CAN CREATE VALUE WITH SOLUTIONS

So, how can you create value through solutions? In our experience, there are five key dimensions of solution value creation, and we will look at each in turn. A common theme that runs through these dimensions is the ability for your company to deliver an offering across customers more effectively than individual customers themselves can. Thinking about your business and your customers’ business along these dimensions can help you identify areas for solution development.

Labor/time savings: Is there an opportunity to allow your customers to outsource some of their labor, or save time? This is one of the most prevalent ways in which solutions create value. The iPod, Kindle and Tivo are all consumer devices that make it easier and faster to achieve an end result than prior methods. IBM, Ecolab and TSMC are all creating “one stop shops” that save their clients time and money. The value created is not merely the price savings that comes from bundling products and services, but rather it is increased value added through the synergies between the different components of the offering. Furthermore, these companies are creating more value by utilizing their scale across all customers. In the TSMC example, the ability to model and predict up front the interaction between the chip design and the packaging saves time and increases yield (hence lowering overall costs).

Where can you disproportionately reduce customer risk without assuming it all yourself, thereby creating value?

Content/knowledge: How can you bundle content in a different way, or provide access to content that customers can't easily get otherwise? Here again, the iPod, Kindle and Tivo are obvious consumer examples. Nothing that they provide can't be achieved a different way – but they make it easier and more convenient. In the agricultural world, a company called Telvent|DTN provides information services to farmers, primarily current prices for cash crops. By tracking local commodity prices that individual buyers have on offer, they are able to help farmers find the best prices for their products. The farmers could find this information on their own, but it would be a time-consuming process. Because they can find it all on one place through DTN, it is then a logical and easy step for them to execute the sale through DTN's system. This adds to DTN's price database and further increases the value of their "solution" though a virtuous cycle. It is no wonder that DTN has locked up a near-monopoly position in this market, and as a result they have a platform to deliver further services (like premium weather content and futures pricing analysis) to their customers.

Capital/assets: Is there a way to reduce the capital that your customers need, or to utilize capital in a more efficient way? GE is doing this in locomotives and medical imaging equipment by sharing the capital asset in a more efficient way, and letting the customer pay for actual usage (per hour, per scan, etc.), thereby reducing the capital cost of asset ownership. Zipcar operates on the same principal. The average Zipcar, for example, is driven about 35,000 miles per year. Compare that with the average of ten to twelve thousand per year for privately owned cars, and it becomes clear that Zipcar is getting much better asset utilization than a private owner would ever get. At the same time, the Zipcar customers pay less in total usage, because they are not paying for the idle asset time.

Security/reliability/risk reduction: How can you guarantee a higher quality or more consistent outcome for your customers? Where can you disproportionately reduce customer risk without assuming it all yourself, thereby creating value? By controlling more of the value chain, and by delivering results rather than transactional services, companies like Ecolab and Johnson Controls get paid to guarantee an outcome that customers can't ensure on their own. Risk is something that most companies seek to reduce, and that creates opportunities to get paid to mitigate risk for customers. If you can reduce risk, through superior knowledge, technology or processes, then you can truly create and capture value.

Value-based pricing: How can you price your goods and services to optimize the value split between you and your customers? How can you provide a lower unit price for customers, and use that pricing structure to drive incremental business? How can you leverage scale in operations, asset deployment, or other areas to optimize the value for you and your customers? The iPod/iTunes system for the first time allowed customers to buy individual tracks of their choosing, whereas previously they would not pay the full album price just to get a few songs that they wanted. Zipcar and GE lowered the per unit consumption cost for customers by similarly

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letting them pay for only the amount of the product or service that they really needed, expanding the market in the process. An important aspect of value-based pricing is to understand how value is created for different customer segments, and then finding ways to capture the segment-specific value rather than using a one-size-fits-all approach. If you can identify compromises that your current pricing creates for customers, and find alternatives that better align with customer requirements, you may be able to lower unit cost for customers but increase overall revenue and margin for your company.

TRANSLATING THEORY TO ACTION

There are many different forms that solutions can take, and many different ways that they can add value for a company and its customers. In the end, value creation comes back to the familiar strategic issues that companies have been wrestling with for years. The frameworks outlined here can help your company identify ways to create new solutions, and to modify your business model to increase the value delivered to customers. We suggest the following steps as a course of action:

1. Understand your customers, how they are segmented, and what they need; if necessary, conduct primary “Voice of the Customer” market research to refresh your point of view.
2. Define the value chain for your industry from the customers’ points of view across different market segments and understand the commoditization timeframe. Know how you and your competitors create value today and how it is likely to evolve over time. Identify potential disruptions from technology, environmental, regulatory changes and adjacent market players.
3. Use the output from the above steps as the input to an innovation process to generate new business opportunities, and then put them through a rigorous business development process.
4. Identify potential partners along the value chain that can help you more effectively deliver solutions, either through alliance, joint venture or acquisition.
5. Ensure that you capture the value potential by putting in place a process and organization that focuses on priority customer segments, evolves the offering, implements value-based pricing, manages the sales channels and is regularly on the lookout for additional opportunities.

Bridge Strategy Group has extensive experience working with a wide variety of companies across industries at each step of this process. Starting a discussion of “solution development” may initially seem like a daunting and vague task. But we believe that with the right approach and a well defined process, there is a clear pathway forward to greater value creation for you and your customers.



BRIDGE STRATEGY GROUP LLC

Bridge Strategy Group is an experience-led general management consultancy committed to helping our clients rapidly improve their business performance.

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