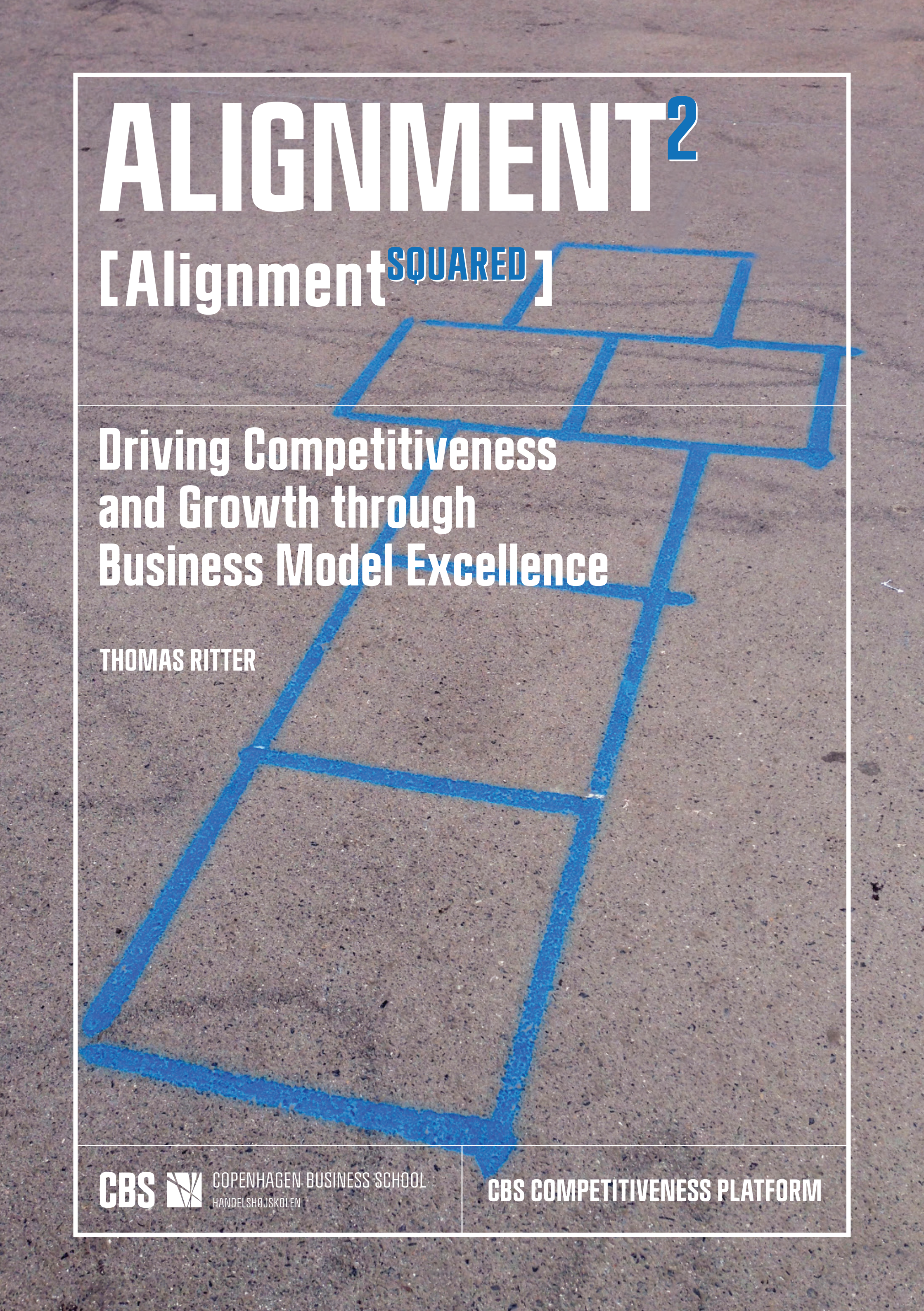
# Alignment² [Alignment Squared]

## Driving Competitiveness and Growth through Business Model Excellence

Ritter, Thomas



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## [Alignment SQUARED]

## Driving Competitiveness and Growth through Business Model Excellence

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CBS COMPETITIVENESS PLATFORM

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# ALIGNMENT$^2$

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# DRIVING COMPETITIVENESS AND GROWTH THROUGH BUSINESS MODEL EXCELLENCE

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ALIGNMENT

the proper positioning or

state of adjustment of parts

in relation to each other

(merriam-webster.com)

# PROLOG / PREFACE / FOREWORD

The concept of alignment squares emerged some 10 years ago when I was running an executive-education module for the distribution partners of a global IT company. The aim of the seminar was to improve the commercial capabilities of the partner because the global IT company could only grow when its distribution partners increased their own sales. To facilitate the “Understand Your Business” module, I developed a square with four dimensions—this basic format has survived the passage of time.

However, the dimensions of the business alignment square have matured over the years as a result of countless discussions with executives. For example, we no longer talk about “products”, and “product-service systems” or “hybrid offerings” sound rather technical. Today, firms sell their “value propositions.”

Moreover, what started as “geographical regions” and “distribution channels” have transformed into “value demonstration.” Over the course of discussions with executives from a variety of industries, it became clear that contributing to customers’ value-creation processes while appropriating value for the firm (value proposition) is very different from making a promise to the customer (value demonstration). The development of effective value demonstrations is therefore a key challenge for many firms.

Notably, the “customer” dimension is still the customer dimension. In fact, the importance of defining the customer base has not changed at all. However, our understanding of how best to describe customers and how to divide them into segments has developed over the years. The general consensus is that customers are best described in terms of their needs because those needs are directly connected to the business. However, developing accurate descriptions of customer needs is still a challenge.

In the initial versions of the square, I referred to the fourth dimension as “competences”, as the general discussion of the basis for competitive advantage still centered on the notion of firms’ core competences. However, the term “capabilities” quickly became more mainstream and the ongoing discussions of dynamic capabilities have further cemented the fact that we need to focus on capabilities.

Even when the initial versions of the business alignment squares were in their infancy, my most interesting discussions with executives centered on the connections among the dimensions. Firms often focused on important questions, such as “How good are we at combining the dimensions into one well-operating business model?”, “Who is buying what?”, “How do we interact with our customers?”, “Which capabilities do we need to communicate our value?”, and “Which capabilities secure our value propositions?”. In general we spent much more time discussing the connections than discussing the actual dimensions of their business model. Although defining the dimensions was not easy in all cases, getting the connections right and aligning the business model proved to be a greater challenge. However, success in this area offered significant gains for executives.

This book aims to illustrate how the squares can be used to discuss businesses and business models, how to analyze business, and how to structure information. It does not offer an academic review of the business-model literature, nor does it include an analysis of established models and frameworks for strategy development. A guided tour through 1-2-FOUR squares and their use is what this book is all about.

As the squares have not changed significantly in the past year, it feels “safe” to finally write this book, although I know there will be changes and new insights. I would like to thank all of the many executives who have inspired me to develop the squares, who have challenged my thoughts about business, who have provided me with examples, and who have given me access to their firms.

Writing is a creative, time-consuming process. I am therefore very thankful to my family for bearing with me and for so generously accepting the effects of book writing. Without a doubt, the alignment in our home is the most important.

Thomas Ritter

Copenhagen, September 2014

# CONTENTS

# PART I

# OBJECTIVES SQUARE

# CHAPTER 1
# A QUICK GUIDE TO THE OBJECTIVES OF THIS BOOK

Regardless of whether they are establishing startups or are sitting on the boards of well-established companies, executives often find themselves discussing their firms' competitiveness and competitive advantages. These discussions quickly expand to include the firm's business model and the changes necessary if the firm is to stay or, perhaps, to become competitive. In these "strategic discussions about strategy", executives are focused on the big issues they face in their businesses. Despite the lack of a clear, universally agreed definition of "strategic management", several questions regularly grace the pages of business journals, where they are posited to be the major strategic issues that top executives must address:

- What do we want to achieve in – and through our organization? Why does our firm or organization[1] exist? What are our objectives?
- For whom are we a valuable partner? Who are the targets and beneficiaries of our value contribution? Who are our customers?
- What do we offer? How do we contribute to customers? What is our market position? What is our value proposition?
- How do we explain our value propositions to customers? What are our sales channels? What is our go-to-market strategy? How do we approach and convince customers? Do we offer useful communication regarding our value proposition? Do our customers understand our value proposition?
- Which capabilities does our organization need in order to uncover the answers to the above questions and to deliver on the answers? How do we organize our business to ensure that we not only have the right capabilities but are also highly efficient?

All of these questions are elements of a firm's overall strategy, and they are all vital to the definition of the firm's business model. If you find these

[1] As the ideas described in this book apply to all organizations, I use the terms "organization", "firm", and "company" interchangeably.

questions interesting and want to answer them for your own organization—and if you want to work with frameworks and tools that will enhance your discussions of these issues—then this book will be valuable. Some will argue the book is about strategy, while others will say it is about business models or value-creation systems. Each of these views is perfectly correct.

In order to structure the first part of the discussion regarding competitiveness and growth through business model excellence, I have organized the above set of questions around five question words: “why”, “who”, “what”, “how”, and “which”.[2]

WHY—“Why” implies a search for a reason. In our context, the “why” focuses on the reasons for the business’s existence. In Chapter 2, we discuss the “why” and divide the answer to this question into two dimensions. These two dimensions serve as the inner square of business alignment—the fundamental core that guides all decisions related to a business. It centers on such questions as: Why are we doing this? What is the business objective?

WHO—“Who” suggests a search for a particular person or group of people. In Chapter 3, customers are added to the framework. More specifically, Chapter 3 presents a way to segment customers in order to describe and capture for whom the organization tries to contribute value in the market place, and who is expected to contribute to the organization. The fundamental difference between “Why” and “Who” in this context is that the former refers to the beneficiaries of business ownership, while the latter refers to the beneficiaries of business operation.

WHAT—“What” asks for information about something. In the strategic management context, the “what” focuses on the firm’s value proposition. In other words, what is the business selling? What does the business contribute to the customers (the “who”)? In addition to traditional terms like “products” and “services”, recent catchwords—such as “solutions”, “bundles” and “value”—attempt to capture what a business actually does provide in its transactions with customers and what it contributes to customers’ value creation. In Chapter 4, you will find tools useful for defining and developing value propositions.

HOW—“How” asks for a description of the way in which something is done. An important question for a business is how the organization can convince customers (the “who”) to buy its offerings (the “what”). How a

[2] Question words are commonly used in business model descriptions, see e.g. Abell (1980) who uses who, what and how to describe a business.

firm sells is very different from what a firm sells. Moreover, having a perfect value proposition and not selling it is a recipe for failure, nor is it a good idea to communicate a value proposition to customers that cannot be delivered. Some refer to this area as sales and marketing, while others call it key account management or go-to-market strategies. I refer to it as “value demonstration”, which nicely aligns with the term “value proposition”. Chapter 5 deals with value demonstrations.

WHICH—“Which” refers to a choice. I use Chapter 6 to discuss choices regarding the capabilities a business needs to support its value proposition (the “what”) and the value demonstration (the “how”) for its customers (the “who”). Value propositions and value demonstrations do not simply appear out of nothing—they are produced by an organization’s capabilities. The central strategic “which” question is: Which capabilities do we need to support and to protect the business?

The “who”, “what”, “how”, and “which” questions serve as a framework for describing the chosen way of fulfilling the business objective, which is the “why” question (Figure 1.1). Surrounding the business objective square, the “who”, “what”, “how”, and “which” dimensions create a square that closely describes the business model and can capture the essence of any organization.

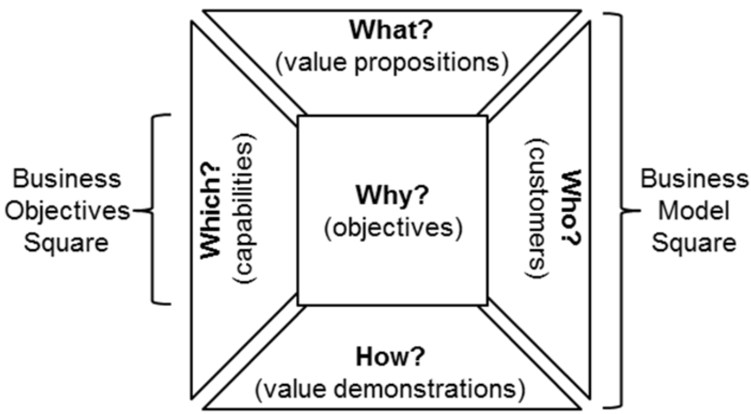



*Figure 1.1: Business Objectives Square and Business Model Square*

The above questions (illustrated in Figure 1.1) allow discussions of a business to bring its objectives in alignment with its business model.

However, a major additional challenge has yet to be resolved: How are the four different dimensions of the business model aligned? Simply making lists of important elements found in each dimension is not sufficient to ensure the success of a business. An executive's job is not only to address the essential strategic questions outlines above but also to align them. True success lies in getting the alignment among the dimensions right. As such, executives have to "square" alignment. In practice, this is done by extending the four dimensions of the business model square by its elements, which results in four alignment squares (see Figure 1.2).

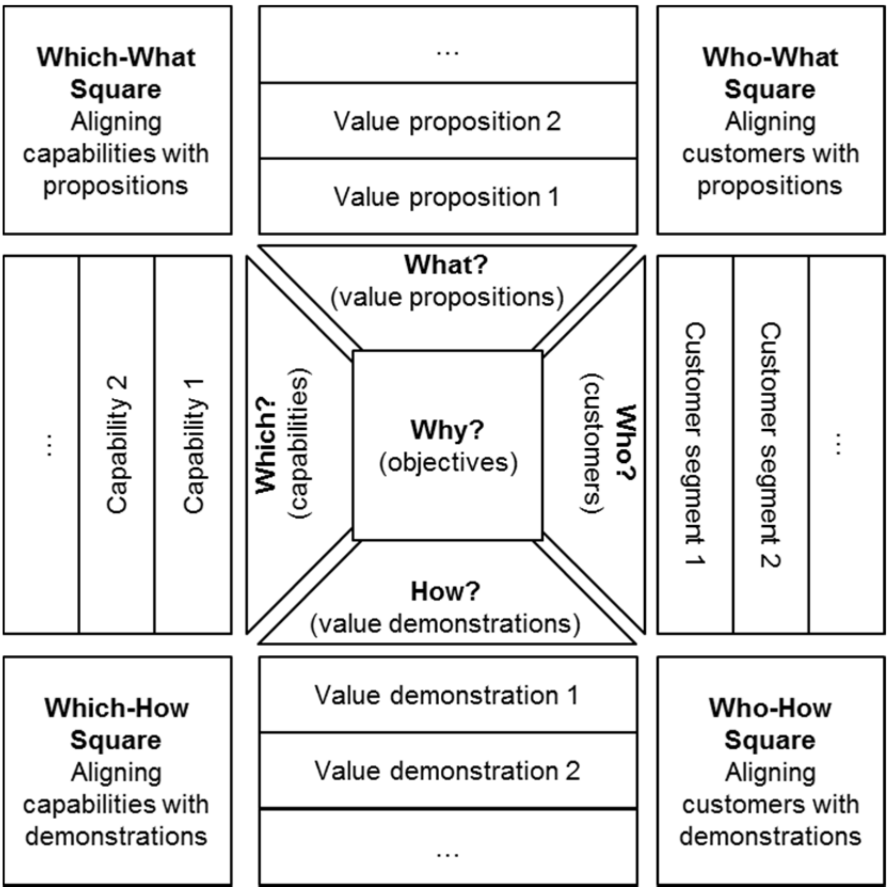



*Figure 1.2: Business Alignment Square*

Although this step seems trivial at the outset, the four alignment squares are the real challenge. Understanding and getting the alignment right leads to business model excellence and is a source of competitive advantage and growth. In other words, the challenge of a business is not restricted to answering the questions—defining the business objectives and the business model dimensions—correctly. Additionally, the challenge is to make the four dimensions and their elements work together. Therefore, the book deals with the four alignment squares in Part III, addressing one square per chapter. Part III also includes a chapter covering the business alignment square as a whole.

Throughout Part III, “business model excellence” is discussed—ways of improving a business model to ensure that the business excels. There are many terms that refer to changing an existing business into something that is hopefully better, such as “business model innovation”, “business model renovation”, “business model optimization”, and “business model development”. However, I suggest that an organization seeks excellence. This concept allows the organization to keep those parts of the business model that work and it recognizes that change is not always a good idea. It also allows for minor changes, for partial changes in just one dimension, or even for changes in just one element of one dimension. Rarely is a business model so wrong that everything has to be changed.

At the end of Part III, business alignment has been squared at three levels: an alignment of business objectives between owners and executives, an alignment between business objectives and business model, and four alignments between the dimensions of the business model. In many firms, these 1-2-FOUR squares have proven to be valuable tools for discussing the business and its development with a significant impact.

Finally, in Part IV, the 1-2-FOUR squares are applied to five highly topical issues: analyzing challenges to a business, whether executives should talk about one or two business models, globalization of business models, organizational issues, and the sourcing of capabilities.

## What is a business?

Before we embark on our journey of squaring alignment, let us consider some business basics, which in themselves can be controversial. A business is an activity or a process that turns available inputs into outputs that customers desire. As such, a business must secure the necessary inputs, it must transform the supplies into outputs, and it must commercialize the outputs (Figure 1.3). Therefore, all firms are resource integrators, and profit is determined by the difference between income (received for the firm's offerings) and costs (of resources). Executives have to orchestrate the three essential processes of procuring resources, transforming resources into offerings, and commercializing those offerings.

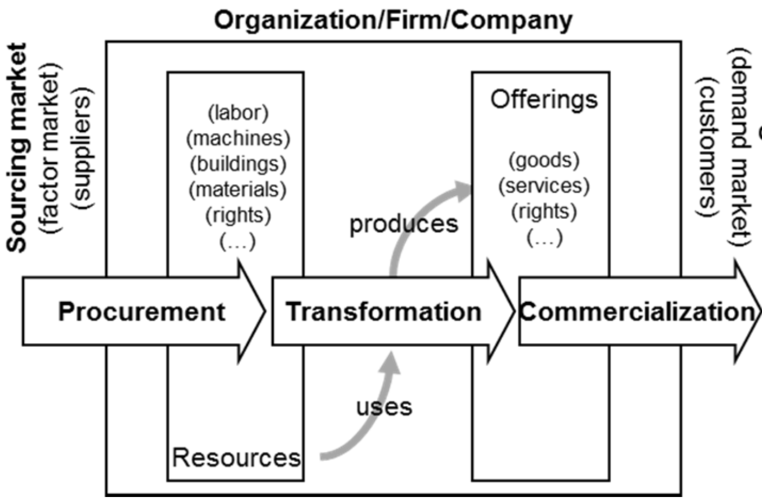



*Figure 1.3: Three Essential Business Processes*

- All resources needed in the firm must be procured. They include financial resources (e.g., money, loans, credits, or investments), human resources (e.g., employees), physical resources (e.g., materials, machines, space, and utilities), intellectual property (e.g., rights and patents), and informational resources. At the executive board level, procurement is typically represented by a chief procurement officer, while financial and human resource procurement are often represented by a chief financial officer and a chief human resource officer. This activity may also be called purchasing or sourcing.
- Resource transformation encompasses all of the processes in a firm that bundle and change the procured resources into offerings, i.e., what the firm sells to its customers. In manufacturing firms, these processes

are often called production and are headed by a chief production officer. In service firms and, increasingly, in some manufacturing firms, this area is called operations and is headed by a chief operations officer.

- The commercialization of offerings captures all processes related to understanding customer needs, convincing customers of a firm's offerings, and finalizing an agreement. This area has traditionally been referred to as "marketing" and "sales". In many firms, the term "marketing" has become narrowly related to (mass-)communication, leaving much of this third essential activity of a business uncovered. I therefore adopt the term "commercializing" for this area of business activities, which is typically represented at executive board level by chief marketing officers, chief sales officers, chief customer officers, and chief commercial officers.

Based on this simple understanding of a business, the exercise presented in Figure 1.4 offers a good basis for a fruitful discussion among executives.

One observation is that the executives within a firm may have vastly different perceptions of where the focus has been and where it should be. Another observation is that commercialization often gets the lowest numbers, i.e., the least attention. There is no natural reason for this phenomenon. In fact, it proves dangerous for a business to fail to focus on commercialization. As much as a business needs supplies (e.g., outsourcing and offshoring initiatives), efficient production (e.g., lean initiatives), and innovation (e.g., new product-development programs), it also needs customers and ways to convince customers of the advantages of buying its products or services.

In a nutshell, a business exists under the following conditions:

- There must be a customer need. Customers must have untapped value-creation potential, and view realization of that potential as beneficial. However, customers may not be aware of their need. In that case, we talk about "latent needs"—the firm has to alert customers to their existence. In addition, there must be some potential for value realization; otherwise, no accessible revenue stream is available to the firm. Therefore, the firm needs to build an understanding of what the customer values and the firm needs to continually learn about changes in the value-creation potential.

- The firm needs to have the capabilities necessary for addressing the untapped value-creation potential with a relevant value proposition.

| | Procurement | Transformation | Commercialization |
|---|---|---|---|
| **How much focus did this area have last year?** (Distribute 100%) (Give examples) | | | |
| **How excellent are we in this area today?** (1 to 10, with 10 being world class) (Give examples) | | | |
| **How much will we focus on this area next year?** (Distribute 100%) (Give examples) | | | |

*Figure 1.4: Balancing Executive Focus among Business Processes*

If the firm is unable to supply a suitable solution, customers will not be interested and the business cannot continue to exist, or start in terms of entrepreneurial ventures. Capabilities without customers are business failures.

- The firm must be able to capture value from the customer, as that is the only way to make a profit. Newspapers provide valuable information to readers, so they have no problem defining the newspaper's value contribution to readers. However, they struggle to capture value for themselves in today's world of free newspaper and Internet access.
- The firm needs to have the capabilities necessary to reach the customers in order to convince them of their value proposition. The lack of such capabilities can result in business failure, as the order books are likely to remain empty. At the very least, it results in lost opportunities, as the market potential is not realized.
- The ability to convince customers relies heavily on the superiority of the value proposition. Thus, a value contribution is not sufficient if other businesses offer "an even better deal".

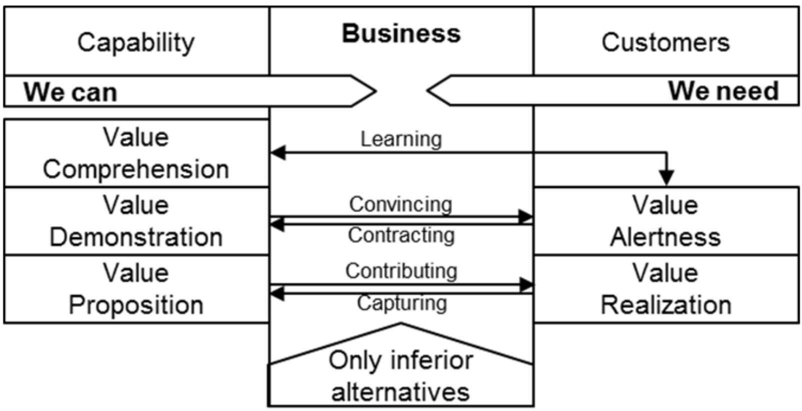



*Figure 1.4: Necessary Conditions for a Business*

## Value Co-Creation

Given the three essential processes of a firm, any business must create value along three different interfaces. This is the true meaning of "co-creating value" (Figure 3.1). There are multiple actors at each interface, and they do not all prefer the same value creation. As such, there are significant differences among the various actors that are involved in a business in some way.

First, all suppliers must create value for themselves by supplying to the business. More specifically, they must feel that there is no better alternative for them than to supply their resources to the firm in question. Likewise, every employee must feel that they are in the best job available at the time. Otherwise, he or she will resign. Every supplier of material, machines, office space, services, or other inputs must create value and believe that they have no better alternative. Second, all owners must create value for themselves—this aspect is discussed in Chapter 2. Third, all customers need to create value for themselves by interacting with the business—this is the topic of Chapter 3.

Therefore, when analyzing for whom the business is relevant, the answer will always be that the business must be relevant for all—there has always been and there must always be value co-creation. Consequently, mission statements cover all areas, as the following generic examples illustrate:

- "Our mission is to provide our customers with second-to-none offerings."
- "Our mission is to create returns on equity that are above the market average for our owners."
- "We want to create a respectful working environment for our employees in which we respect diversity."
- "We want to be the preferred customers for our valued suppliers."

In practice, mission statements often melt these different value creation perspectives together. Therefore, it is often useful to split owners and customers into two explicit groups, as the "why" question defines objectives for owners and the "who" question defines the needs of customers. There is a distinct difference between the interests of owners and the interests of customers—the latter include those that the business serves in the market, those for whom the output of the business is relevant, and those who should buy from the business.

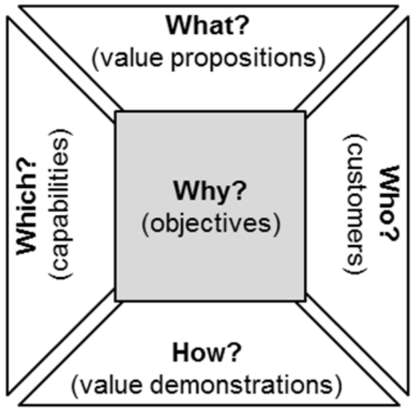
Suppliers' value creation is not forgotten in this book, but it is relegated to the final chapter. This does not imply that one area is more important than the others—all three co-exist and all three are dependent on each other.

In other words, a business will have nothing to sell if suppliers do not provide inputs and owners will gain no returns if customers are lacking. In some cases, it is difficult to decide whether a firm is a supplier or a customer. For example, airlines are customers of airports and airports make themselves attractive to airlines. However, airlines also supply passengers to airports, which are potential revenue streams for airport shops and restaurants. In summary, then, the focus is value creation, regardless of the area.

Keeping these basic conditions for a business in mind, the first square in need of alignment is the business objective square: why are the owners interested in running a particular business – what's in it for them?

# CHAPTER 2

# THE OBJECTIVES OF A BUSINESS—WHY RUN THE BUSINESS?




For people to “do business” or “invest in a business”, the business must fulfil an objective. This objective has nothing to do with customers and their needs. Rather, it is related to the business owners’ needs. The business objective covers the answer to the central question: Why are they in the game? If there is nothing in a business for the people who own it, why should they bother to run the business at all?

The fundamental goal of “running a business” is simple: to earn money or, in other words, to make a profit. Firms that do not make a profit will disappear when their funds dry up. They will most likely file for bankruptcy or simply close their doors. Unprofitable organizations become a constant pain for their owners, who must continually infuse money into them even though the main idea is exactly the opposite—to gain returns in exchange for investments and for taking business risks. Not surprisingly, the main focus of top management teams is the optimization of shareholder profit and the acknowledgement of stakeholder supremacy. In other words, executives prioritize the shareholders’ interests, recognizing the importance of pleasing owners with profits.

This simple focus becomes a bit more complicated in practice because of two factors: risk and time. Some owners are risk averse, meaning that they prefer lower risk combined with lower profitability, whereas other owners welcome more risk. Equally important is the fact that owners differ with regard to the timeframe in which they wish to optimize their return on investment. The stereotypical difference between an equity fund and a family owned business is that the equity fund likes all initiatives that aim to produce profits in a short timeframe, whereas a privately held business focuses on the long-term implications of business decisions. Given these differences, the profit orientation of the business warrants explicit discussions between the owners and the management team in order to ensure that these two groups are aligned.

In contrast to “for-profit” organizations, numerous organizations focus on a “good cause” as well as non-governmental organizations adopt a “non-profit” label. While this label allows us to differentiate these organizations from those that are “for-profit”, it implies that they employ different management tools than for-profit organizations, and that “for-profit” and “non-profit” are opposites on a scale. Both of these implicit assumptions are wrong.

First, non-profit organizations need a business model that enables them to “collect” money. They also need management and accounting tools, and they market themselves, just like for-profit organizations. Even more importantly, non-profit organizations compete with for-profit organizations for customers’ attention, time, and disposable income—consumers can choose to skip a movie night in order to support a good cause, and firms can choose to support a good cause instead of buying Christmas presents for their business contacts or shift expenses originally slated for a marketing campaign to a donation. Therefore, non-profit and for-profit organizations are highly similar. The fundamental difference is that non-profit organizations allocate the difference between turnover and costs to a good cause, rather than to the owners. The similarities between the two types of organizations suggest that the same management models and tools can be used. They also explain why managers can easily shift between these two types of organizations.

Second, “for-profit” and “non-profit” are not the extreme outer points of a scale. Rather, the two goals may co-exist for a single business.[3] Given the focus on corporate social responsibility, many for-profit organizations support “non-profit” initiatives like sponsorships for local community

[3] See, e.g., Birkinshaw, Foss, and Lindenberg (2014) on “combining purpose with profits”.

activities and donations to good causes. Likewise, many firms have adopted good citizenship and environmental protection in their mission statements and corporate values.

Therefore, the objective of an organization can be described as a combination of two dimensions: “for profit” (supporting the owners of the organization) and “for purpose” (supporting society; see Table 2.1). The latter typically relates to a specific group of people (e.g., children, the ill, the homeless), a specific place (e.g., an area with a particular environmental element, a tourist spot, a local community), or a specific subject (e.g., animals, historical artefacts). An organization’s purpose can be related to all of humanity (e.g., saving the planet by reducing $CO^2$), to a nation (e.g., maintaining a high level of security, such as in governmental agencies), to a rural township (e.g., subsidizing a local shop or school), to certain areas of interest (e.g., supporting research for a cure for Alzheimer’s disease or cancer, or a certain sport), or to animals (e.g., protecting endangered animals). Sometimes, the purpose is solely related to the owners of the business: some owners sacrifice profits for the purpose of “having a business” (e.g., they like to be owners), or for the purpose of being appreciated by peers or some reference group (e.g., they like to be sponsors).

| | **For profit** | **For purpose** |
|---|---|---|
| **Beneficiary** | Group of owners defined by their shares of ownership | Group of people defined by specific characteristics |
| **Key performance indicator** | Share value, dividends, risk | Donations, costs of operation, impact |
| **Label** | Corporate shareholder responsibility | Corporate social responsibility |

*Table 2.1: A Comparison of the Profit and Purpose Objectives*

Given this understanding of the objective of a business, every business can and must position itself within the business objectives square (Figure 2.1).

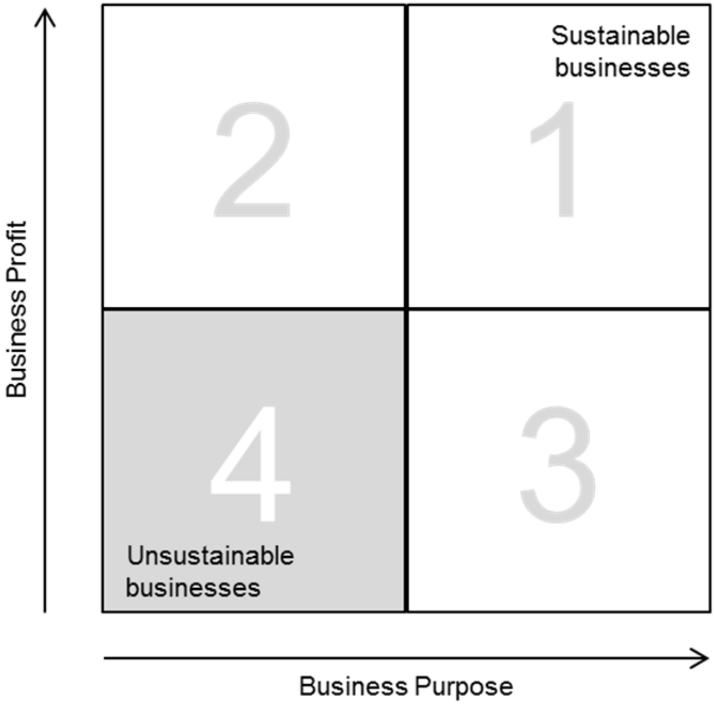



*Figure 2.1: Business Objectives Square*

Box 1: These businesses deliberately establish synergies between stakeholder interests and societal interests. Typically, family owned, privately held firms are very aware of their societal impact in terms of employment in their local communities and their contributions to local activities. They rely on local infrastructure (e.g., hotels and restaurants for meetings) and often sponsor local activities (e.g., sports clubs and community parties). Novo Nordisk, the world leader in diabetes treatment, has a long history of "triple bottom line" management (see text box).

**The Triple Bottom Line—Our Way of Doing Business**[4]
We believe that a healthy economy, environment and society are fundamental to long-term business success. This is why we manage our

[4] novonordisk.com

business in accordance with the Triple Bottom Line business principle and pursue business solutions that maximise value to our stakeholders as well as our shareholders.

In practice, this means that any decision should always seek to combine three considerations: is it financially, socially and environmentally responsible? This way, we continuously optimise our business performance and enhance our contribution to the societies we operate in.

Some businesses, or the entrepreneurs behind them, have a “calling”—something that they want to change in the world. Simon Sinek popularized this idea in his book *Start With Why*, where the “why” is the higher meaning of the business. Novo Nordisk has the mission to “change diabetes” (as opposed to selling insulin), and Richard Branson Virgin firms are known as “rebels and disruptors” of established industries (as opposed to being value-for-money competitor).

Box 4: Diametrically different from Box 1, organizations in Box 4 do not earn any profits and do not contribute to a purpose. This is the dead zone of the business objectives square. If no one benefits from the existence of a business, then the business has no reason to exist. Firms can only be in this box temporarily because this state always comes to end. If a business is in this box, it must have great and promising prospects that entice people into investing. In other words, the firm must be on its way toward the other boxes—on a tight and trustworthy schedule—if it is to succeed. Alternatively, if there is no hope of value creation for either shareholders or society, the business will eventually be dissolved.

Box 2: This box features the typical business in which a firm is concerned about creating value for its owners. Top management in these organizations is concerned about share-price development and dividends. Executives hold investor meetings and briefings, and they praise their financial results and highlight the firm’s prosperous future. If times are poor for the business, top management finds plausible explanations for the disappointing performance and presents plans for getting it right in the future. Most firms qualify for this box, as this is the typical way of running a business. In this regard, a survey of Danish firms found that 66% of top executives focus more on profits than on keeping jobs in Denmark.[5] Even those politicians who ask businesses to contribute to society and to take

[5] *Børsen*, September 4, 2013.

(more) social responsibility acknowledge that firms must be concerned with making a profit and that politicians should take care of society.[6]

Box 3: Humanitarian organizations (e.g., Red Cross, Doctors Without Borders), environmental organizations (e.g., Greenpeace, World Wildlife Fund), and interest groups (e.g., American Cancer Society, Alzheimer's Foundation) all have one aim: to support a certain task in order to improve society. Their fund-generation efforts are driven by a desire to contribute to the purpose that defines their activities. Typical objectives in this box include "maximizing funds for research", "increasing public attention on an issue", and "building and maintaining a platform for meeting like-minded people". Similarly, organizations can set operational targets that they wish to fulfil while minimizing the costs of the business. A fire department is one such business (see text box).

The mission of the Southfield Fire Department is to provide the citizens and visitors of Southfield with the highest quality of fire prevention, emergency medical case and fire protection available.[7]

The recent focus on "corporate social responsibility" has given rise to the idea that all firms are, or should be, in Box 3. However, many CSR initiatives are driven by cost-cutting interests (e.g., lower energy use supports profits), by marketing impacts (e.g., sponsorships allow the firm to market its products; for example, agreeing to sponsor the Olympic Games is not driven by societal motives), or by a need to ensure regulatory compliance (e.g., exhaust-emission limits for ships and trucks). While these initiatives support a purpose, they are not driven by purely societal objectives. Rather, they are welcomed and positive contributions that simultaneously serve the organization's obligations to stakeholders. Thus, the analysis of the business objective should avoid "nice statements" and define the true priorities for the business: profit, or purpose, or both.

Firms are not fixed in their positions within the business objectives square they can move from box to box. State-owned airlines were once typical Box 1 firms; they made money, they provided air-transport capacity when society needed it, and they directed a portion of their profits to good causes. However, when low-cost carriers with new business models

[6] *Børsen*, interview with Danish Prime Minister Helle Thorning-Schmidt (2013).
[7] cityofsouthfield.com.

emerged, incumbent airlines' profits disappeared—as did national security interests for controlling airlines. Thus, many of these airlines now find themselves in Box 4.

Organizations owned by interest groups, such as Danish Crown (owned by pig farmers), Arla (owned by milk farmers), or Coop (owned by consumers), face an interesting challenge in defining their business objective. On one hand, these firms are run like for-profit businesses, as they strive to maximize their profits in order to pay their owners. On the other hand, they must also care for their owners' broader interests in such activities as maintaining unprofitable grocery stores in rural areas in order to ensure food supplies. Such stretches are difficult to manage and create tensions because the key performance indicators in the business objectives square are inconsistent and contradictory.

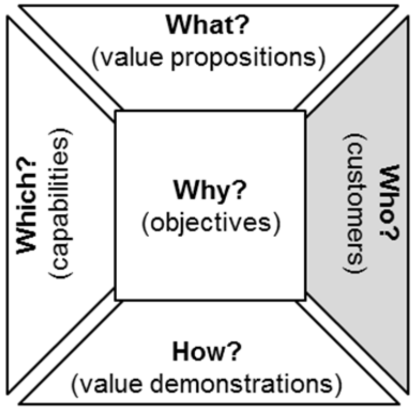
Likewise, architects often have to trade off between profits and their own artistic style. Only well-known architects can combine their own desire for fame (their purpose) with profits.

In summary, it is important to ensure agreement and consistency among owners and between owners and executives about the objectives of a business. This inner alignment must be achieved, as an appropriate business model cannot be developed without a commonly agreed objective. Thus, draw the business objective square (Figure 2.3) and fill in the key performance indicators that apply to your business. There will undoubtedly be dilemmas, contradictions, and surprising differences among those involved in these discussions. Nevertheless, this first alignment hurdle is key to ensuring business model excellence.

# PART II

# BUSINESS MODEL SQUARE

# CHAPTER 3
# THE CUSTOMERS OF A BUSINESS— WHO ARE WE SERVING?




From the firm's perspective, a "customer" is the person or persons who decide whether to accept a business's offering. Thus, a family buying a car is one customer because they make one decision. Likewise, a firm that involves various employees in a single purchasing decision is one customer because it makes one decision. The correct framing of a customer depends on the business. For example, Copenhagen Business School is a single customer for utility firms, paper producers, and copy-machine producers because these items are purchased centrally on the basis of a single decision made for the entire school. However, a textbook publisher may have more than 400 customers at Copenhagen Business School because every professor makes his or her own decisions regarding which books to use.

It is important to maintain a broad understanding of "customers" as those who are affected by the output of a business. A customer does not necessarily buy that output, nor does a customer necessarily use the products or services that a business offers.

## Customer need

When analyzing customers, firms must capture differences in customer needs through proper segmentation. If height, weight, hair color, home address, and disposable income have no or only weak correlations with customer needs and, thereby, with purchasing behavior, such descriptors are not good enough to build an understanding of the customer dimension. Similarly, in business markets, if industry classification, number of employees, the address of headquarters, or yearly turnover do not explain customers' behavior, these descriptors should not be used to understand and segment customers. In general, there is too much focus on observable variables and too little focus on meaningful variables. Moreover, the current hype surrounding big data may be misguided—big data does not always improve a firm's insight into its customers. While important information can be gained from the analysis of huge databases, the analysis of meaningless data cannot produce a meaningful understanding. This is the old "garbage in, garbage out" principle. In essence, an understanding of the needs of a customer lies at the core of the customer dimension. Customer needs are the alpha and omega for any business.

A "customer need" can be defined as the fundamental problem the customer needs to solve and the associated description of desired outcomes: a future state, an achieved goal, an accomplished task, a completed mission, a realized feeling, a solved problem, a fulfilled desire, or a job completed.[8] Examples of consumer needs include a happy life, an optimal body-mass index, a cozy home, social acceptance, a submitted income tax declaration, and a finished marathon. Firms' needs might include higher productivity, better product offerings, and success in new markets.

A customer need is not a process. Rather, it is the desired outcome of a process. Therefore, the term "customer want" is sometimes used to describe the same concept. The key issue regarding customer needs is where or how customers want to be after a process, rather than how they want to get there. For example, a need to be at a location at a certain time does not specify the process of getting there (e.g., walking, running, cycling, riding a taxi or a bus, driving a car, or taking a plane).

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[8] The job-done perspective was promoted by Ulwick (2002) and Christensen et al. (2007).

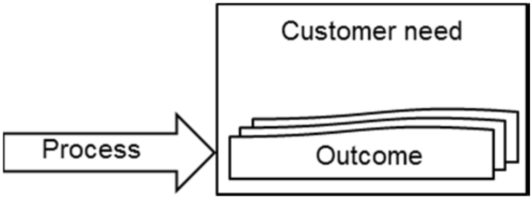



*Figure 3.1: Customer Need as a Portfolio of Outcomes*

Customers rarely have only one need, and a need rarely only has one outcome. Typically, there are several outcomes in which a customer is interested while fulfilling a need. In the transportation example above, a customer wants to be transported from her home to her office. The outcome in that case is to be at the office. Simultaneously, the customer also desires a mode of transportation that is convenient, efficient, and eco-friendly. This can be packaged into one larger customer need: the desired outcome is to be at the office after taking a convenient, efficient, and eco-friendly mode of transportation. However, this can also be described as a bundle or a portfolio of four outcomes: arrival at the office, convenience, time efficiency, and eco-friendliness (Figure 3.2). This view offers some useful insights into the trade-offs customers have to make when faced with competing outcomes. For example, eco-friendliness and time efficiency compete with each other because the fastest type of transportation is likely to be the one that pollutes the most. Thus, there can be friction between desired outcomes (indicated by arrows on Figure 3.2). Most people would like to adopt a healthy lifestyle, but they also want to use their time for activities other than cooking and exercising.

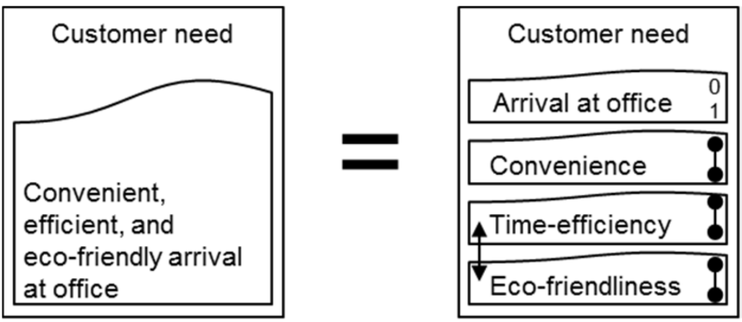



*Figure 3.2: Integrated Customer-Need Description versus Separated Customer-Need Description*

We can also distinguish between must-have and wish-to-have outcomes. For example, the traveler described above must get to the office (must-have outcome; indicated by 0/1 in Figure 3.2), while the other outcomes can be optimized and trade-offs can be made (wish-to-have outcomes; indicated by scales in Figure 3.2).

## Different levels of customer needs

Outcomes are inputs for a customers' next process, and all inputs are outcomes of an earlier process. As such, there is always a lower, narrower level of customer needs and a higher, broader level of customer needs. There is some danger in setting the focus of a business too narrowly when discussing customer needs. One well-known marketing saying is that a customer does not need a drill but he does need a hole in the wall, and even the hole in the wall is too narrow a definition of the customer's need because the hole is not what makes a living room cozy. The levels of customer needs for this example are shown in Figure 3.3.

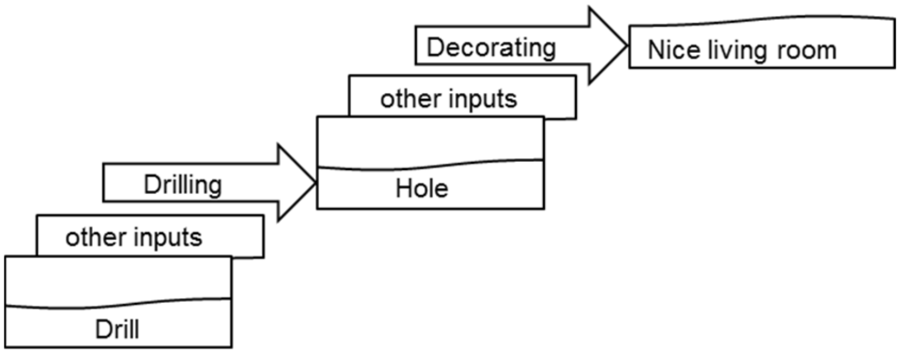



*Figure 3.3: Different Levels of Customer Needs*

If we return to our transportation example, we might ask: Why does the customer need to be at a certain place at a certain time? If seeing the family is the "real" need, video conferencing may be a process that could address the need. If the need is to be with people and socialize, there may be other people nearby with whom the customer can socialize. As the mode of transportation itself becomes an input in another process, alternative ways of addressing a customer's need might challenge the value of the initial process.

The purchase of a book in a bookstore was long seen as a value-creation process. Its outcome, i.e., ownership of a book, was viewed as the ultimate value creation. This understanding has been challenged in several ways. First, book ownership can be achieved by buying a book online rather than at a bookstore (the amazon.com challenge). Second, reading the book is a follow-up value-creating process for most people. This value can also be created by borrowing books (the library challenge). Third, with modern technology at customers' fingertips, hard-copy books are not a requirement—an e-book on a reader serves as a valuable input in the value-creating process of reading (the digital challenge). Finally, one outcome of reading a book is knowledge about the content of the book. However, this knowledge can be gained by listening to the book (sound book), watching a documentary about the book or going to a lecture about the content of the book (the platform challenge).

In the business world, I have been involved in projects in which a clear customer need—such as improved productivity of production—was stated as the project deliverable at the outset. However, throughout the project, this assumed customer need was just one outcome of the actual underlying need, such as higher returns for stakeholders. I often find that this higher-level need can be achieved in a different, often better, way. In the field of marketing and customer insight, the misjudgment of customer needs at lower levels has been termed "marketing myopia"[9], which occurs when the view on what customers really want is too narrow.

Similarly, customer needs can be defined too broadly. As a result, problems become too complex to be solved by a supplier. For example, the jump from supplying toothpaste to supplying a "total health solution" is not straightforward for a business. Such cases can be termed "hyperopia", as they are a type of strategic farsightedness that projects a business too far into the customers' processes.

Consider the drill example again. The view that the drill is the relevant customer need is too narrow. The supplier should consider the other relevant inputs (such as a drill bit, a plug, and a screw) and other outcomes of drilling (such as dust generation). On the other hand, moving from the manufacturing of drills into interior architect seems too far a move (Figure 3.4).

[9] Levitt (1960).

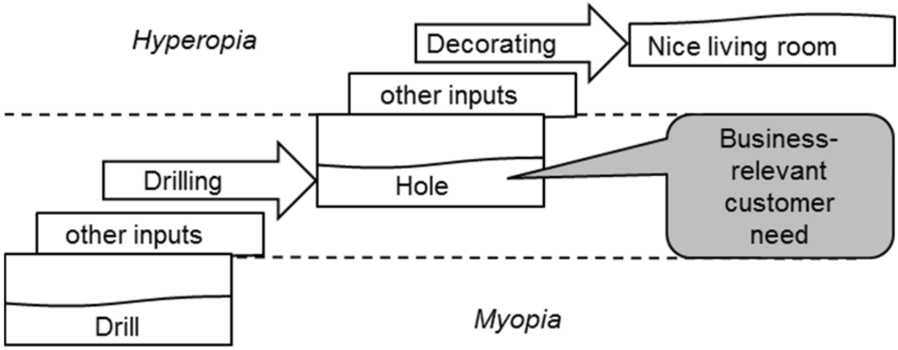



*Figure 3.4: Myopia and Hyperopia*

Most managers struggle to determine the relevant customer need for a given business—there are no straightforward rules. Firms need to gain an overview of the larger picture (i.e., needs earlier and later in the process) and evaluate the implications of their choices. Likewise, in order to detect changes in the market place, they need to regularly revisit their decisions to determine whether or not their choice is still appropriate. There are established market boundaries encapsulating the business-relevant need. There are also challengers who change those boundaries. It is important to have an understanding of the boundaries and the firm's position, as well as competitors' positions and customers' expectations. For example, are customers willing and able to integrate resources (e.g., customers would accept buying a drill separately from other inputs), or would they prefer to buy bundles (a drill along with plug and screws) or even solutions (someone who drills the hole or decorates the living room)?

With this understanding of customer needs, we can develop a need-based segmentation of customers by defining groups of customers with similar needs, i.e., similar portfolios of desired outcomes. The customers must be grouped according to their needs because that is the only clear and useful type of segmentation. Four steps have proven to be useful and effective in segmenting customers according to their needs:[10]

- Step 1: Dividing customers into customer groups according to their overall connection to the business.

[10] Andersen and Ritter (2008) used the concept of CUBEical Segmentation to develop the idea of customer types, roles, and scenes.

- Step 2: Dividing customer groups into customer types according to their specific needs.
- Step 3: Dividing customer types into customer roles.
- Step 4: Dividing customer roles into customer scenes.

## Step 1: Customer groups

In the initial segmentation step, we want to capture overall differences in customer needs. We also want to generate a complete picture of the customer landscape in which the business operates. The central questions to be answered in this step are:

- Who is affected by our business?
- Who has an interest in our business?
- Who must be involved in order to make our business a success?

These questions lead to a wide understanding of customers that often goes beyond the typical definition of a customer. This wider understanding is also referred to as an understanding of a firm's eco-system, its value chain or its business landscape. Let us consider an example: When Airbus launched its large A380 aircraft, the following customer groups were relevant:

- Airlines needed to accept the aircraft as part of their fleets and to see value-creation potential in such outcomes as increased capacity and lower costs of use.
- Passengers needed to accept the aircraft as a safe and comfortable means of transportation.
- Airports needed to accept the aircraft as a way to achieve growth in passenger numbers and, thus, invest in remodeling their buildings and infrastructure to accommodate the super-sized aircraft.
- Governmental aviation authorities needed to accept the aircraft as safe.
- Leasing firms needed to accept the business potential of super-large airplanes.
- Turbine producers needed to accept the business potential in developing engines for such large aircraft, which could harm their businesses as turbine volumes might decrease (assuming that one large aircraft replaces three to four smaller aircraft).

All of these customers had different needs, and all of them were relevant. Airbus did not have the option to choose one or two customer groups, and ignore the remainder. All of the customer groups had to be convinced that the A380 was a great idea. If only one customer group was not convinced, the whole business would falter. This highlights why Step 1 is so important—an organization must see and understand its entire ecosystem.

The logic applies to all businesses (Figure 3.5). Pharmaceutical firms typically regard regulators, insurers, hospitals, doctors, patients, and patients' relatives as important customer groups. Ingredient manufacturers can see integrators, branded-product manufacturers, distributors, and consumers on their radar. Architects have to deal with regulators, investors, owners, and residents. Newspapers deal with advertisers, distribution partners, and readers. Textbook publishers have governments, teachers, children, and parents as customer groups.

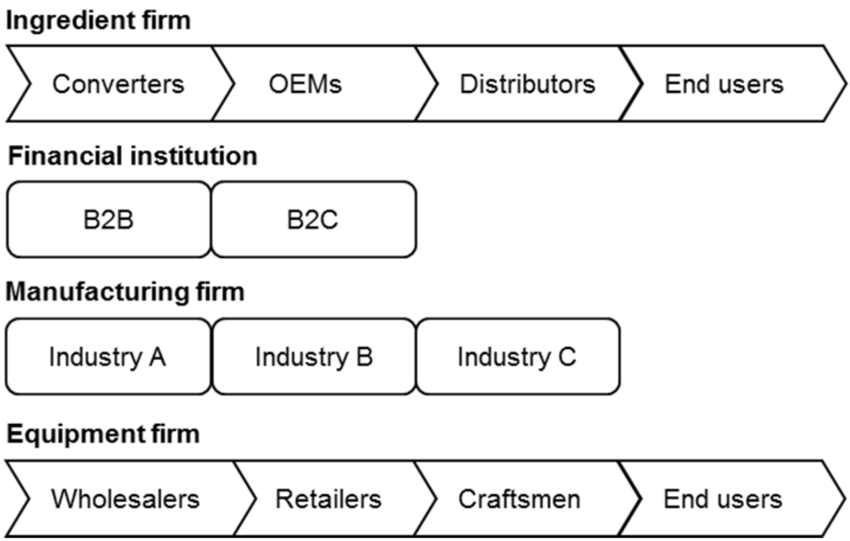



*Figure 3.5: Illustrations of Customer Groups*

Equally important is the fact that some firms divide customers into business and private customers (e.g., banks, insurance companies), or into different industries, such as transportation and heating customers (e.g., oil and gas firms) or food processing, manufacturing, and construction (e.g., equipment manufacturers). All of these distinctions are made to distinguish among very different customer needs.

The presence of several customer groups is the norm rather than the exception. If one customer group is overlooked in strategic planning, perhaps because there is no direct interaction with that group, a business may be derailed. A business can chose to let other businesses deal with certain customer groups (e.g., by hiring lobbyists to interact with politicians or by using retailers to distribute products), but the identification and understanding of all customer groups is important.

## Step 2: Customer Types

Customers within each customer group differ in a variety of ways. They may think differently, behave differently, and decide differently.[11] These differences are based on the different needs that customers have even when they are in the same customer group. In other words, they depend on the customers' portfolios of desired outcomes. For example, commuters moving between home and office are one customer group for bus, train, and airline operators. However, there are significant differences among customers in this customer group because they have a variety of desired outcomes beside the desire to arrive at a certain place. The other outcomes define how customers utilize their time while they use these modes of transportation.[12] Consider two different passengers:

- Efficiency seekers want to use their time on public transport for themselves: they read, sleep, listen to music, or respond to emails—whatever they feel they must achieve in their transit time. In addition to the "arrival" outcome, they value the "efficiency" outcome. Interestingly, efficiency in this context does not refer to the transportation time (speed). These passengers may not mind a longer transportation time if they can efficiently use that time.
- Socializers view public transport as a perfect platform for meeting new friends. They spontaneously chat with whoever is next to them. Thus, they value the "contacts" outcome—the more new contacts they make on a trip, the better.

If these two customer types happen to sit next to each other, the transportation company will have two dissatisfied customers: one who is

[11] The concept of customer types is described in more detail in Andersen and Ritter (2008).
[12] This example stems from a consulting project undertaken by AndersenPartners for Rejseplanen.dk. It is described in Andersen and Ritter (2008).

annoyed about being disturbed, and the other who is disappointed that he or she was unable to make contact.

| | Price chaser | Performer | Innovator | Ecologist |
|---|---|---|---|---|
| Description of behavior and decision making | These customers continually pressure us on **price** and will leave us immediately if a cheaper option becomes available. | These customers are very concerned about **product performance**. Therefore, quality and technical details are important. | These customers **constantly rethink** their products. They push for innovations all of the time. | These customers focus on **the eco footprint and/or natural products**. They push for “green solutions” all of the time. |
| Need (desired outcome) | Cheap supply | Quality supply | Innovative supply | Eco-friendly supply |
| Basis for decisions | Price | Feature | Innovativeness | Eco-footprint |
| Criteria | Inexpensive | Fulfillment | New | Low $CO^2$ emissions |
| Reason for changing to a competitor | Competitor cuts prices | Competitor launches better features | Competitor pioneers next generation | Competitor improves environmental policies |

*Table 3.1: Customer Types of an Ingredient Supplier*

Consider a different example: women in need of a pregnancy test. This need appears to work nicely as a customer group definition, as the outcome is the knowledge of the test result. However, in step 2, a truly effective segmentation distinguishes between women testing in hope of pregnancy and women afraid of being pregnant.[13] If the customer need is

[13] This example is described in Andersen and Ritter (2008).

pregnancy, the packaging and positioning of the test might be very different from the situation in which the desired outcome is “not pregnant”.

An ingredient manufacturer might identify four customer types (Table 3.1) based on differences among its industrial customers. All of these customers are on the same level in the value chain, they share the same official industry classification, and they are in the same customer group. Moreover, they all share the obvious need for ingredients. However, the differences in their input needs are significant—they have different alternative outcomes.

hese examples highlight the fact that customer segmentation must not stop at the obvious level that is captured in step 1. At the customer-type level, firms must move beyond the obvious to understand the underlying motivations of customers. They must seek answers to such questions as: What additional problems are customers trying to solve? What additional outcomes do customers desire? Why do customers buy or refrain from buying certain products or services? It is easy to assume that a passenger needs transportation. It is more difficult for executives to understand what a passenger wants to do while being transported, but this knowledge is much more relevant.

The questions for identifying customer types are:

- Are all customers in this customer group behaving in the same way?
- What makes these customers different from each other?
- What do particular customers need?
- What drives a particular customer’s behavior and decisions?

## Step 3: Customer roles

As pointed out earlier, one customer equals one buying decision. However, this does not mean that there is only one person involved in a decision or that the same person always decides in the same way. The differences in customer needs can be explained by the presence of different roles. A “role” is a set of activities. They can be identified by analyzing the customer’s activity cycle and the customer’s relationships with others. In a business setting, typical roles are “purchaser”, “decision maker”, “user” and “gate keeper”[14] – each of these roles has carries

[14] These roles have been suggested by Webster and Wind (1972).

different needs and focuses on different outcomes (Figure 3.7)[15]. The same is true for multi-person consumer decisions, such as those that occur when a family buys a car or a house, or a group of people decide on a holiday destination.

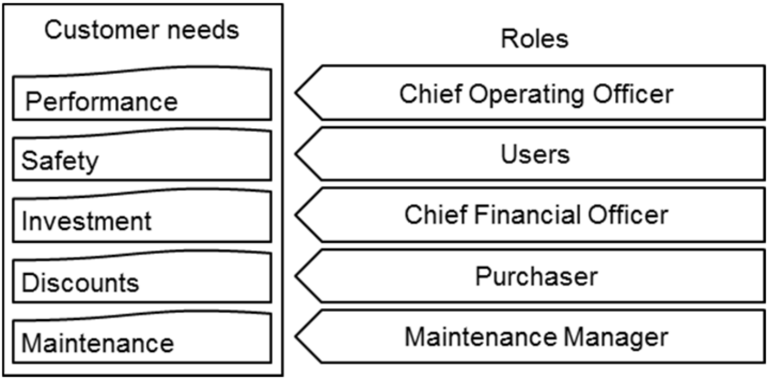



*Figure 3.7: Roles in Business-to-Business Purchasing*

Notably, a single person can have different roles. In the course of a day, a person's roles might shift among "father", "commuter", "colleague", and "manager". Customers' needs change according to their roles. For example, an airline passenger in the role of businessman may need workspace and Internet connectivity in the lounge and in the aircraft. The same passenger, in his role as father, may need a playground and child-friendly entertainment a few days later.

Different roles may even be relevant at the same moment in time. For example, a person sitting at a dinner table at a family gathering might simultaneously be a "son", a "husband", a "father", a "brother", an "in-law", and an "uncle". Even though customers frequently change roles, the customer roles themselves are stable and easily recognizable. Therefore, the associated needs and outcomes are stable.

[15] This does not imply that all roles have equal weight in decision making nor that all decision makers agree. See the three different account situations in Andersen and Ritter (2008).

## Step 4: Customer scenes

Customer scenes are the places and spaces in which customers are located. A “scene” describes the set of resources that a customer has on hand in a given place. For example, being inside or outside has an impact on what customers need or on the products they want to use. Similarly, the fire brigade has a specific set of desired outcomes when looking for communication devices, such as walkie-talkies. They need devices that will not melt at high temperatures and that can be used when wearing fire-protection gear. These outcomes are derived from the scene in which the fire brigade wants to use the equipment.

## Segmenting customers

If we apply the four-step segmentation framework, segmenting customers according to customer needs becomes a straightforward exercise that answers four questions (Figure 3.7):

- Who is affected by the business? (customer groups)
- What is the customer thinking? (customer types)
- What is the customer doing? (customer roles)
- Where is the customer? (customer scenes)

This analysis reveals the details necessary to drive a business. Nevertheless, including all of the information in the customer dimension might be challenging. Therefore, it might be helpful to select the most important customers and leave the remaining details for more detailed analyses, such as those used in key-account management.

Let us return to the ingredient manufacturer mentioned above. The firm has four customer groups, of which the most important are OEMs. For OEMs, four customer types were identified. The different roles and scenes can be discarded when building the customer dimension for the business model. As such, the resulting customer dimension features seven different customers (Figure 3.8).

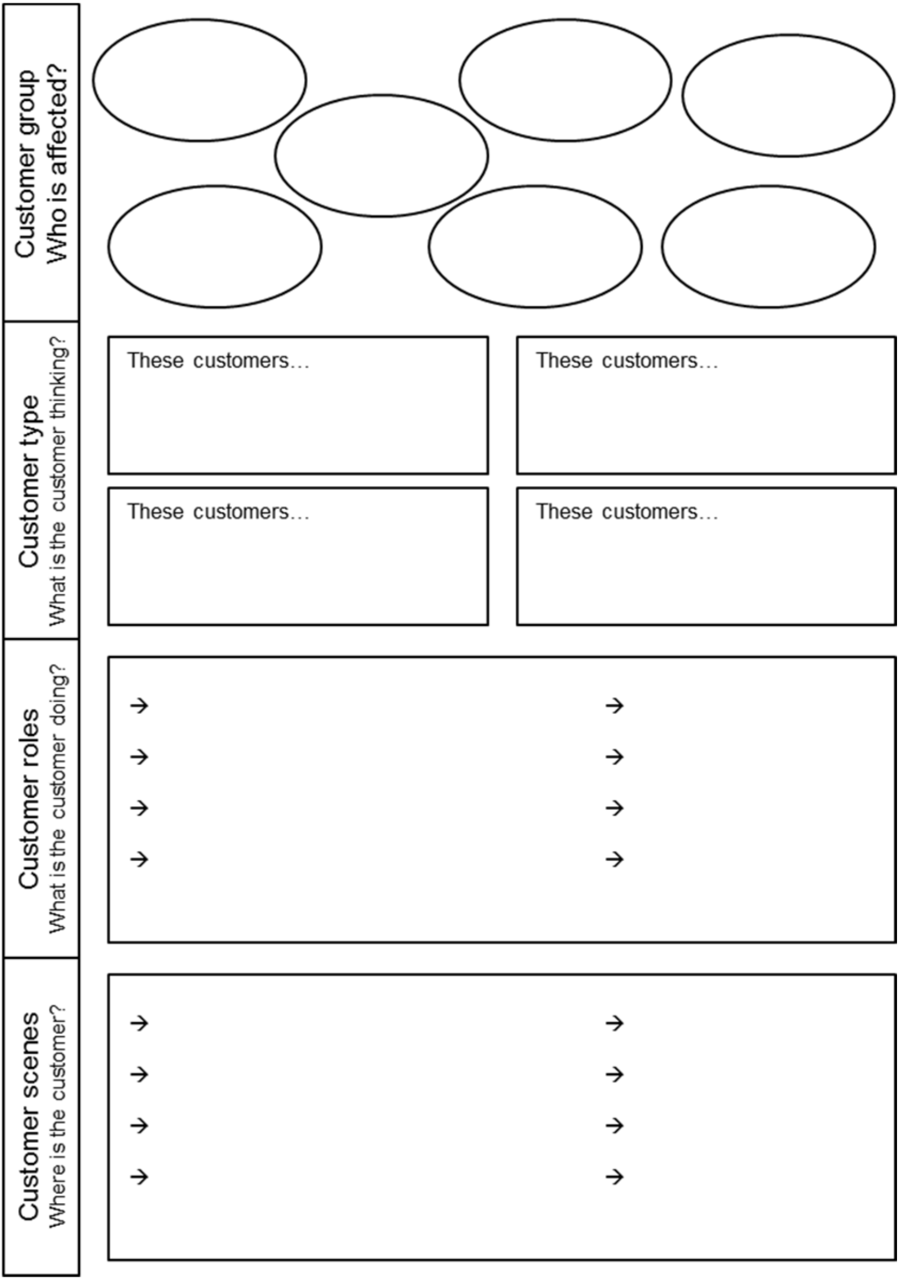



*Figure 3.7: Customer Segmentation Worksheet*

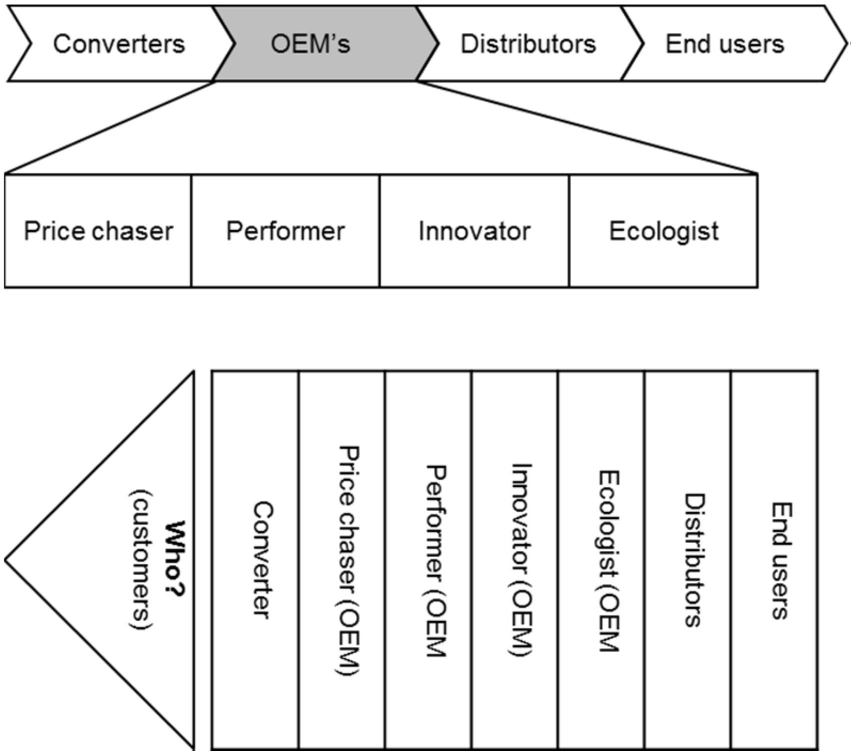
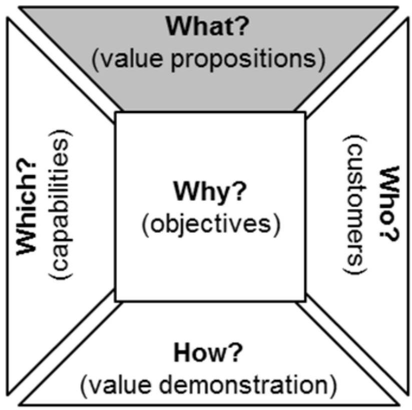



*Figure 3.8: Customer Dimension of an Ingredient Manufacturer*

Having developed a needs-based understanding of the customer, we can now turn our attention to the value propositions relevant to these customers.

# CHAPTER 4
# VALUE PROPOSITIONS—
# WHAT DO WE OFFER TO CUSTOMERS?




As mentioned in Chapter 2, customers are interested in their own needs and their own value creation. Value creation has two elements. The first is a process element in which something happens. This is the value-creation process. The second is a result element in which something has happened, an outcome has been achieved. The created value is the difference between the benefits realized from the value-creation process and the sacrifices incurred, i.e. by using inputs during the process. This view enables us to add a value perspective to the discussion of customer needs and related processes (Figure 4.1).

Figure 4.1 also shows the essential equations regarding value[16]: Beyond value being the difference between benefits and sacrifices (equation 1), a customer will choose amongst alternatives the process with the highest value creation potential (equation 2), i.e. the process where the difference between benefits and sacrifices is largest (equation 3).

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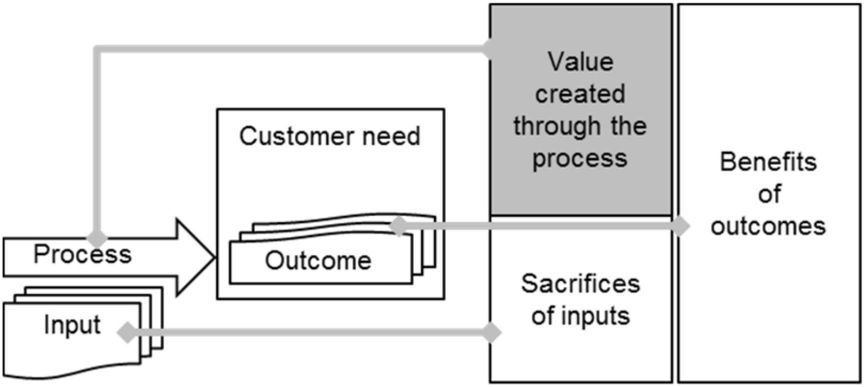
[16] The value equation is adapted from Andersen and Narus (1999).




$$\begin{aligned} \text{Value} &= \text{Benefits} - \text{Sacrifices} \\ V_{\text{chosen}} &> V_{\text{alternative}} \\ B_{\text{chosen}} - S_{\text{chosen}} &> B_{\text{alternative}} - S_{\text{alternative}} \end{aligned}$$

Figure 4.1: Value, Customer Need and Value-Creation Process

## Customer Value

Customer value is often defined in monetary terms by calculating the costs of the inputs and the benefits of the outcomes[17]. This may be difficult at times. For example, what is the value of a good feeling or the value of an inherited piece of jewelry? While most of the sacrifices often are financial costs, i.e. the price paid for the inputs, there can be other sacrifices like the time and efforts a customer spends in the process.

Some important implications of this view on customer value must be highlighted. First, the customer is the only actor that can create value[18] because the customer has to realize the benefits by using the inputs provided. Suppliers can only help, contribute, or offer support. If the customer is not "processing", i.e. employing the inputs to achieve the outcomes, negative value is created because the sacrifices of the inputs are incurred by the customer but no benefits are achieved. Thinking of the

[17] Andersen and Narus (1999) use value "to express in monetary terms the functionality or performance of a market offering in a given customer application", i.e. the value is specific to the process.

[18] This point is highlighted by, e.g., Grönroos (2011). Also, Andersen and Narus (1999) advocate for a "value-in-use" approach, i.e. that value has to be understood in the application.

pharmaceutical industry, patient value is not created when patients buy medicine but when they take it and then enjoy a higher quality of life.

Likewise, some people need to lose weight. The extent to which customers fulfill this need—and the time it takes to do so—are determined by how or whether they use different resources, not by whether they buy them. As such, in-home training equipment, running shoes, and vitamin pills do not produce any value at the time of purchase—only at the time of usage. If not used at all or used in the wrong way, the best value propositions fail to create value. In such cases, suppliers typically state that their customers “were not ready for the product” or that customers were “non-compliant”.

Therefore, the benefits of a supplier’s contribution to a customer’s value-creation process depend on the customer’s ability to realize the benefits of the inputs.[19] This understanding has important consequences for firms, as a customer’s appreciation of a supplier’s value proposition depends on the customer’s ability to integrate and realize that value proposition. Thus, suppliers must understand customers’ value-creation needs and assess their value-creation abilities.

Along these lines, the term “value proposition” highlights the fact that a firm can only make suggestions and contributions to a customer; it can never create value for the customer. The notion that value can only be created by the customer directly contradicts prominent streams of research arguing that a supplier creates value.

Second, all suppliers support a customer process and, thus, all firms are service providers. In other words, they enable their customers to undertake a value-creation process.[20] Third, as the customer plays an active role in the value-creation process, it is difficult to determine the supplier’s exact value contribution. The calculation of the supplier’s contribution becomes even more difficult when other resources are also consumed in the value-creation process.

Fourth, customers differ in their value assessments due to differences in their needs (i.e., the bundle of desired outcomes; see Chapter 3) as well as in their assessments of sacrifices. The time it takes to assemble an IKEA wardrobe may be a small sacrifice of some customers but a significant cost for others.

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[19] Danatzis, Kleinaltenkamp and Karpen (2014).

[20] This point has been discussed as “the service-dominant logic” (Vargo and Lusch, 2004).

## Supplier’s value proposition

As suppliers are not able to offer “value” to their customers, what are they providing? A supplier simply provides a “value proposition”—a suggestion for how customers can create value for themselves by using one (or more) of the supplier’s resources, e.g. products or services. Three elements are key to specifying the value proposition (Figure 4.3): a

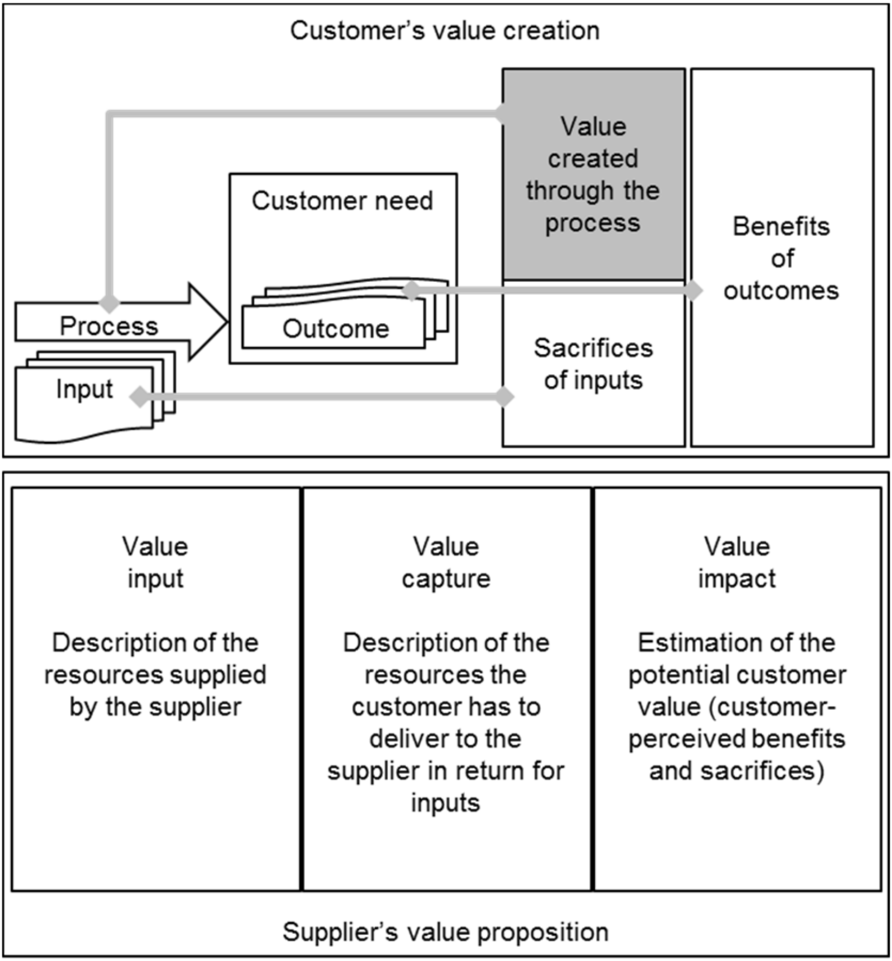


*Figure 4.3: The Three Elements of a Value Proposition*

description of the resources (inputs) delivered by the supplier, a description of the resources that the customer provides to the supplier in return for the inputs, and a description of the expected value the customer may realize in the value-creation process.

## Value input

Many terms are used to describe the inputs provided by a supplier, including “products and services”, “offerings”, “contributions”, and “solutions”. The term “resource” might appear somewhat unexciting next to these modern terms, but it serves to highlight that the only items a supplier can actually deliver are bundles of resources.

Resources can be classified into five categories: physical, information, financial, intellectual, and human (Table 4.1). Moreover, there are two methods of transferring property rights: ownership and usership. The inputs provided by a supplier can be displayed in a resource-exchange grid[21] (Table 4.2). For each transaction, a resource-exchange grid can be filled in specifying the intended value input to a customer. Once delivered both customers and suppliers can check whether or not the “delivery grid” fits the “resource exchange grids”. The before and after comparison of the resource-exchange grid identifies large gaps, this has to be addressed within the firm and with the clients.

| Resource types | Examples |
|---|---|
| Physical resources | Goods (physical goods), equipment, material |
| Information resources | Information (data, ideas, knowledge) |
| Financial resources | Financial means (money, shares), vouchers, coupons |
| Intellectual resources | Brands, patents, intellectual property rights |
| Human resources | People |

*Table 4.1: Resource Types*

[21] The resource-input grid was developed by Geersbro and Ritter (2011).

| Property right / Resource type | Right to own (examples) | Right to use (examples) |
|---|---|---|
| Physical resources | Buy a book, a car, a machine, material | Lease or rent goods: Rolls Royce “power by the hour”, car leasing |
| Information resources | Buy a database | Pay for streaming or per hour |
| Financial resources | Pay with cash, buying firm shares/stock | Loans, credit lines |
| Intellectual resources | Transfer of brand ownership | Franchise of brands, Coke bottlers agreements, References |
| Human resources | - | Employment |

*Table 4.2: Resource-Exchange Grid with Examples*

## Value capture

A supplier is motivated to provide inputs to a customer by the resources the customer provides to the supplier in return—this is referred to as “value capture.” These resources must support the supplier’s value-creation process; otherwise, they are of no value. Value capture is also referred to as “value appropriation”, “revenue models” and “supplier incentive”. A customer can contribute to a supplier’s value creation in eight ways (Table 4.3).[22]

Value capture is related to the customer’s process in various ways. Most commonly, we find the input-related revenue model in which the customer pays for inputs per transaction (typically in exchange for ownership) or for access to an input for a certain period of time (typically for usership). For example, a customer can buy or lease a car, or buy or rent an apartment, while firms can buy or rent office space and production equipment. Notably, the use of this type of value capture is decreasing because input-related revenue models increase customer’s business risk.

[22] These value-creation functions are discussed in Ritter and Walter (2011).

| Value-creation functions of customers | Explanation |
|---|---|
| Payment | Financial means, e.g., money or credits |
| Volume | Quantitative capacity utilization (the right number of orders) |
| Quality | Qualitative capacity utilization (the right orders) |
| Safeguard | Short-term capacity leverage |
| Innovation | Input for research and development |
| Information | Knowledge input for the business |
| Access | Access to potential customers, suppliers, and other important actors |
| Motivation | Efficiency gains through employee motivation |

*Table 4.3: Value Capture Options for a Supplier*

Alternatively, suppliers can capture value during the customer's process, perhaps in conjunction with the amount of time and the intensity with which an input is used in the process. For example, customers may only pay for the amount of time that they actually use the Internet, and airlines may pay for engines per flown air mile (not per engine, per month, or per running hour). Finally, value capture can be related to the outcomes of the process. For example, firms may pay for a copy machine per copy (not per machine, per month, or per operating minute).

In recent years, a "free" model has emerged in which customers are offered inputs without value capture. This revenue model has challenged the news outlets, which found themselves forced to provide online news (input) for free (no capture), leaving them unable to generate revenue in the traditional manner.

In reality, suppliers often rely on a combination of these capture models. The price of a taxi ride is often a combination of an initial starting fee (input based), the time that the ride takes (process based), and the distance travelled (process based). Similarly, customers pay for mobile network access per month (input based), per minute of usage for traditional phone calls (process based), and per text message (outcome based).

Value capture can be calculated in three ways:

- Cost-based capture: What is the supplier's cost for providing the input and the target profit margin?
- Competitor-based capture: What is the cost of the alternative for a customer?
- Benefit-based capture: What is the benefit of the input for the customer?

In a nutshell, value capture can be described along three dimensions: the eight value-creating functions (what the supplier gets), the four reference points (free, input, process, outcome), and the three calculation methods.

## Value impact

Many firms are moving towards value-based selling in which a significant part of their value proposition reflects their calculation of the value that the customer realizes from using the supplier's input. Typically, these value-modelling exercises develop lists of outcomes and inputs, attach prices to those items, and calculate the resulting "expected customer value"[23].

## Different value propositions

Firms often offer several value propositions, which reflect different combinations of inputs, capture, and impacts. As such, a firm should have a portfolio of value propositions that mirrors the differences in its customer base. Firms also try to differentiate themselves from their competitors. They use these differences to convince customers of the advantages of their value propositions. In other words, a firm must manage its value propositions not only to minimize the distance between the proposition and the customer's preferences, but also to maximize the difference between the proposition and competitors' value propositions (Figure 4.4).[24]

Once a business has defined its target customers (the "who") and its value propositions (the "what"), the business must demonstrate its potential to its customers in order to convince them of buying.

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[23] See examples in Anderson and Narus (1999).
[24] The Three-Circle Analysis (Urbany and Davies, 2007)/Sweet-Spot Analysis (Collis and Rukstad, 2008) can serve as a useful tool for capturing these two differences.

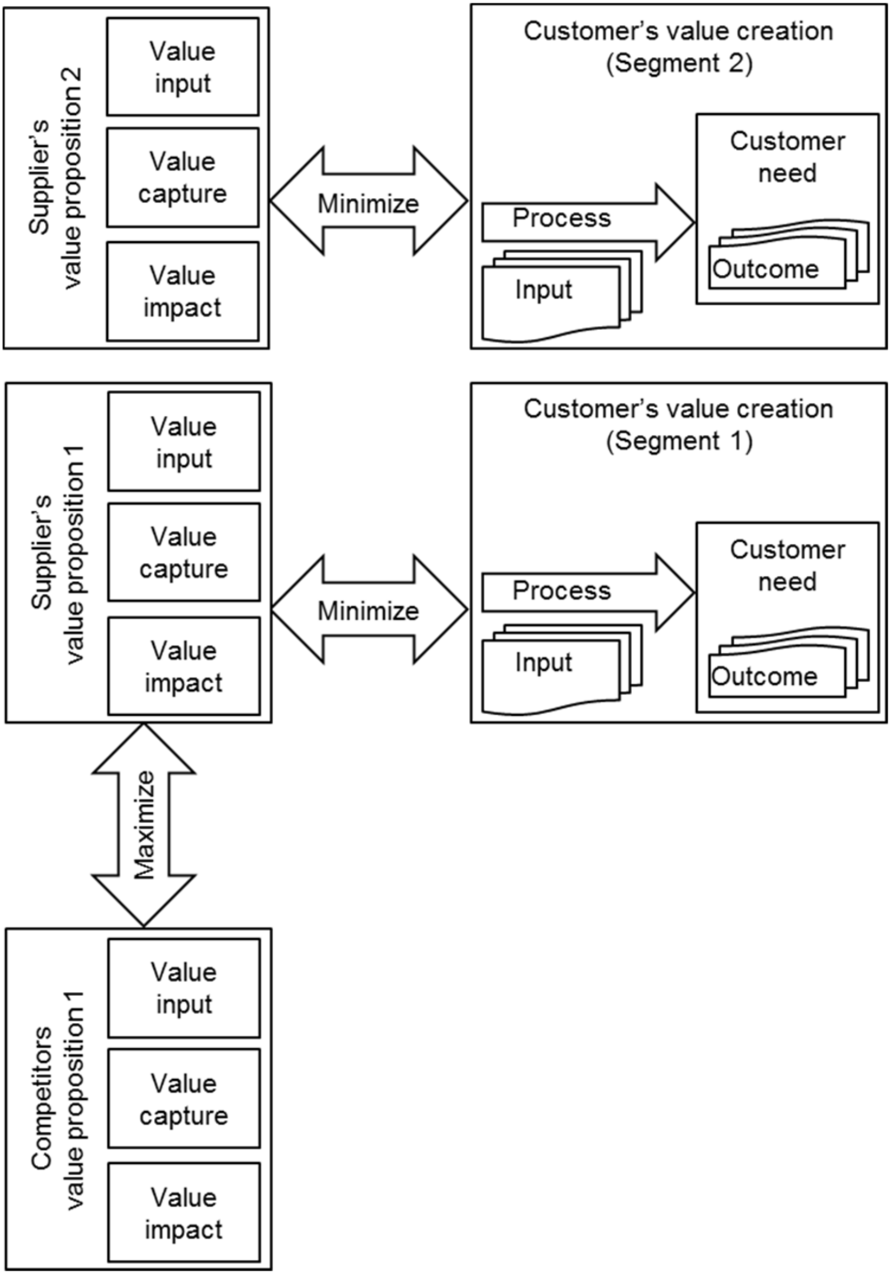
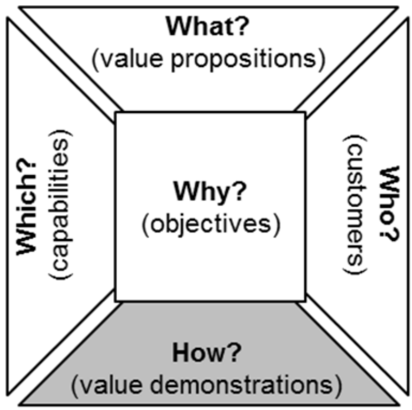



*Figure 4.4: Value Proposition Differences and Distances*

# CHAPTER 5
# VALUE DEMONSTRATIONS—HOW DO WE CONVINCE OUR CUSTOMERS?




Firms need to demonstrate their value propositions to customers—even with the best value proposition, firms will fail if customers have never heard about it or if they are unconvinced. Moreover, firms must demonstrate their superiority relative to their competitors because customers will only buy the option they perceive as best.

A value demonstration is a method (or a mode, an approach or a technique) for convincingly explaining the value propositions of a business to customers. It is an essential job of every business. Nevertheless, this key task is often underestimated, if not forgotten. The key questions to be addressed are:

- What is the best way to exemplify the advantages of our value proposition?
- How can the customer experience our proposition, especially if our offering is intangible?
- How can we document the potential benefits given that those benefits depend on the customer?

This goal may seem very similar to goals that are typically assigned to marketing and sales. In fact, value demonstration is often performed by the marketing and sales department. However, value demonstration is not limited to these departments, and not all marketing and sales activities are related to value demonstration. In addition, although value demonstration may seem to fall under the more general field of communication, value can be demonstrated using means other than communication. Therefore, the essential concept of getting the value proposition across—getting customers to understand and to buy into the value proposition—is best framed as value demonstration.[25]

The different means for demonstrating value can be characterized in terms of four dimensions: the sender, the format, the platform, and the scene.

## Sender

The most common sender of a value demonstration is the firm itself. The supplier engages in sales and marketing activities in order to convince the customer. Alternatively, customers themselves can communicate their experience with a supplier and their supplies in testimonials. In today's world of the Internet and social connectivity, customer-to-customer interactions are manifold and some initiatives go around the world with extremely high coverage. For example, "the Ice Bucket Challenge" is acclaimed to have raised over 110 million dollar within a few weeks—the challenge also being posted on Facebook and tweeted on Twitter millions of times.

A related source of value demonstration are key opinion leaders—people who have a certain status or image in the eyes of current and potential customers. In the pharmaceutical industry, for example, well-known experts in therapeutic fields can serve as outstanding communicators and ambassadors for a firm's products or as or value destroyers if their verdicts are negative. In fast-moving consumer goods, consumer associations and independent foundations communicate their judgments about different offerings. Positive statements made by these organizations are used intensively to promote offerings. Similarly, in the fashion industry, an association with celebrities is often assumed to convey the value message.

[25] Despite the fact that it is seldom used, the term "value demonstration" is not new. See, e.g., Andersen, Kumar, and Narus (2007).

## Format

In its most simple format, value can be directly demonstrated to customers. This option is commonly used for physical products. Along these lines, supermarkets display hundreds of products for customers to examine and they often offer customers an opportunity to sample the products. Similarly, car dealers allow potential customers to test drive their cars, and mattresses can be taken for a “test sleep”. If it is not possible to see, touch, and feel a product due to packaging, then the packaging is used for communicating the value input and value impact.

In technical sales situations, value propositions are often described using “fact sheets”—detailed descriptions of key features. Alternatively, firms produce videos and pictures of their value propositions. Finally, drawings, digital representations (for products such as car parts), or models (common in architecture) can also be used for value demonstrations.

Firms can also choose to use customer case studies to explain the positive impacts of their inputs. In addition, firms apply value modelling in which they develop detailed calculations of the benefits and sacrifices of the inputs.[26] Such value calculations often involve Microsoft Excel or applications developed for mobile devices, which ensure flexible on-site calculations in direct interaction with customers.

## Platforms

Many demonstrations of value in business markets occur in personal, face-to-face meetings. Alternatively, phone and email exchanges can be used for this purpose. One-way demonstrations of value can occur through such traditional channels as newspapers, magazines, radio, and TV, or through modern formats, such as Facebook, Twitter, Google, or text messaging. Other options include two-way chats and blogs.

## Scenes

As discussed in Chapter 3, scenes are the places at which a customer comes in contact with a business. Although needs were in focus in Chapter 3, the same logic applies to value demonstration. The business must understand where the customer is when they encounter the value demonstration. Typical supplier-driven scenes include factory tours, show

[26] Value modeling is described in detail in Anderson and Narus (1999).

rooms, and flagship stores. Many consumer brands, such as Apple, Microsoft, Nike, and Vorwerk, work with such outlets. Fairs, trade shows, and exhibitions are other common supplier-developed scenes for demonstrating value.

However, customers encounter a great deal of communication in their daily lives—in their living rooms or kitchen via telephone, radio, TV, or print; in traffic via billboards or car radios; and at work, sports clubs, shopping malls, and airports. In short, customers can encounter a value demonstration just about anywhere.

## Effectiveness

The effectiveness of value demonstrations varies significantly. Customer endorsements tend to be more powerful than supplier claims, personal two-way interactions are often more successful than digital one-way contact, and a hands-on experience is typically better than a picture. The extent of a value demonstration's effectiveness depends on the value proposition and on customers' preferences.

Let us consider a few examples of value demonstration. In order to rid itself of a low-quality image, LIDL,[27] a German discount supermarket, opened a gourmet restaurant, DILL, in Stockholm. DILL was only open for three weeks, and it was fully booked every day. Renowned chefs and highly trained staff worked at the restaurant, which received superb reviews in the media. Later, it was revealed that all of the ingredients used in the restaurant came from Lidl. The media stunt was covered by news outlets around the world, providing Lidl with GBP 4 million in free media coverage.

Danske Bank[28] had an image as traditional, conservative, and expensive bank. To change this, Danske Bank changed the colors of its signs at certain branches from its company colors of dark blue and white to yellow and black, colors which Danes associate with discounts. The campaign made the national news and awareness of the bank rose significantly. Despite some customers' belief that the color change would be permanent, the signs were changed back to the bank's company colors after four weeks.

[27] Visit dill.lidl.se or see the video on YouTube.
[28] See diverse articles about "Danske Banks gul kampagne" on business.dk and bureaubiz.dk.

When Maersk Line[29] launched its Daily Maersk offering—the first container shopping product to ensure total reliability regarding arrival times—in 2011, the campaign website featured a video explaining the value impact ("Daily Maersk: Introducing Absolute Reliability") as well as video-taped customer interviews featuring Sony Europe and numerous journalists, all of whom were very positive and excited about the game-changing new offering.

The Copenhagen Phil,[30] the city's philharmonic orchestra, faced a decline in demand. In addition, its public funding was in danger. The key challenge was to demonstrate value to audiences who did not usually visit the typical classical music setting—the concert hall. A solution was found in flash mobs—unannounced concerts at surprising venues—at Copenhagen's central rail station in May 2011 and in the Copenhagen metro in April 2012. The resulting videos were highly emotional and served to effectively communicate the value proposition of the philharmonic orchestra. The resulting media hype secured audience members as well as public funding.

A way to demonstrate value differences can be found in many fast-moving consumer-goods advertisements—the low-middle-high comparison. Typically, retailers' promotion material features three similar products but of different qualities and, subsequently, at different price points. Typically, the distinctions are made among cheap, value-for-money, and special (for food); among layman, hobby, and professional (for tools); or among daily, chic, and party (for clothing).

Assessing the effectiveness of value demonstrations can be straight forward in terms of contracts signed, order volume and order profitability. Yet measuring effectiveness can be challenging: how much is a like in Facebook worth? Which of a firm's value demonstrations make the greatest impact and ensures contracts?

Gaining an overview over the current pool of value demonstrations is a good and necessary starting point (Figure 5.1). After the as-is analysis, discussions can venture to rank the effectiveness of the current portfolio and to identify new value demonstration opportunities.

A demonstration might become outdated or it may not be fully aligned to its audience. In either case, the development of a new brochure, the renewal of a website, or the re-scripting of customer dialogues serve as typical methods of optimization.

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[29] The launch website is no longer operational, but videos are still available at YouTube.
[30] See copenhagenphil.dk

In conjunction with its attempt to optimize its newspaper advertisements in 2005, the German car manufacturer Volkswagen released an advertisement in which it “hard-handedly removed all soft and emotional arguments for buying a Volkswagen”. The result was an advertisement in which half of the space was empty. The ad served as a very strong signal of the fact that buying a Volkswagen is not only a rational decision (the rational arguments were described in the remaining text) but also, to a great extent, an emotional decision.

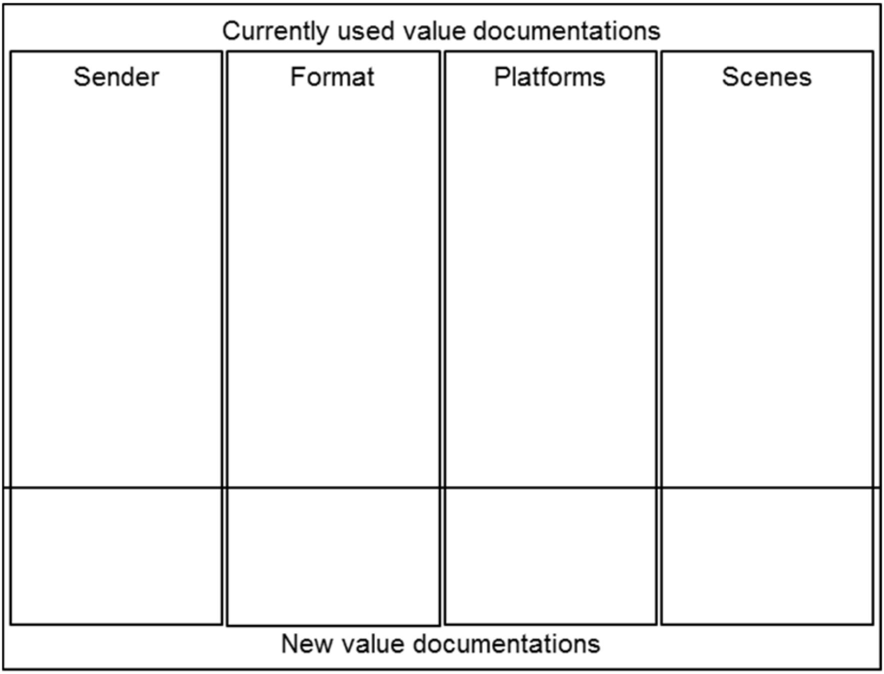


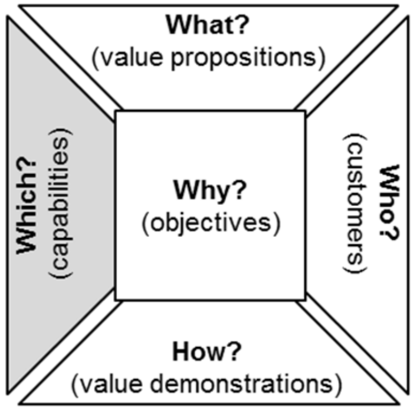

*Figure 5.1: Worksheet for discussing value documentations*

## Before and after demonstration

Just like value propositions, the “how” dimension has also a “before and after” side. The main focus is on before-use value demonstrations, which aim to bring customers on board. However, as customers need to create the value for themselves and as suppliers are interested in satisfied customers, there is a need to document the created value, i.e., the value-in-use. Although it has typically been more widely used in business-to-business dealings, this after-the-fact value demonstration is increasingly utilized in numerous situations, especially when value capture is based on performance. In these cases, there needs to be some form of value documentation or value verification.[31] For example, health care firms are met with requirements to document improvements in quality of life after medication beyond the traditional proof of health improvements.

[31] See, e.g., Storbacka and Pennanen (2014).

# CHAPTER 6
# CAPABILITIES—
# WHICH CAPABILITIES ARE NEEDED?




Thus far, we have developed an understanding of the customers, the value propositions, and the value demonstrations. Implementation of each of these key dimensions of a business model requires certain capabilities—also referred to as “activities”, “activity systems”, “competencies”, or “routines”. Capabilities are (bundles of) processes in which inputs are used and transformed into an outcome. The logic used here is similar to that found in Chapter 3 for customers. In this chapter, however, the focus is internal to the firm—on the capabilities the firm needs to drive the other three elements of the business.

The list of capabilities often believed to be relevant or necessary seems endless, and includes marketing, sales, production, logistics, new product development, purchasing, sourcing, market research, customer knowledge, and negotiation, to name a few. In order to structure the discussion of a firm’s capabilities, the three essential processes of a firm introduced in Chapter 3—procuring, transforming, and commercializing—serve as a good starting point.

Support processes and more general functions, such as finance, accounting, human resources (HR), and information technology (IT), are often viewed as outside of or different from the three essential business processes, as they cut across the organization and are typically centralized.[32] In addition, we find leadership and integration processes, which bind the organization together. As the overall importance and cross-process nature of these activities makes them special, most firms prefer to separate them from the essential processes. This leaves a firm with five processes—three essential processes and two cross-cutting processes (see Figure 6.1 and Table 6.1).

| Basic process | Procuring | Supporting | Leading | Trans-forming | Commer-cializing |
|---|---|---|---|---|---|
| Typical department titles | Procurement, Sourcing, Supply Chain Management | Finance, Accounting, Controlling, HR, IT | Board, Executive Team, Management Team, Leadership Group | Production, Operations, R&D | Sales, Marketing, Call Center, Key Account Management, Marketing Research, Business Development |
| Typical C-level/VP titles | VP Procurement, VP Strategic Sourcing, VP Supply Chain Management | Chief Finance Officer, VP Controlling, VP HR, VP IT | CEO, President | Chief Operations Officer, Chief Production Officer, VP R&D, VP Inbound/ Outbound Logistics | Chief Commercial Officer, Chief Sales Officer, Chief Marketing Officer, Chief Customer Officer, Chief Business Development Officer |

*Table 3.1: Processes, Departments, and Titles*

[32] Porter (1985) distinguishes between primary and support activities, where support activities go across primary activities.

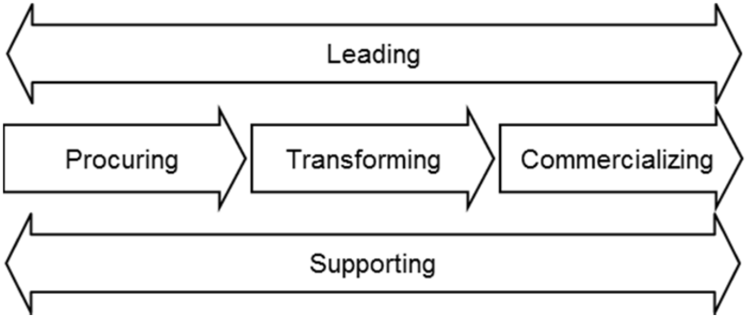


*Figure 6.1: Essential and Cross-Cutting processes*

The five processes take on three different modes:

- Efficiency mode: On the operational level, all processes are run in line with the agreed protocols or established routines. This can be characterized as “business as usual”. Lean projects may establish the optimal level of activity and resource usage, and one can talk about operational efficiency. The status of the efficiency mode is often displayed on large screens and whiteboards in production, where the focus is on such factors as the number of minutes a production system operates in optimal mode or the degree of order fulfillment and accuracy.
- Ad-hoc mode: In a “perfect” world without disturbances, mistakes, or variance, processes could run in efficiency mode for ever. However, day-to-day business activities are plagued by disturbances, mistakes, and variance. Material shortages causes line stops, paper jams obstruct printing, electricity failures demand emergency repair, calendar hiccups cause meeting chaos, and traffic leads to unexpected delays. There are ample opportunities for processes to leave efficiency mode. At that point, other processes are needed to address the immediate situation and to move the process back into efficiency mode. Therefore, a business must have processes designed to deal with changes, such as people who can fix a printer, an emergency evacuation plan, and/or a fast-response group to fix production-line problems.
- Innovation mode: All essential and cross-cutting processes are also subject to innovation, new ways of undertaking certain activities,

demand for new outcomes, and new requirements for inputs in terms of quality and quantity (e.g., laws forbidding the use of certain materials, demands for cost cutting, or inventions or discoveries). As such, the innovation mode is concerned with changing either the processes or the resources used in the processes.[33]

On the basis of the five processes and the three modes, we can draw a capability map that allows us to identify the most important capabilities for the business (Figure 6.2). In general, all boxes on the map are relevant and a business most cover and fill each box. Therefore, the main challenge is uncovering which capabilities are the key contributors to success. In others, which capabilities set the business apart from its competitors? In addition, which capabilities are “world class” or “second to none”? Which capabilities are a liability for the firm because they are below standards?

An old-fashioned but effective workshop exercise is to draw a blank capability map on a board and give participants a limited number of green, yellow, and red Post-It Notes on which to write out the firm’s best-practice capabilities (green—“we are great at this”), key-success capabilities (yellow—“we must do this to successfully compete”), and below-standard capabilities (red—“we are not doing this well”). Thereafter, participants position their Post-It Notes on the capability map. The distribution of the colored Post-It Notes alone often triggers interesting discussions. Discussions about the capabilities put forth on the Post-It Notes can be summarized in action plans.

An alternative analysis tool is a capability matrix, which places the importance of a capability for value creation on one axis and the business’s strength in that capability on the other (Figure 6.3). In that case, the colors of the Post-It Notes would correspond to one axis or the other. After capabilities are placed on the matrix, participants can easily discern among core, gap, trap, and waste capabilities.

[33] These innovative capabilities are also called “dynamic capabilities” (Teece, Pisano and Shuen, 1997).

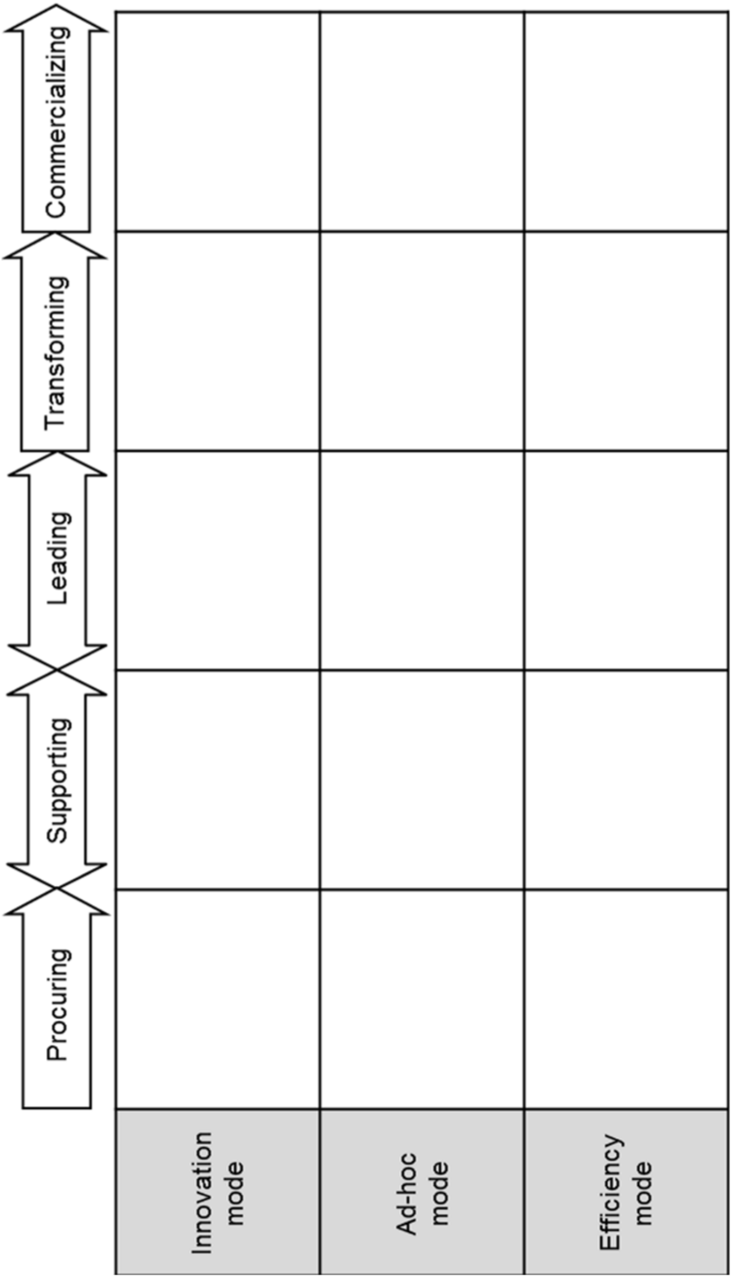



*Figure 6.2: Capability Map*

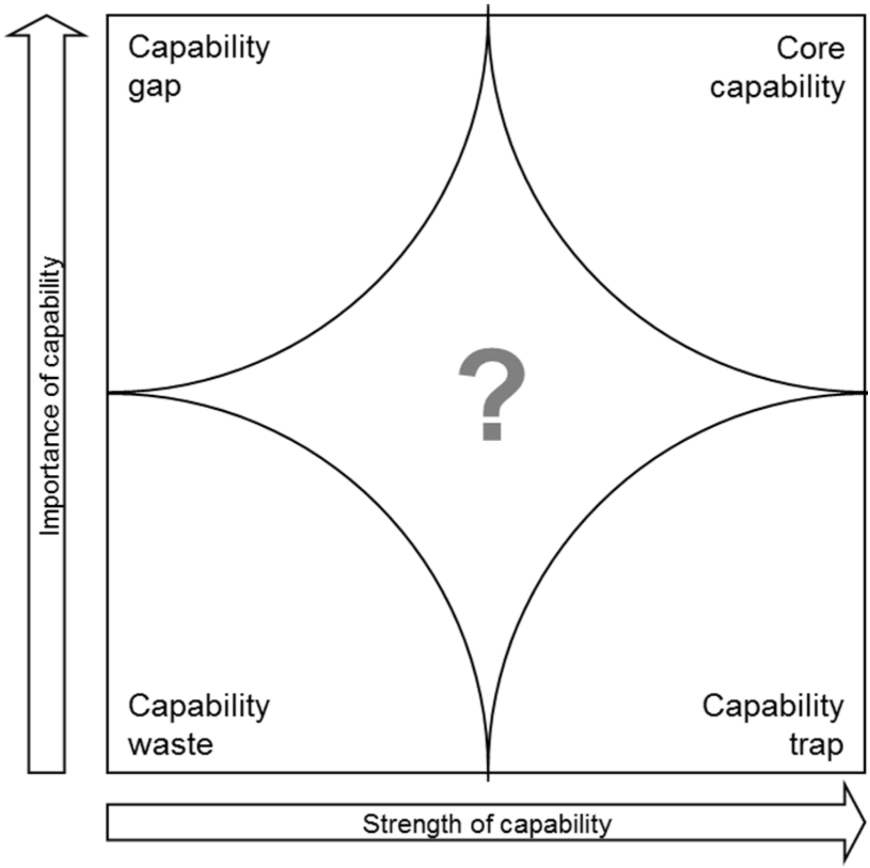



*Figure 6.3: Capability Matrix*

A third useful exercise is to discuss the importance of a capability using four questions:[34]

- Does this capability create value, i.e., does it contribute significantly to the business?
- Is this capability rare, i.e., is the capability only possessed by the business or a few others?

[34] These questions are based on Barney (1991)'s VRIN model.

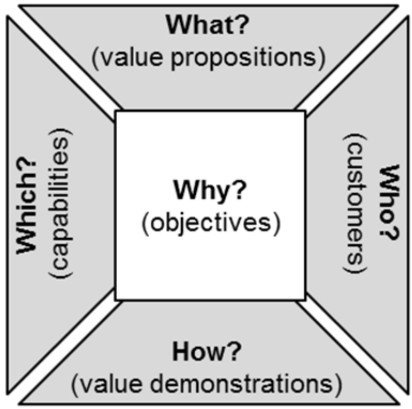
- Is this capability imitable, i.e., can competitors copy it? How fast?
- Can the business be run with alternative capabilities, i.e., can competitors use other capabilities to achieve a similar outcome?

All of these exercises have one goal: to tease out the key capabilities of a firm. Naturally, all businesses cover all boxes in the capability map. The main questions are the following: What are the key items? How well does the business perform in terms of its key capabilities?

# PART III

# BUSINESS ALIGNMENT SQUARES

# CHAPTER 7
# SQUARING THE SQUARE: CONNECTING THE DIMENSIONS




The past four chapters have suggested ways for understanding and structuring the four dimensions that describe a business. So far, so good. However, executives must also be able to bring these dimensions together and the dimensions must be aligned. A perfect understanding of customer needs and a set of world-class value propositions are of no value if the two do not fit together. If a business can deliver the world's best hammer but its customers only have screws, there is an alignment problem. Similarly, value demonstrations that are not understood or appreciated by customers are useless. Danske Bank had its share of problems in 2012 when the expensive "New Standards" communication campaign totally failed to align with its customers—this misalignment resulted in several top-level firings. Familiarity with the four sides of the business model square is a great step towards understanding and developing a business, but aligning the four dimensions is a necessity if success is to be achieved.

To illustrate alignment in practice, let us consider a typical business model of a state-funded university covering education:[35]

[35] Universities typically have additional business models for contracted research, conference organization, and non-degree educational programs.

*Customers*: Students are an obvious customer group, and their parents and families are also highly relevant. Other customer groups include the government as a regulator and as a provider of funding (two customer roles); and firms and organizations as future employers and as classroom contributors in terms of guest lectures, case studies, and internships (four customer roles). There are also several types of student customers—some are quick, self-guided learners, others do not take their studies seriously, and still others struggle despite their efforts to learn. In terms of student roles, a life cycle view highlights the stages of applicant, initial degree student, early career student, executive student, and alumni (not necessarily in this order and with potential re-occurrence). In terms of student scenes, we can distinguish between students studying on campus and distance learners, i.e. students who are not physically present on campus.

*Value propositions for students*: A university typically offers a range of bachelor, master, diploma, executive master, and PhD programs. These programs include such elements as lectures, the use of on-line learning platforms, library access, career services, and extra-curricular activities.

*Value demonstration for students*: A university presents its programs in brochures, on websites, at special events and informational meetings on campus, and at education fairs. A powerful tool to communicate programs to potential students is recommendations by current and former students.

*Capabilities*: A university needs administrators to handle admissions, program planning and finances, and graduation; faculty for teaching; and facilities that enable learning.

The above lists are short and not exhaustive, but they capture the essence of each dimension with regards to a university's education business model. The alignment of these dimensions can be illustrated as in Figure 7.1.

The figure illustrates some important issues. First, the different student roles (the who) and the value propositions (the what) are clearly aligned. For each role, there is a corresponding program. While this orderly match has its advantages, it also demonstrates the inflexibility of this setup: there is no bachelor or master program for an executive, the education process has to be entered after high-school. In addition, the figure shows no differentiation between on-campus and off-campus students and programs, for example high-school graduates who have full-time employment and would therefore be interested in distance learning program can easily be "overseen" in the figure.

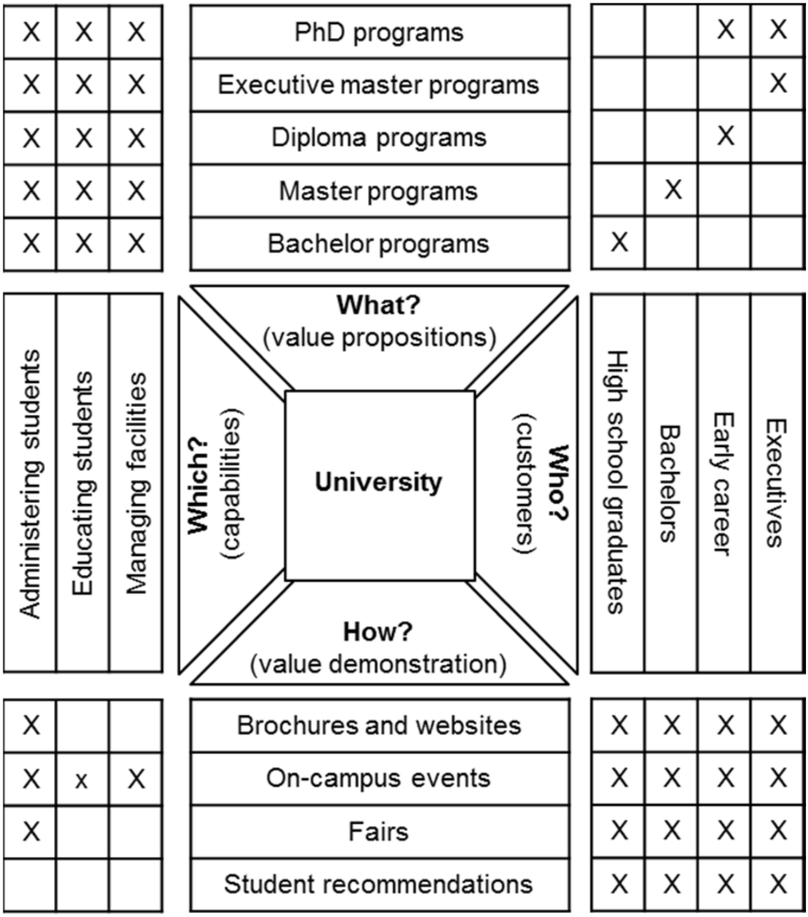



*Figure 7.1: Business Alignment Squares for a University*

The alignment between capabilities and value propositions is complete, as all possible boxes are checked. In other words, every capability contributes to each offering. In this respect, no resources are assigned only to certain offerings, which creates full flexibility in terms of capacity utilization—resources can be employed across value propositions as needed. Yet there might be opportunities to improve program quality by developing dedicated resources, for example bachelor student houses vs. executive education facilities.

Value demonstration is mainly driven by program administration personnel—only at on-site events and meetings faculty members give short lectures. One of the most powerful value-demonstration channels is recommendations made by current and past students. But the university has little control over this channel, as it exists mainly outside of the university. However, the program administrators can invite current and former students to talk about their experiences at the university at various events and meetings.

Let us consider a second example. Bang & Olufsen (B&O)[36] "manufactures a highly distinctive and exclusive range of televisions, music systems, loudspeakers, telephones, and multimedia products that combine technological excellence with emotional appeal". The company is "an international design icon and a global symbol of audio-visual

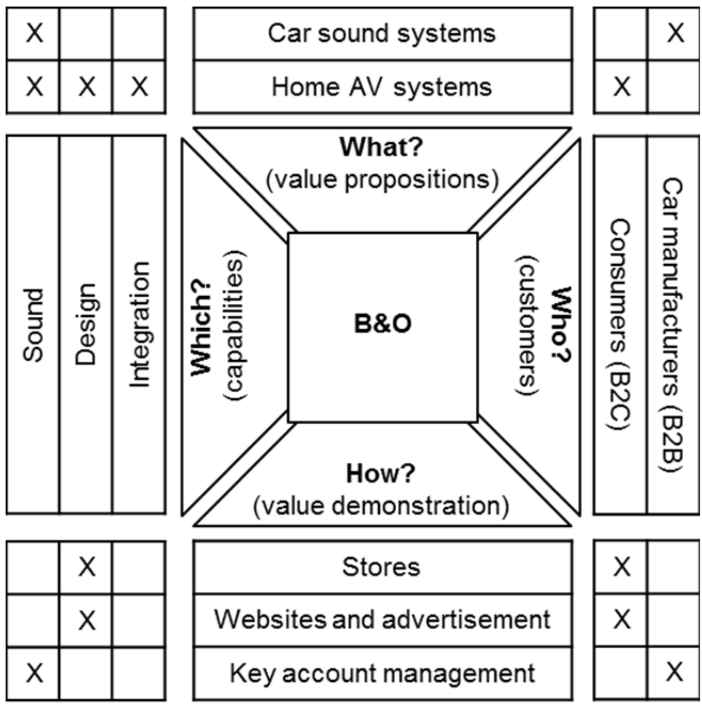



*Figure 7.2: Business Alignment Squares of Bang & Olufsen*

[36] The quoted text and the numbers used in this example are taken from Bang & Olufsen's website and from the company's Annual Report 2013/14.

excellence”. Moreover, “Bang & Olufsen products are sold mainly by an extensive, independent retail network across more than 100 countries. The majority of these retailers are concept stores, which exclusively sell Bang & Olufsen products”. The company states that “besides entertainment products for the home environment, Bang & Olufsen applies its acoustic skills and design competences in creating high-performance sound systems for the high-end car industry, bringing the entertainment experience to a new level”. This information can be translated into the business alignment squares illustrated in Figure 7.2.

In B&O’s case, there is also clear alignment between customers and value propositions, but this occurs on a very abstract high level (B2B versus B2C). The same is true for the alignment between customers and value demonstration. Looking at the business alignment squares, the B2C and the B2B elements do share only little in common, so they can be considered two business models (see Chapter 13). While sound is central to the B&O value proposition according to the firm’s announcements, sound is not demonstrated in their shops through sound studios, nor can the sound experience be demonstrated on paper or on a screen via a website. Thus, there is some misalignment in the squares.

Based on the financial information found in B&O’s Annual Report, the business model dimensions can be scaled in the business alignment squares (Figure 7.3) so that the shape represents the financial situation. The only exception is value demonstration, for which no relevant figures are available.

Figure 7.3 illustrates that the B2C part of B&O is accounting for the majority of the business, with TV being the main product. Production is the main cost for B&O, the firm also invests in sales and marketing of its offerings. Given that there are no significant profits made and therefore no profits shown in the figure, B&O has not enough brand equity in the market – the firm has to support its brand and cannot use the brand to generate profits.

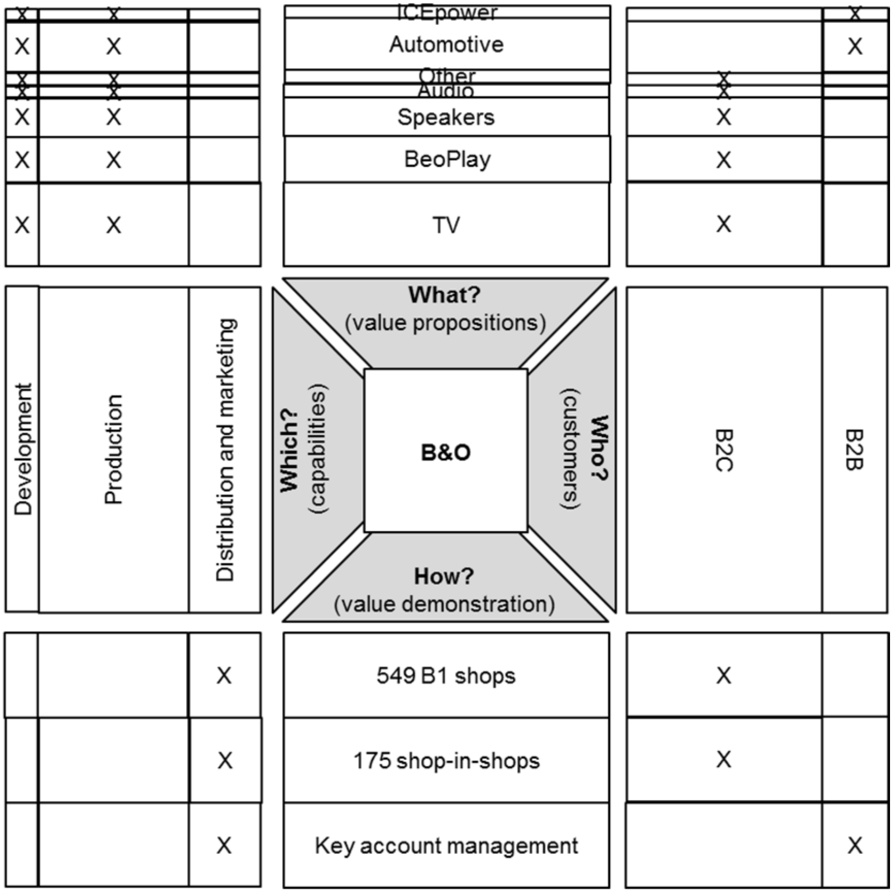



*Figure 7.3: Business Alignment Squares of B&O Scaled to Financial Records*

The alignment square adds insight into the inner logic of the business model by including the links among dimensions and by allowing for various parts to be scaled on the basis of such measures as turnover, costs, or profits. This type of static-snapshot analysis is necessary to develop a starting point for establishing business model excellence, i.e. optimizing, developing, and innovating a business model. Moreover, in order to initiate business development, the four alignment squares must be carefully scrutinized (Figure 7.4).

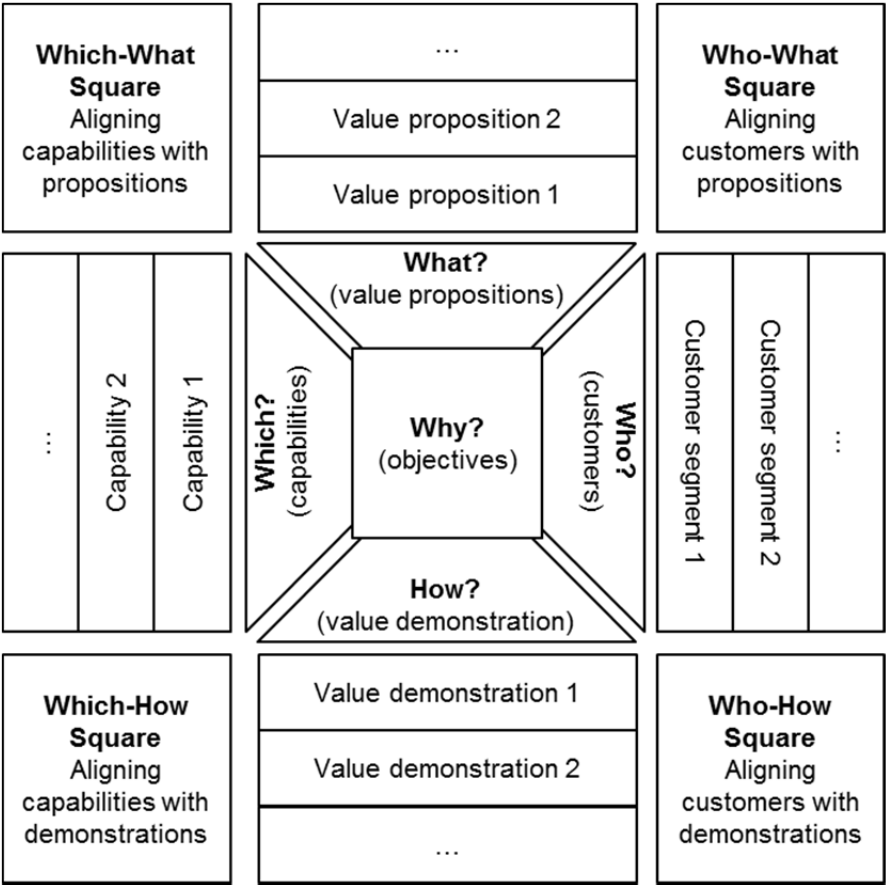
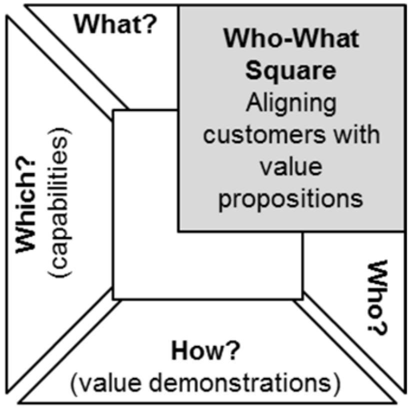



*Figure 7.4: The Four Alignment Squares of a Business Model*

In the following four chapters, each of the four squares is discussed in detail.

# CHAPTER 8
# THE WHO-WHAT SQUARE




Connecting customers with value propositions has long been a challenge in business strategy. Firms find themselves struggling with basic—but key—questions: Who should buy what? How many value propositions do we need to sufficiently cover our customer base?

## The need for a Who-What alignment logic

As discussed in Chapter 7, the ideal situation is one in which there is a clearly defined logic that links different customer segments to the different value propositions. In the university case, for example, there is clear alignment between customer roles (e.g., high-school graduates and bachelors) and value propositions (e.g., bachelor and master programs). Many businesses have various offerings that may be relevant to a single customer. For example, ISS, a global facility-management firm, offers cleaning, canteen operation, and reception services to firms. Banks offer their customers checking accounts, housing loans, short-term consumer loans, saving products, investment opportunities, and a variety of other products. Whatever the number of relevant value propositions, there must be a clear link from a customer segment to relevant value propositions. In other words, there must be recognition of who should buy what. If all customers undifferentiated buy everything, chaos reigns. If the wrong customers buy into a value proposition not designed for this customer, the result is a mess.

Interestingly, some firms have clear ideas for moving customers through the square. DR—Danish public radio and television—has different radio stations aimed at different ages. As a person ages, they are expected to change stations because one station always stays “young”, while another station captures the next age bracket. Danes talk about this progression as a sign of aging, saying things along the lines of: “Imagine that I am so old that I listen to DR1 programs and actually enjoy them!” One might, however, wonder why DR has adopted this particular Who-What square logic. Why not keep listeners on the same frequency all their lives and launch new frequencies when the next generation arrives?

## When logics fail

Once established and optimized, the alignment logic needs to be monitored and regularly revisited because changes can occur that might harm the value of the business model. For many years, the airline industry had a clear alignment logic. After grouping passengers as business travelers or tourists, airlines sold expensive first-class and business-class tickets to business travelers, and cheaper economy-class tickets to tourists. The dividing line between the two value propositions of “expensive travel” and “cheaper travel” was a Saturday-night stay, such that cheaper tickets were only available to passengers staying a Saturday night before taking a return flight (Figure 8.1). However, the emergence of low-cost carriers demolished the requirement for a Saturday night stay. At the same time, many firms began to face significant pressures to save costs, which they responded to by introducing corporate-travel policies promoting, if not requiring, the use of economy-class tickets. Moreover, many travelers became disenchanted with flying, equating the experience to taking a bus. Consequently, the expensive, high-margin tickets were no longer popular, and the entire alignment logic disappeared.

The challenge in the Who-What alignment square is ensuring that the right customers buy the right products. In the pharmaceutical industry, a medication may be granted approval for a new indication, which means that a medicine originally launched for the treatment of one disease may later be used for the treatment of another disease. If the two treatments have different price points, the challenge is to make one group buy the same medication for a higher price just because the diagnosis is different.

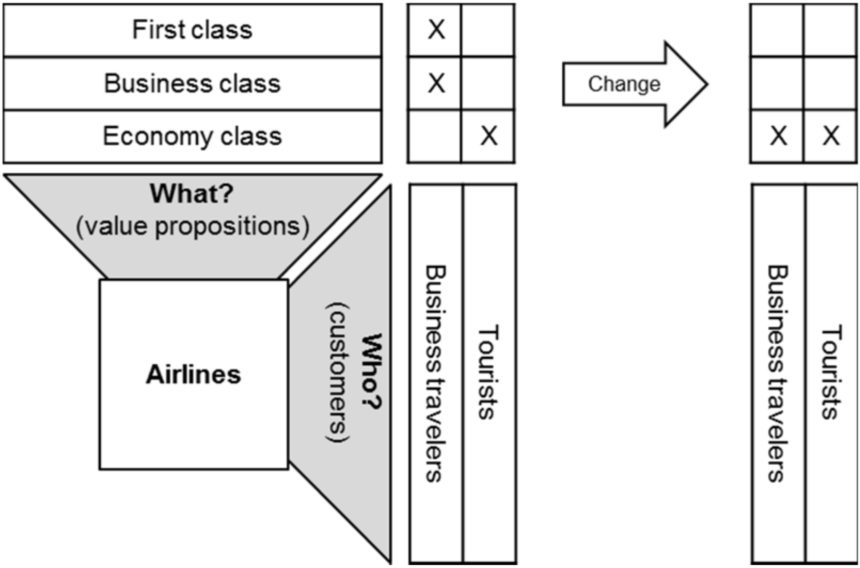



*Figure 8.1: Change in the Who-What Alignment Square in the Airline Industry*

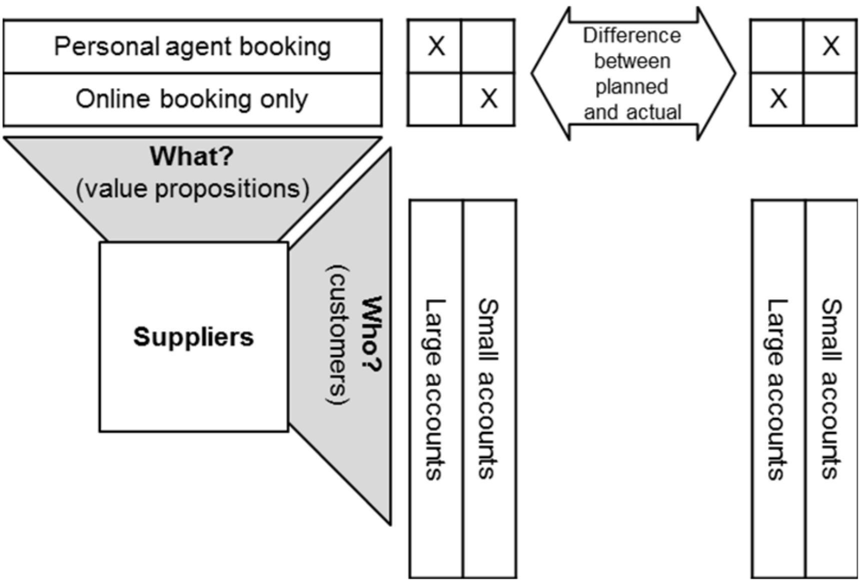



*Figure 8.2: Contracted and Realized Service-Level Agreements*

Another common challenge is enforcing intended service levels for different customer groups (Figure 8.2). Many firms offer automated, web-enabled booking to small, low-turnover customers, while high-volume customers may book through an agent, which is more expensive for the firm. However, these firms' major customers are professionals who know how to use an ordering tool perfectly well and actually prefer to book online. In contrast, small accounts may call agents with every booking despite the fact that their contracts refer them to online booking only.

## When value propositions modularize into partial value propositions

Consider another interesting development evident in the airline industry: the modularization of value propositions. Previously, most airlines offered a "total package" for economy-class travel, which included transport, seating, baggage, food, and drinks. Today, this value proposition has been modularized into separate items, each of which is available for individual purchase (Figure 8.3). Customers do not get more, but they do get the chance to pick and choose as they desire. Instead of one value proposition, a customer can choose among a number of value propositions.

Similarly, computers cannot work without software. However, in most cases, the software is sold separately. All mobile phones need energy, but the charger may need to be purchased separately.

Modularization poses a major threat to traditional retailers. In the old days, customers had to buy into a consolidated value proposition: see and try the product, get advice on what to buy, and then buy it. This worked perfectly in the absence of alternative channels. The Internet has changed this situation dramatically—online retailers can offer products at lower prices because the "try the product and get advice" part is not part of their value propositions. Traditional retail outlets must incur the costs of running and staffing a store, and their customers may leave the store without making a purchase because they can buy the products for a lower price via the Internet (Figure 8.4).

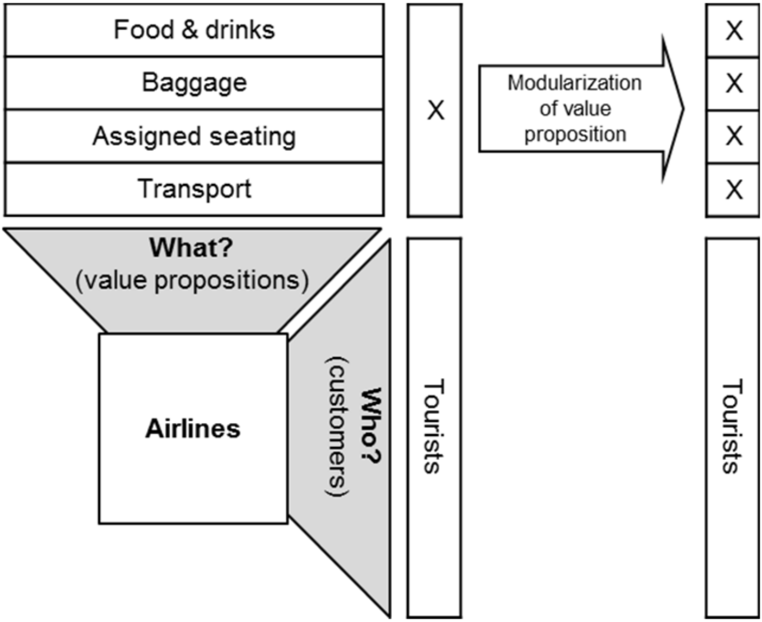



*Figure 8.3: Modularization of value propositions*

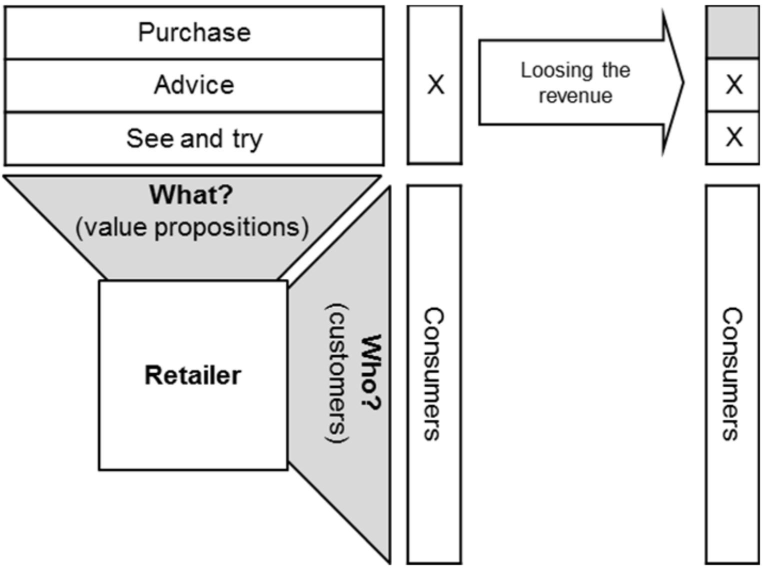



*Figure 8.4: Retailer Challenge—Losing the Sale but Keeping the Costs*

## Expanding the Who-What square from inside

The Who-What square describes the firm's financial income because, in essence, it captures turnover (price per value proposition multiplied by the number of customers buying) and profitability (margin per value proposition multiplied by the number of customers buying). Many firms have an organic growth strategy that focuses on increasing the value of their Who-What square. The options for expanding the existing Who-What square are (Figure 8.5):

*Sell more:* One way to achieve growth is to increase sales volume per customer by selling more of the same product to the same customer. McDonalds, for example, excels at turning normal meals into extra-large meals, the famous supersize deals. Supermarkets often feature special deals like "extra-value" boxes of cereal. Telecommunication firms offer lower prices for additional numbers and extra phones.

*Raise prices:* Another option is to increase prices while everything else stays the same. Utility firms, insurance firms, and banks regularly send letters to their customers announcing increases in their prices. The higher prices are normally attributed to changes in the cost structure or increases in supply costs, which might mean that their profitability would not increase. However, customer turnover increases when the price per unit rises.

*Engage in "upselling":* An interesting possibility for increasing turnover within the existing square is to transfer customers to "higher" value propositions, which are often characterized by a combination of better features for the customer and better margins for the supplier. For example, the typical wine menu in a restaurant has the "best margin wines" in the mid-range, as restaurants find it relatively easy to get guests to transfer from the cheapest offering to the middle. Car dealers, home appliance retailers, and electronics manufacturers all market products based on the idea that "for just a little bit more, you get so much more". This option is of particular interest in areas where no-payment options are the entry mode for customers., i.e., where customers need to transfer from a basic, free option to an advanced, for-payment option before the supplier receives any income. Examples include LinkedIn Premium, newspaper subscriptions to access full content, and in-app purchases.

*Cross-sell:* While upselling trades one checkmark in the Who-What square for another, better-paid square, cross-selling adds checkmarks to the existing one(s). This occurs, for example, when a guest checks in at a hotel and adds dinner and wellness treatments, when a customer buys a car and adds winter tires, when a firm purchases an industrial machine and adds a service contract, or when a family buys furniture at IKEA and eats there. Cross-sales can fill the empty holes in the square.

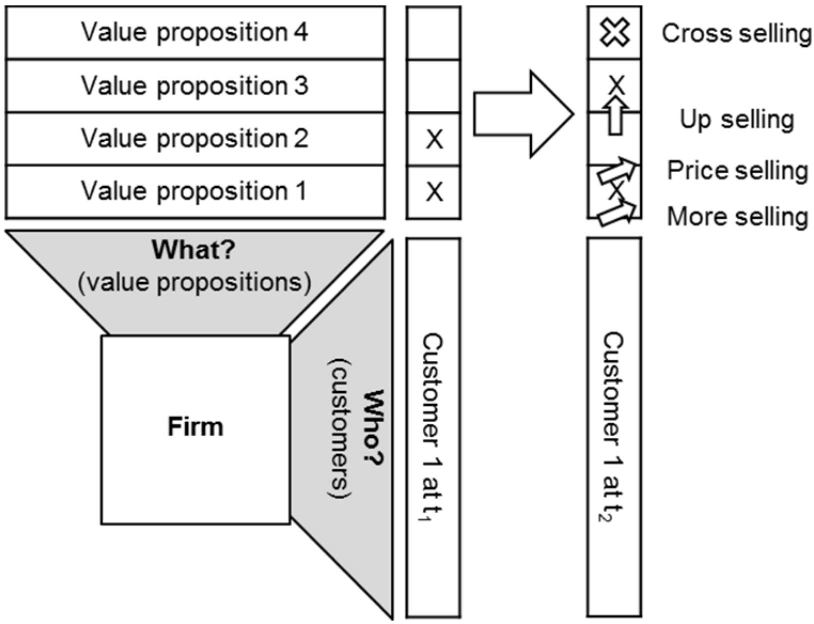



*Figure 8.5: Within-Square Growth Options*

## Growing the Who-What square itself

The four growth options described above apply to an existing Who-What square. As such, they rely on existing value propositions and existing customers. Naturally, growth is not restricted to the given Who-What square. The square can be expanded along the two dimensions, i.e., adding customers and adding value propositions.

The first expansion option is to add customers who have the same needs as existing customers. In other words, the firm can seek out new customers who share characteristics with existing segments in terms of group, type, role, and scene. The firm already has experiences in how to handle these kinds of customers and it has relevant value propositions.

This option can be split into two sub-options: customer takeover and customer onboarding.

*Customer takeover*: In this case, the new customers are acquired from competitors and have therefore been on the market. Such customer acquisition leaves the overall market size constant but changes market shares. This is a common growth pattern, especially in markets where contracts are regularly put out for tendering, such as in advertising, cleaning and facility management, firm pension management, and bus and train transport.

*Customer onboarding*: In this case, the new customers are new to the market. In other words, they have not previously bought into similar value propositions. Onboarding increases the number of customers on a market as well as the value of the overall market. This is typical for completely new offerings. For examples, when mobile phones were first introduced to the market, telecommunication companies competed for new-to-market customers, converting non-customers into mobile-phone owners. In fast-moving consumer goods, customer onboarding is typically referred to as "growing the category". In the pharmaceutical industry, turning ill but previously untreated people into patients offers huge growth potential. In diabetes treatment, for example, Novo Nordisk has embraced the "rule of halves,"[37] which highlights the fact that the current patient base is only about 25 percent of the potential market size.

In addition to customers, the Who-What square can be expanded in line with the ideas that Ansoff presents in his Market-Growth Matrix:[38] new customer segments can be added to the existing customer base or new value propositions can be introduced. In this regard, there are three options (Figure 8.6):

*Value-proposition expansion:* Firms often develop value propositions that are new to the business and sell them to existing customers. For example, servitization—in which producers of machines and equipment expand their portfolio of value propositions with maintenance and repair services—is a huge trend in manufacturing industries. In 2014, Vestas (wind energy) announced that it expects to earn more through service-based value propositions than through its traditional wind-turbine business. Pharmaceutical firms are expanding into diagnostics in order to offer "solutions" that enable a doctor to correctly and efficiently diagnose a

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[37] See the Novo Nordisk website, changingdiabetesbarometer.com

[38] Ansoff (1957) distinguishes between markets (instead of customers) and products (instead of value propositions).

patient, and then prescribe treatment. Likewise, sports-car manufacturer Porsche expanded its sports car offerings by adding an SUV, the Porsche Cayenne—a very different value proposition aimed at ensuring that the company's customers do not defect when their needs for space and comfort change.

Alternatively, a value-proposition expansion can emerge for products near the end of their life cycles. Firms such as Kodak faced a major challenge when digital photography was introduced to the once purely analog photography market, which later become "digital only". In that situation, the original value proposition was cannibalized by the new value proposition. In Nokia, smart phones expanded, and later cannibalized, the traditional "button-phone" offering.

In the above examples, the expansion was close and related to the original value propositions. However, other firms depart significantly from their original set of value propositions. For example, UK retailer Sainsbury began to offer electricity, banking, mobile phones and much more to its retail customers 15 years ago. A similar growth strategy is being implemented by the Danish retailer Coop, which is expanding into banking.

*Customer-base expansion:* The addition of new customers may be a winning concept. The VIPP trash bin was originally invented for business use, and was mainly used by hairdressers, and later by dentists and general practitioners. However, the company enjoyed impressive growth after marketing the VIPP bin to consumers as a designer product.[39]

*Diversification* (proposition and base expansion): The video-console market initially addressed "hard-core gamers" who played to win. However, when Nintendo launched its Wii game console, the move-detection feature (a new value proposition) provided the company with access to the "social gamers" segment—those who play for fun (new customers). This move significantly expanded the video-console market.

Not every growth initiative focused on the Who-What square is a success. When the Coca Cola Corporation launched New Coke in 1985,[40] it invested heavily in a new taste, in production, and in marketing. However, its new product was met by angry customers—there was no alignment between Coke's new value proposition and customer needs. Likewise, Carlsberg's new packaging—a lighter, more modern bottle—was rejected by customers when it was introduced. The significant misalignment

[39] Vipp.com.
[40] Coca-colacompany.com/history/the-real-story-of-new-coke.

eventually resulted in reintroducing the old design and offering free beer on the re-launch day.

All of a business's turnover is derived in the Who-What square. Figure 8.6 gives an overview of growth options. However, this turnover can only be achieved if the value proposition is convincingly demonstrated to customers, who then accept it and buy into it. Thus, an important precondition for turnover and growth is the optimization of the Who-How square.

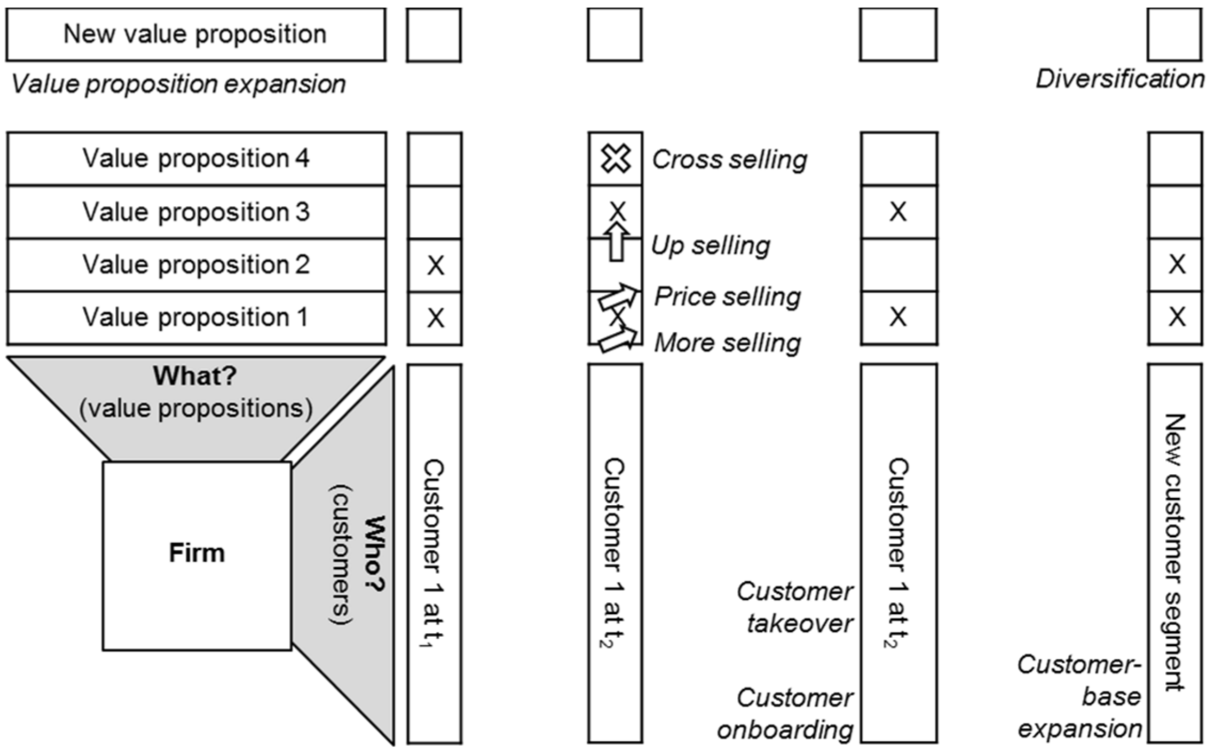
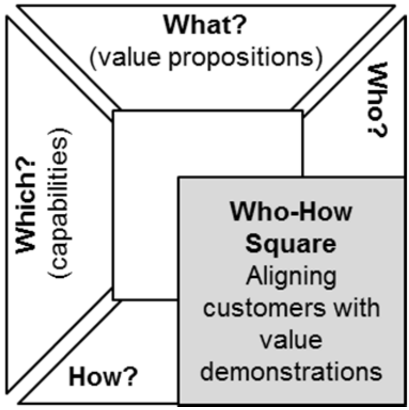



*Figure 8.5: Growth Options*

# CHAPTER 9
# THE WHO-HOW SQUARE




As discussed in Chapter 5, customers need to understand the value proposition. Therefore, firms must find ways of demonstrating their offerings to customers. However, customers differ, as discussed in Chapter 4. Thus, a business needs to align customer segments with specific value demonstrations if it is to optimize the business's results. Similar to the Who-What square, the key questions for the Who-How square are: Which kind of customer is exposed to which kind of value demonstration? How often should a customer be exposed to a given value demonstration? How many different value demonstrations should one customer be exposed to?

## Developing the Who-How square

*More or less of the same:* Firms can choose to increase or decrease the exposure of existing value demonstrations towards their customers. Even in 2014, TV and radio advertising remain popular. This existing connection can be enforced by increasingly broadcast an advertisement—the same customer hears or sees the same advertisement more often. Alternatively, a firm can decide to reduce exposure.

*Moving a customer:* Advances in the form of the Internet and related digital tools, such as Facebook, Twitter, and LinkedIn, have given rise to new value demonstration formats that often are cheaper and more powerful than printed material. These formats can include such features as live dialogues or videos. Firms are actively moving customers from paper-based demonstrations to demonstrations based on the Internet. Alternative moves are announcing a customer as a key account and therewith introducing the customer to a key account manager and access to seminars as new value demonstration tools.

*Adding other value demonstrations:* At time, firms allow certain consumers to order a sample of a product (e.g., food items), in which case the value demonstration becomes a hands-on experience. If product samples are not possible, firms may “upgrade” prospective customers to visit their factories or their show-rooms. In the pharmaceutical industry, doctors are often invited to conferences to meet key opinion leaders in their field, which adds a new type of value demonstration to the existing meetings with sales representatives.

## Introducing value demonstrations for new customers

At times, firms have to communicate with non-customers—people that are not yet in contact with the business. For example, Copenhagen Phil needed to communicate the value of classical music to non-users (as mentioned in Chapter 5). The problem was that the true acoustic value could only be produced in concert halls, which were seldom frequented by non-customers. In order to reach the non-customer segment, Copenhagen Phil used two flash mobs in which the orchestra spontaneously performed in a metro and at the main station. In other words, the organization met potential customers where they were.

The Danish government wanted to promote first-time voter participation in the local elections in 2013. For this purpose, an animated film using “youth slang” was created. While the alignment was correct (new value demonstration for new customers), the promotional video was highly controversial and received widespread critique for its inability to reach young voters. This negative attention arose because the video did not appeal to the needs of the target group.

In 2008, the owner of River Pools & Spa in Virginia, Marcus Sheridan, started a blog on issues related to indoor and outdoor pools. The blog offered short, informative, easy-to-understand discussions on topics that seemed to be of concern to customers.[41] This new website communicated

[41] See article by Christian W. Larsen, Huset Markedsføring, August 28, 2014.

the advantages of River Pools & Spa so well that many new customers began to buy from the firm. The information made available on the website turned non-customers into customers, and attracted customers away from competitors.

At times, other actors may play a major role in demonstrating value. Lawyers faced a growing interest in people making their will as people got aware of the problems involved with not making a testament. The awareness was triggered by a TV drama series on national TV describing a families struggle with a problematic will.

## The interplay between value propositions and value demonstrations

Thus far, value propositions and value demonstrations have been highlighted as depending and reinforcing each other, although they remain different. In reality, these two dimensions also compete with each other.

For example, a consultant can demonstrate her knowledge of a subject by discussing an assignment with a client, offering potential solutions, and sharing experiences. While this is a substantial value demonstration, it is also a great part of the value proposition the consultant want to charge for. When giving this knowledge as part of a value demonstration, the customer already received inputs before the contract even started. What is left to charge for when essential knowledge is already passed on to the client during value demonstration? The situation in executive education is the same—there is no use in running education programs on the basis of a thought such as: “Could you please train the group so that we can understand the value proposition?”

## Self-segmentation

Many value demonstrations reach customers rather undifferentiated: advertisement is put in all letter boxes, TV advertisement is optimized to viewer characteristics but still rather unfocused, websites are visited by very different customers. With these value demonstrations, it is very important to allow customer to self-segment them into “their” demonstration. As businesses do not know who is watching, they need to offer fast directions to get customers to “their” demonstration.

For example, websites nowadays feature different customer stories, e.g., one case on cost safing, one case on green issues, on case on technical brilliance. Customers will click on these case stories according to their needs, i.e. there is a high likelihood that the price chasers will click on the cost savings, the environmentalist on the green issue case and the technical interested on the third story.

## Proof of impact

Executives increasingly want to see a direct connection between investments and business results. This includes the effectiveness of value demonstrations which has intensified the discussion about return on marketing investments and business impact calculations of marketing activities. However, this is a difficult discipline. All turnover and profit is accounted for in the Who-What square, either per customer or per offering – this makes it easy to document impact for the sales people as they typically sit with negotiations and, finally, get contracts. For all activities earlier in the process, there is no such straight forward way. Executives build and test quasi-measures such as Facebook likes, number of clicks, retweets, newspaper space gained by public relations initiatives. While this is currently far from optimal, measures are developing.

Figure 9.1 illustrates the different optimization options in the Who-How square. After having reached alignment between customers and value propositions and customers and value demonstrations, the following two chapters focus on the alignment of capabilities with value propositions and value demonstrations. This step is necessary to ensure that a business can deliver on the decisions taken so far.

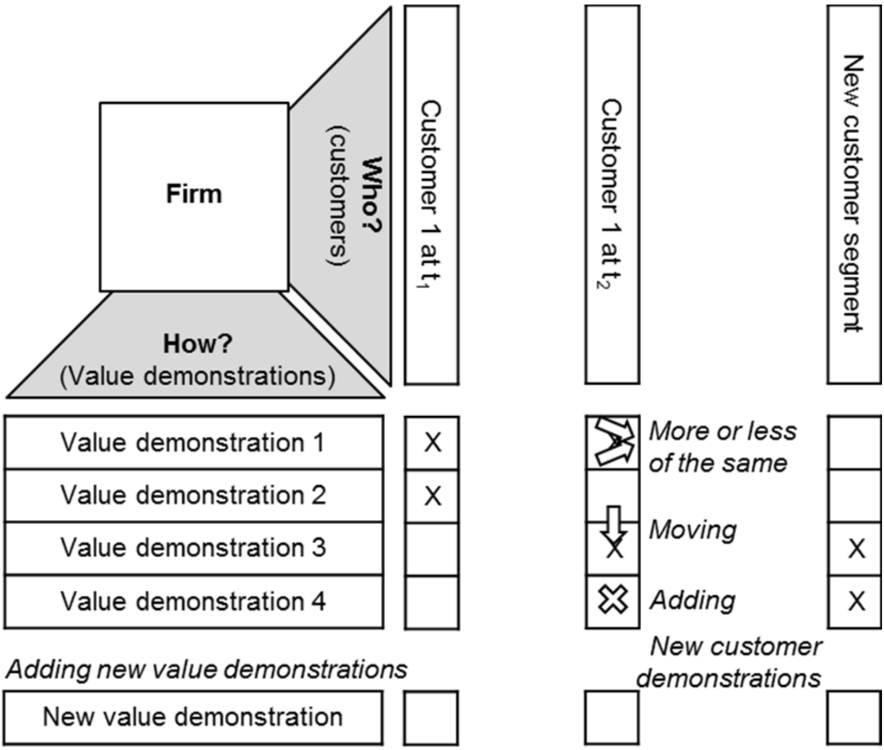
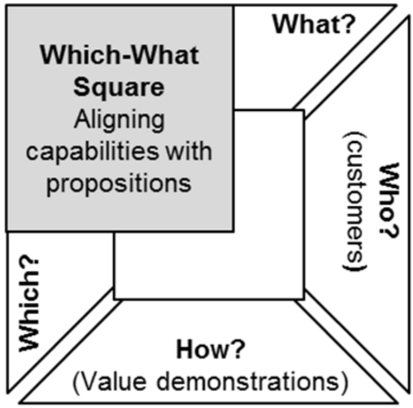



*Figure 9.1: Development Options for the Who-How Square*

# CHAPTER 10
# THE WHICH-WHAT SQUARE




The Which-What square captures the alignment of a business's capabilities (what the business does well) with its value propositions (the business's deliverables to its customers). Therefore, the Which-What square captures the capabilities necessary for each value proposition (indicated by a cross) and it defines the costs associated with producing the value propositions.

The importance of resources and capabilities for business performance has long been in focus, and the need to analyze combination of capabilities and value propositions was suggested 30 years ago.[42] The Which-What square allows for discussions of optimization (how many capabilities are used per value proposition), allocation (which capability is central to each value proposition and might therefore be a bottleneck), and replacement (how to change from one capability to another).

## Optimizing existing crosses

Similar to the more-selling and price-selling options in the Who-What square, an individual connection can be optimized by making it cheaper. This can be achieved by using either cheaper inputs or fewer inputs. A key managerial objective is to reduce capability use per value proposition

[42] Wernerfelt (1984).

in order to lower costs. Concepts such as Lean[43] and the Toyota Way[44] are prominent tools in this optimization endeavor. In addition, discussions of outsourcing, offshoring, and automation are common in the search for cost-cutting opportunities.

The removal of a capability from a value proposition without changing the value proposition is the most radical form of optimization in the Which-What square. At times, a value proposition contains elements that a customer does not need. The removal of these elements does not change the value proposition for the customer, but it does create possibilities to more effectively use the resources. For example, the availability of fast-response service in case of breakdowns in production and IT systems might not be important for some customers. As such, fast-response can be removed from the package offered to those customers. Similarly, IT systems may encompass functionalities not used by the customer, and products reaching the end of their lifecycle may no longer receive R&D resources.

Optimization can also be achieved by "upgrading" or "downgrading"—by replacing one capability with another. The use of a lower-cost capability to produce the same value proposition (e.g., moving production to a low-cost site, which is a strategy typical adopted by multi-national corporations) or the introduction of a more flexible production setup are possible ways to "move value propositions between capabilities".

## Enlarging the square

The Which-What square can be enlarged in the several ways. First, capabilities can be combined to create new value propositions. This is similar to cross-selling in the Who-What square. For example, the Danish telecommunications firm TDC has capabilities in both fixed-line telephony and mobile telephony. The firm therefore launched an offering called "TDC Duet", which combined a fixed-line phone number with a mobile number, thereby offering new functionalities. This was a new value proposition at the time of its launch and it left competitors in both the fixed-line and mobile markets behind, as they could not offer a combined value proposition. Likewise, Apple combined its capabilities in digital-music players with mobile phone capabilities to create the iPhone as a replacement for the two devices.

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[43] E.g., Modig and Åhlström (2012).
[44] E.g., Liker (2004).

Second, capabilities can be leveraged to create new value propositions. In this case, a capability is used for a new value proposition. Atlanta-based Weather Channel provides consumers with information on local weather conditions through a smart-phone weather application. It combines that information with its knowledge of what people typically purchase in those weather conditions in order to customize advertisements. This represents a new value proposition for advertising agencies in terms of optimizing their performance.

Third, capabilities can be added through in-house-development or acquisition. They can then be used to supplement an existing value proposition or to build new value propositions.

## Reducing the square

While most of the attention in business is on growth, reduction is also a viable option for enhancing alignment. For example, one firm praised itself for a certain capability, which was indeed outstanding. However, none of that firm's value propositions made use of the focal capability. Such "capabilities with no crosses" are either remains from the past, i.e., once important capabilities that became irrelevant but were not divested, or they are promising candidates for the future, i.e., capabilities that are not yet included in value propositions but are likely to be included in the future. In either case, the close monitoring of applications for the capability is necessary. Divestments are one possible way of resolving this issue.

Figure 10.1 illustrates the different choices within the Which-What square. Capabilities are not only important for value propositions but also for demonstrating the value to customers. Thus, the next chapter explores the fourth of the business alignment squares.

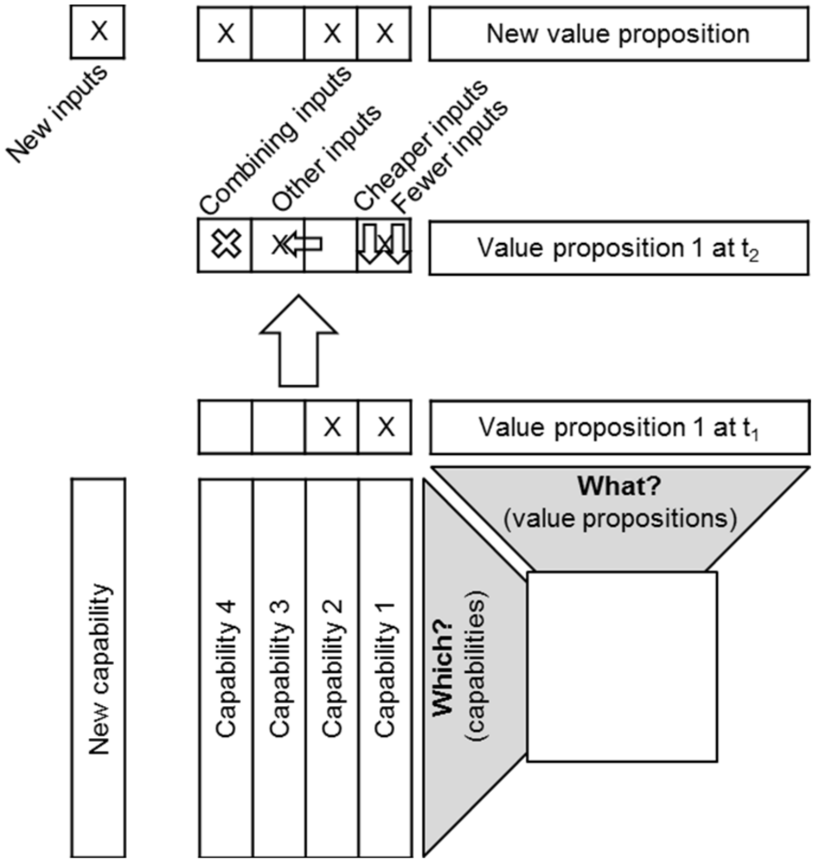
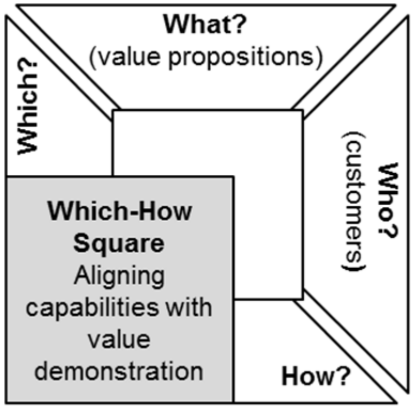



*Figure 10.1: Which-What square development options*

# CHAPTER 11
# THE WHICH-HOW SQUARE




The Which-How square defines the use of the firm's capabilities for demonstrating the value propositions. The square reflects the costs for sales and marketing as well as the involvement of different capabilities in value demonstration. For example, in technical and scientific sales, technical and R&D personnel are involved in the demonstration of value because they can discuss the technical issues with the customer. This typically introduces high costs and internal coordination issues among departments.

The key questions in this square are:

- Which capabilities need to be involved in a demonstration tool?
- Can the use of capabilities and therewith costs be reduced without compromising effectiveness of a value demonstration?
- Which new value demonstrations can be built given the existing capabilities?
- Which new capabilities need to be developed to maintain existing value demonstrations and develop new ones?
- Which capabilities are obsolete for value demonstration?

In the Bang & Olufsen (B&O) example discussed in Chapter 7, the firm's core capabilities are identified as sound, design, and integration expertise. However, the company's value-demonstration tools do not offer a sound experience. All printed material is soundless, and B&O shops are neatly designed (so that there is a cross) but there is less opportunity to experience the acclaimed sound quality. In other words, an essential cross is missing or at least could be optimized.

A common discussion in this square is the use of production sites, research labs, and running customer installations for demonstrating value to prospective customers. While many firms report very positive experiences with bringing customers to factory visits and the like, these value demonstrations demand investments and they do have consequences for human resource management because customer contact need to be a part of the job description and the candidate must have the right profile beyond the production expertise.

Another interesting issue is the involvement of those in value demonstrations who also will participate in the delivery. In consulting and executive education, customers want to meet the experts to judge on their abilities. This makes value demonstration very expensive because these employees are not working on projects when "being out selling".

The options for the Which-How square are similar to those seen in the Which-What square (Chapter 10), as illustrated in Figure 11.1.

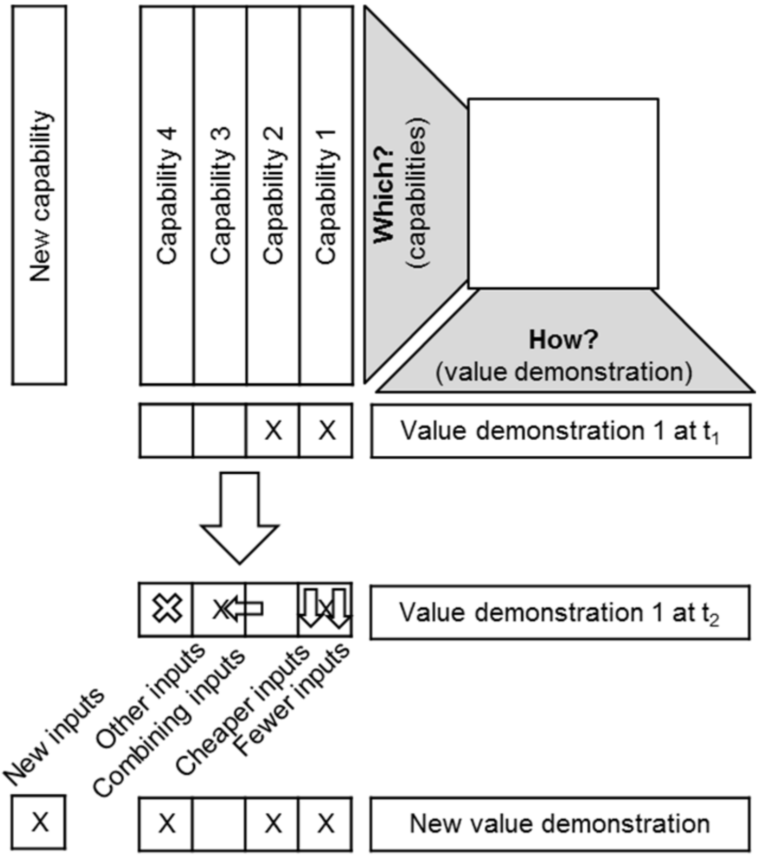



Figure 11.1: Which-How square development options

# PART IV

# BUSINESS MODEL EXCELLENCE

Parts I, II and III of this book presented important questions regarding a business. Thus far, in our attempt to capture and develop the logic of the business, we have suggested the use of Square 1, the "Business Objective Square," for aligning the goals of the owners and executives of a business, and Square 2, the "Business Model Square," for gaining an overview of the elements that define the business. We have also introduced the "Four Squares", which are useful for aligning the four dimensions with one another.

In this part of the book, we use the 1-2-FOUR squares to discuss typical topics of managerial interest. These chapters do not aim to present solutions to specific challenges, but rather to illustrate the use of the squares in framing and discussing various subjects. The chapters can therefore be used as introductions to workshops in which executives discuss the issues at hand and develop solutions using the squares.

# CHAPTER 12
# DISCUSSING CHANGES AND CHALLENGES TO A BUSINESS MODEL

The 1-2-FOUR squares offer executives a map of items that can be used to monitor changes that might challenge the business. Change may challenge a business's very existence by threatening to make it obsolete in its current format or by challenging it in terms of growth opportunities that need to be realized.

A PEST[45] analysis is one type of analysis that can be used in conjunction with the squares (Figure 12.1):

- What kind of political developments influence the business? Regional issues (e.g., embargoes, trade restrictions, or civil war) affect local sales. This might be particularly true for foreign companies. Political interests can impose new laws and regulations that affect value propositions (e.g., a ban on certain materials), or restrict access to key communication platforms, such as Twitter or Facebook. Different regulations support or restrict the development of various capabilities (e.g., biotechnology, genetically modified products) in various countries.
- What kind of economic developments influence the business? The financial crisis has demonstrated how widespread economic changes can occur and the types of challenges such changes may pose to businesses. For example, customer segments may be forced out of the market due to a lack of disposable income; there may be a greater need to document value impacts; the use of value-impact measures aimed at determining value capture (outcome-driven revenue models) may rise; and funding for capability development may be lacking.
- What kind of societal developments influence the business? Customers may have environmental concerns that businesses must address in their value propositions and value demonstrations. For example, there is a movement towards natural ingredients in food and beverages which is driven by society and no science or law. Moreover, the social status associated with certain jobs may change, making it easier or harder to

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[45] PEST stands for political, economical, social, and technological. The concept, which is often used for analyses in strategic management, has also been extended to "PESTLE" to include legal and environmental concerns. Here, these two aspects are treated as political and social aspects, respectably.

hire staff (e.g. there is a lack of young people taking an apprenticeship which in turn leads to a lack of employees with craftsman skills). Similarly, acceptance of centralized elderly care can shift driving certain business out of the market.

- What kind of technological developments influence the business? Technology affects all dimensions of a business. It changes the resources available to customers (e.g., many consumers in Europe now have smart phones, which enable them to interact with businesses in different ways and also give rise to a need for network access). Products and services change significantly due to technological developments (e.g., mobile phones, televisions, consumer electronics, and production equipment). Value documentation is becoming digitalized where possible. Some capabilities have proven worthless (e.g., black and white televisions, and floppy disks), while others have become central (e.g., cloud computing).

Figure 12.1 can be broken down to feature customer segments, value propositions, value demonstrations, and capabilities. This allows for more detailed discussions of changes in the environment and their impacts. This is particularly helpful when the challenges and impacts vary significantly among the different elements.

Thinking of the Bang & Olufsen example: Television technology is changing so fast that a television set is outdated within two to three years. This is very different from owning a television for 10 and more years. In addition, technology introduced flat screens which challenges B&O’s design as a capability because all competitors now can produce a nice-looking television. Also, B&O’s integration capability was based on cables but today units connect via WiFi and Bluetooth. Thus many of the B&O capabilities are under pressure due to technological changes.

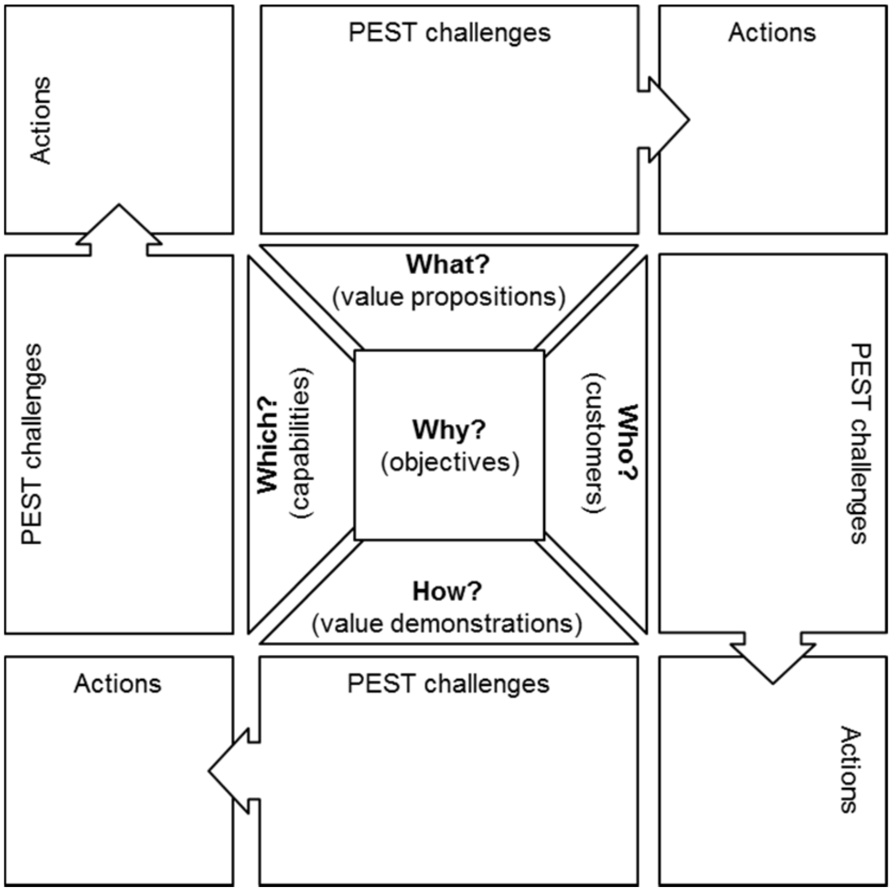


*Figure 12.1: PEST Challenges and Actions to Address Challenges*

Another interesting possibility is to analyze competitors along the four dimensions (Figure 12.2). This analysis would focus on such questions as: Who are our current competitors? Who could potentially become a competitor? Consider, for example, a firm that develops software and delivers it to organizations in the public sector:

- Customers: In addition to competitors currently servicing the public sector, the firm could eventually face competition from firms currently selling software to private firms, i.e., from firms focusing on other customer groups.

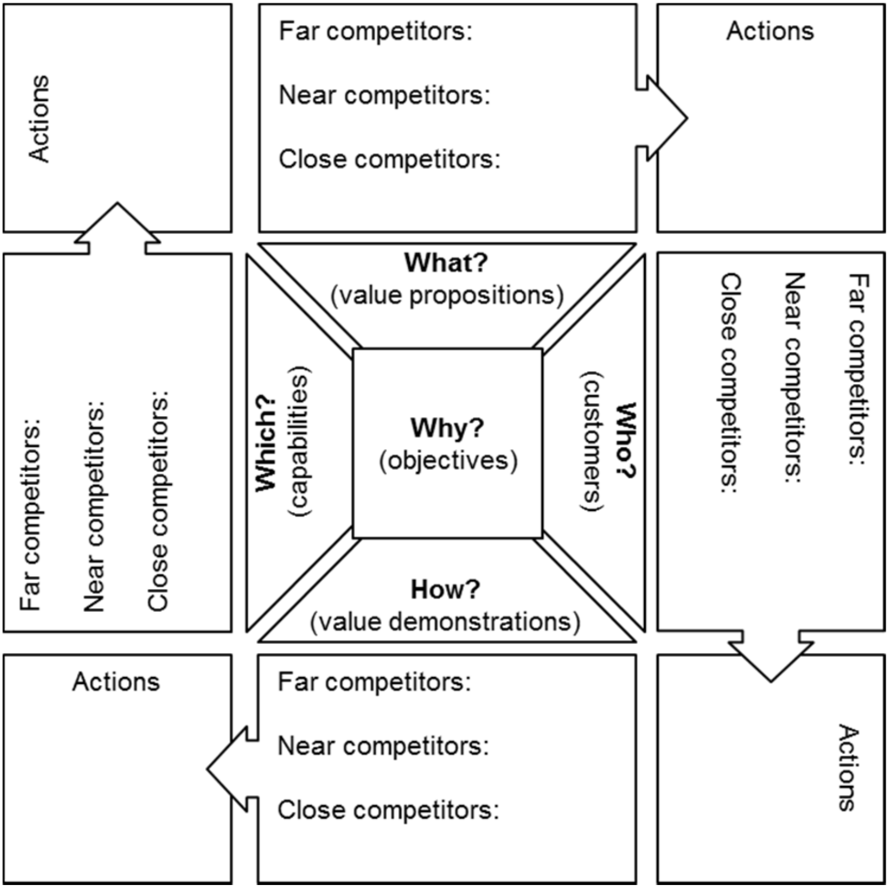


*Figure 12.2: Analysis of Competitors*

- Value propositions: In addition to the list of competitors who develop software, the firm could face competition from firms delivering hardware to the public sector, i.e., from firms focusing on other value propositions.
- Value demonstrations: In addition to the list of competitors handling clients through key account managers, the firm could face competition from firms selling via the Internet or telephone calls, i.e., from firms employing different value demonstrations.
- Capabilities: In addition to the list of competitors employing IT specialists focused on public-sector software, the firm could face competition from firms employing IT specialists focused on the

development of games or applications, i.e., from firms developing different capabilities based on the same resources.

All firms need to consider several layers of competitors. “Close competitors” are those with very similar setups, while “near competitors” are those that do not compete today but are so close that it would be easy for them to compete if they wished to do so. “Far competitors” are organizations that would need time and investments to develop into a competitor.

These analyses serve to illustrate just two the many aspects executives need to monitor in order to fully understand changes and the resulting challenges for a business. While it is important to build an excellent business model in terms of dimensions and their alignment, it is equally important to understand the changes and challenges faced by the business.

# CHAPTER 13
# DISCUSSING DIFFERENCES AMONG BUSINESS MODELS

Often, conversations about businesses, market differentiation, positioning, and customer strategies contain the following statement: “Yes, but this is a different business model.” Everything from minor changes to major departures from current practice seems to qualify as a different business model. The above statement covers a wide range of situations, including:

- Changing the revenue model (the value-capture portion of the value proposition), perhaps by moving from monthly payments to per-hour payments;
- Changing from selling pre-specified bundles of features to offering features as options from which the customer can choose;
- Calculating the value impact and telling a story about it, rather than describing the value contributions;
- Changing sales and orders channels, as seen in a move from traditional high-street shops to web shops;
- Changing delivery channels, perhaps from “get it yourself in our store” to “stream it to your screen;” and
- Changing the underlying technology, as evident in the shift from analog to digital (e.g., for music and pictures).

Undoubtedly, most—if not all—of the above changes result in a significantly different experience for the customer. They also transform industries and challenge firms. However, referring to all of them as “a different business model” leaves them rather undifferentiated.

## Types of new business models

While it is not helpful to fight over definitions, a typology of business-model differences is helpful in discussing the implications of “building different business models”. Based on the four dimensions of the Business Model Square, business models can be defined as different when they have no connection between them. They are, therefore, totally independent of each other (Figure 13.1). This constellation is typical of conglomerates or investment firms that have invested in vastly different businesses in order to spread financial risk.

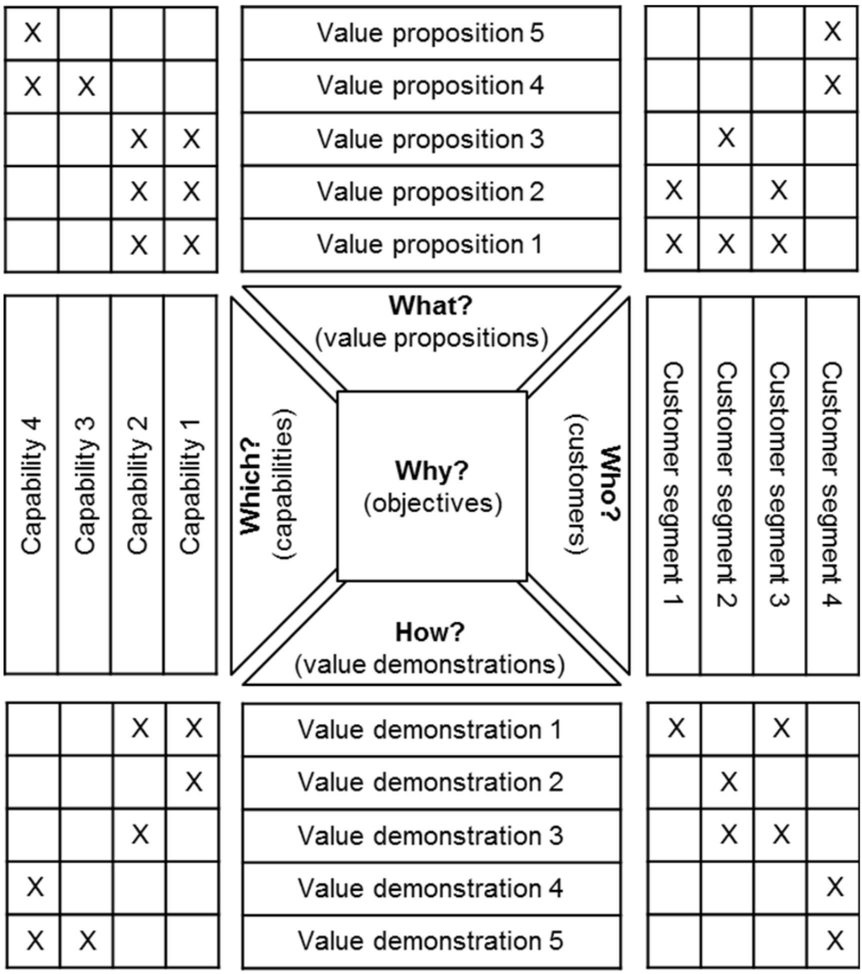


*Figure 13.1: Two Completely Independent Business Models*

Total independence is not the only possible difference between business models. The introduction of changes in some, but not all, elements of a business model is often used to arrive at a “new” business model. We have already discussed some possible changes, such as adding a

| Business model change type | Description | Customers | Value propositions | Value demonstrations | Capabilities |
|---|---|---|---|---|---|
| 1 | Different customers: Communicate and sell the same offering to new customer groups, e.g., export to a new region | × | | | |
| 2 | Different value propositions: Add a new value proposition for existing customers, e.g., launch a new car model | | × | | |
| 3 | Different value demonstrations: Implement a new way of explaining value to customers, e.g., implement value selling or introduce a 3D simulator | | | × | |
| 4 | Different capabilities: Replace a capability, e.g., automate production with robots | | | | × |
| 5 | Attract new customers with a new value proposition, e.g., a five-star hotel chain opens a three-star hotel | × | × | | |
| 6 | Attract new customers through new forms of communication but serve them with existing value propositions, e.g., open a web shop to serve foreign customers | × | | × | |
| 7 | Build an industry expertise in order to address customers from that industry but sell them the same products, produced using the same tools, e.g., a strategy-consulting business enters a new industry | × | | | × |
| 8 | Launch new products that demand a new type of value demonstration, e.g., add service contracts to product sales | | × | × | |
| 9 | Offer a new value proposition based on new capabilities, e.g., change from CD sales to web-based music sales | | × | | × |
| 10 | Use a new capability to demonstrate value in a new way, e.g. establish key account management for large customers | | | × | × |
| 11 | Approach a forgotten segment: Based on new market insight, address a new segment by adapting value propositions and value demonstrations while using existing capabilities | × | × | × | |
| 12 | Make new capabilities available to new customers through new value propositions based on the existing value-demonstration tools, e.g., a high-quality, business travel-oriented airline offers discount tickets for charter tourists through its website | × | × | | × |
| 13 | Globalize a business, e.g., a Scandinavian firm opening a subsidiary in Asia builds new cultural capabilities and a network to demonstrate value to new customers in selling the established value proposition of “Scandinavian design” | × | | × | × |
| 14 | Change everything but the customer, e.g., IBM moves from IT hardware to IT consulting | | × | × | × |
| 15 | Introduce a completely independent, new business model | × | × | × | × |

*Table 13.1: Potential Variations in Business Models*

customer segment or a new value proposition (or both), in the chapters on the four alignment squares (Chapters 8-11). Table 13.1 summarizes possible differences between two business models that can be introduced by systematically changing the dimensions. The table can be used to analyze the differences a given idea or project ("the new business model") would introduce into an existing business model.

The extent to which one refers to a "new" business model as "different" is up to the individual—there are no rules. However, the acknowledgement of the different types of changes is important, as they have very different implications in terms of implementation costs, barriers, and complexity.

## Mergers and Acquisitions

Thus far, we have adopted a development view on the topic of business-model differences. In other words, we have assumed that an organization has a business model and then introduces changes, and we have focused on differences between the old model and the post-change model. The same logic and discussion applies when considering mergers and acquisitions—how different are the two businesses that are to be brought together?

Typical business cases for mergers and acquisitions include opportunities to:

- Enlarge the existing customer base, i.e., increase the volume of the existing business. These types of mergers and acquisitions typically include efficiency gains, as double capabilities can be removed by serving the customers from one base.
- Add different customer groups (new segments) to the existing portfolio. The combined firm may have a wider market reach because it serves a wider variety of customers.
- Add new value propositions. The combined firm is able to offer a wider portfolio for its customer base. Such acquisitions are typical when the target firm's underlying capability (e.g., technologies, service focus) differs from that of the acquirer.
- Add new value demonstrations. The combined firm has a wider platform for interacting with customers (e.g., an online platform, a chain of stores, or a well-tuned sales force).
- Add capabilities. This is typical when technology shifts are on the horizon. Firms acquire new technologies to prepare for a different

future, but they do not immediately translate them into new value propositions or value communications. For example, pharmaceutical firms may buy promising candidates, or ingredient producers may buy new process technologies.

## Strategic alliances

The same arguments can be applied when analyzing potential partners for strategic alliances. For example, Apple and IBM are collaborating to grow iPad sales to business customers.[46] Although many professionals use iPads, Apple has significant value-demonstration experience in consumer marketing. IBM can supplement that capability with its business-to-business sales force. The two firms also plan to develop new applications (value propositions) based on a combination of their IT capabilities, their consumer knowledge (Apple), and their business-customer (IBM) insights.

## Divestments

The links among business models are central when executives face divestment decisions. The ultimate question is: Can a firm sell a business model and remain in business with the remaining elements? If the answer is yes (case 15 in Table 13.1), then there are two business models and one can be sold off. If the answer is no (all other cases in Table 13.1), then the divestment decision must rely on a detailed analysis of the alignment squares in order to develop an understanding of the business risks of giving important parts of the business away. In that case, questions for consideration include: Can these inputs be sourced from the new owner? To what extent will the business be dependent on the new owner?

For example, the Danish energy provider Dong Energy announced that it would be interested in selling its share in A2Sea, a specialist in constructing offshore wind turbines.[47] When Dong Energy originally bought its shares in A2Sea, the market was small and Dong found it necessary to have control over important resources. As the market situation changed, Dong found there was no need for tight control of this capability. The two company's business models are totally independent from each other. As such, a divestment is possible with no implications for Dong Energy's business.

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[46] www.ibm.com and www.apple.com.
[47] Børsen, June 30, 2014, p. 8.

# CHAPTER 14
# DISCUSSING THE INTERNATIONALIZATION AND GLOBALIZATION OF THE BUSINESS

In support of the corporate growth agenda, many executives consider globalizing their businesses to reach a larger market. Growth economies —especially the BRIC countries of Brazil, Russia, India, and China—are often the focus of such discussions. While reaching more customers is often a goal for businesses, the implications of such moves need to be analyzed in order to develop a full understanding of the risks and investment needs.

We therefore suggest that executives carefully consider three questions before they look abroad or intensify their international activities:

- Can the business be further developed in its existing setup? Some executives overlook existing opportunities in home markets because the general trend is to focus on globalization. If business-development opportunities exist locally, they should not be discarded just because they are not global initiatives.
- Is the business healthy enough to support international activities? An unprofitable business may not be the best platform for new international activities. Some firms venture outside their home markets in the belief that doing so will revive their ill-fated businesses. For some, international activities mean a quick decline in cash flow and a significant increase in losses.
- What part or version of the business will be internationalized?

While the first two questions are important for establishing the strategic focus, the third triggers a discussion of the best format for the internationalized business model. A firm can "go international" in a variety of ways, such as:

- Adding new customers but keeping all else the same. This option is mainly viable when new customers can be found directly in the focal country and when those new customers are not notably different from local customers. Alternatively, third parties (e.g., agents) can take over the customer interaction, thereby limiting the extent to which the business faces international customers.

- Adapting the value propositions. Adaptation of the value propositions may be part of the firm's globalization plan, but firms may be surprised by the need to adapt their propositions when they have already made a decision to internationalize. Simple requirements, such as the need to adapt to different electricity sockets, the need to produce manuals and user interfaces in different languages, and the need to comply with different labelling requirements, introduce complexity, which increases costs and risk. More demanding adaptations may include changing recipes to fit local tastes and offering local just-in-time supply. All of these adaptations gradually move the firm toward new value propositions.
- Purposefully developing new value propositions. A typical example is engineering firms with world-leading products that face demand for products with lower-quality specifications at lower price points in new markets. Likewise, climate differences, and differences in infrastructure in terms of electricity, water supply, and telecommunications may require significant efforts to develop suitable value propositions.
- Changing value demonstrations. Many firms find that their established sales channels do not satisfy the needs of new markets. Therefore, investments need to be made in a local sales force, local shops and outlets, and participation in local conferences and meetings.
- Building new capabilities. Firms may need to develop new capabilities related to the demands for new or adapted value propositions, as well as corresponding value demonstrations.

Despite the apparent simplicity of Figure 14.1, the sheer amount of discussions among stakeholders and management teams necessary to ensure the success of internationalization and globalization can be overwhelming. Discussions of the impacts and, more importantly, the associated costs often highlight very different views not only of the existing business model but also of the parts of the business model likely to be affected by internationalization.

One interesting alternative is to internationalize the business's experiences rather than the business model. To do so, a firm uses its experiences from a local market and consults with businesses in other markets on ways of running such a business. This truly represents a "new business model" (consulting), and thereby eliminates impacts on the local business model.

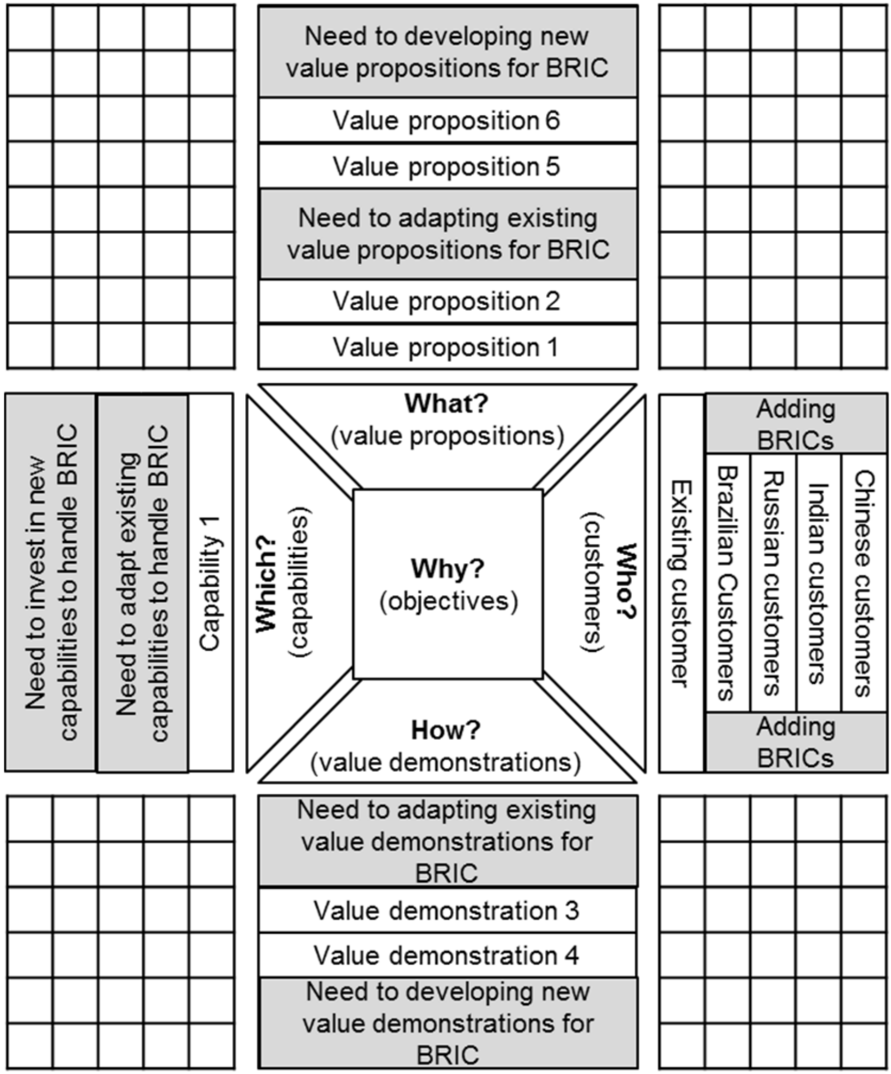


*Figure 14.1: Implications of Internationalization Efforts on a Firm's Business Model*

# CHAPTER 15
# DISCUSSING ORGANIZATIONAL CHARTS

Executives must continually address yet another re-occurring issue: how to best build the organization to ensure that it functions efficiently and effectively. The Business Model Square offers four different options for organizing a business:

- In a *customer-centric organization*, business units correspond to customer segments. These organizations typically feature different departments for B2B and B2C customers (e.g., banks and fast-moving consumer goods (FMCG) firms), or different departments for different client industries or segments (e.g., a sales force divided according to the industries in which clients are active).
- In a *proposition-centric organization*, units are arranged according to the firm's offerings. These organizations have product managers and product-based business units. This type of setup is typical of engineering, life-science, and material-science firms.
- A *demonstration-centric organization* has departments built around a certain value-demonstration mechanism, such as sales channels. Therefore, certain units, such as key-account management, a customer call center, and web-shop unit, can be found on the organizational chart.
- A *capability-centric organization* pools employees according to their capabilities. These organizations are typically characterized by the presence of, for example, a market-research unit and a business-development unit.

Clearly, there is no right or wrong way to organize a business—it is a choice executives have to make. Each of the four approaches has advantages and disadvantages, and each has a good logic as well as elements it cannot support. While firms desiring a powerful force for developing and commercializing a product may feel that it makes perfect sense to pool product expertise, doing so may hinder the optimization of customer management when customers buy different products. This is known as "silo thinking." Alternatively, organizing along customer-segment may result in the replication of resources, as each segment has a product specialist.

Many firms try to combine two logics into a matrix organization in the hope of harvesting the advantages of both. However, matrix organizations may be problematic due to multiple, and at times contradicting demands. Beyond a matrix structure, firms have established communities of practice, often helped by IT platforms for distance learning, document sharing, and interaction. Such “dotted lines” are implemented to enable capability development across business units. The downside of such organizational charts is confusion and tension.

An alternative to a matrix organization is to change the organizational setup regularly. For example, a company may replace a product-centric organization with a customer-centric version. When making such shifts, management teams hope that “old” connections will survive the organizational change and thus continue to contribute to the business, while the new structure can contribute with new impulses. If the old connections are lost, the organizational chart must be changed again. This will result in a regular rhythm of organizational changes.

For example, on July 1, 2014, fast-moving consumer goods giant Procter and Gamble (P&G) removed all marketing-director positions and, in their place, introduced brand directors.[48] P&G Chief Executive A. G. Lafley stated that, as a result, the company transforms to “one integrated brand management organization” with “single-point responsibility for strategy, planning and in-market results”. In other words, instead of having capability-centric units for such activities as strategy, planning, and marketing, P&G introduced a proposition-centric logic focused on brands.

[48] Marketingweek.com, June 30, 2014.


*Figure 15.1: Different Ways of Organizing the Business*

# CHAPTER 16
# DISCUSSING SOURCING FOR CAPABILITIES

One important extension of the 1-2-FOUR squares is the discussion of the sources of a firm's capabilities and the alliances necessary to complement its value propositions. Modern business logic strongly suggests that a firm focuses on core capabilities. All other capabilities shall be outsourced and the firm buys the outcome of non-core processes rather than running those processes internally. Moreover, some firms outsource core areas as long as they believe they have sufficient control and realize adequate margins from outsourcing. Therefore, not all capabilities important for competing may be located within the firm.

Thus far, the capabilities of a business have served as the internal starting point of discussing business models with no attention to where the capabilities come from. As highlighted in Chapter 2, a business's capabilities have to be developed from resources purchased in factor markets. In order to visualize purchasing, the Business Model Square can be inverted, such that capabilities are placed to the right and suppliers (customers in the original version) are placed to the left. In this inverted version of the Business Model Square, suppliers and firm capabilities are still connected by value propositions (the suppliers' propositions to the firm) and by value demonstrations (the suppliers' value demonstrations to the firm). This version of the square enables the discussion of the different inputs into the firm's capabilities.

Co-suppliers' value propositions can also be teased out (Figure 16.1). These propositions reflect contributions made by suppliers that do not enter the firm but are offered directly to customers. For example, a company might only be able to sell a machine but also needs to offer maintenance upon customer demands. The company can choose to build a network of maintenance firms and offer to connect those service suppliers to the customer, but the customer and the service supplier contract directly with each other. As such, the service supplier constitutes an important part of the firm's value proposition to customers even though that part of the business is not part of the firm.

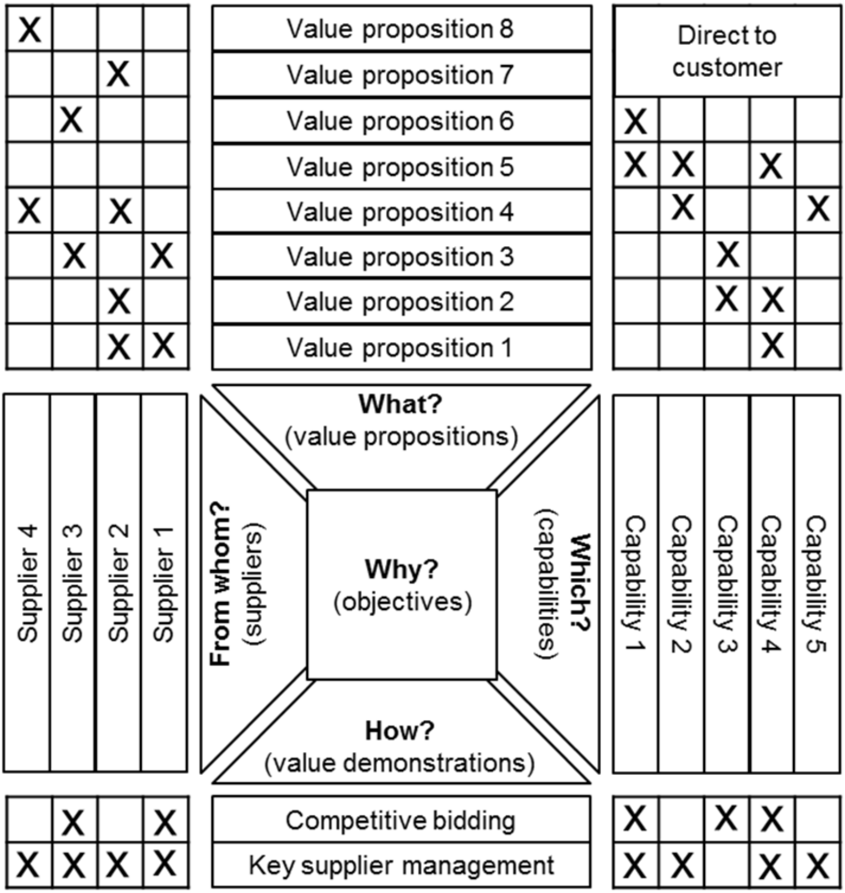


*Figure 16.1: Sourcing Square*

The above figure allows for the illustration and discussion of single versus multiple sourcing strategies (one or more suppliers per value proposition), dependence on suppliers (suppliers with critical resources or suppliers spanning numerous value propositions), tensions caused by using the same supplier for several critical components, key supplier management, and competitive bidding (commodity products).

Open business models are also widely discussed. The openness of a business model is determined by the extent to which the firm depends on other firms to produce a suitable value proposition for its customers. For example, car manufacturers and oil companies run very different businesses and they typically do not coordinate their value propositions. Each makes value propositions on its own. But the individual value proposition from a car manufacturer wouldn't be enough without an accompanying value proposition from an oil company. Thus, the two are highly dependent on each other. Nevertheless, the two businesses seldom collaborate, in contrast to the situation in the wind-turbine industry, where there is a need for collaboration on training, exchanging technical specifications, and coordinating tools and parts. Therefore, determining the set of connected value propositions for customers, and understanding the weak points and potential improvements for an open business are vital.

# EPILOGUE: NEVER STOP COMPETING

Some squares later, where are we? The initial point of departure in this book was a simple desire: to illustrate a business in a clear, easy way that was complex enough to allow for discussions of strategy. The development of a tool to fulfill that desire involved various iterations and numerous workshops. In each workshop, specific problems sharpened the outlines of the squares, shaping them into proven tools for discussions. As a result, the 1-2-FOUR squares can be applied to answer a whole portfolio of questions and facilitate an array of activities. Moreover, the squares have proven to be good communication tools in discussions of business, competitive advantage, competitiveness, and strategy.

Notably, however, the squares do not provide the answers. Rather, they serve as tools useful for assessing a business. Tough market conditions have encouraged firms to differentiate themselves from their competitors, while also moving closer to customers and their needs. However, this increased awareness of “cut-throat” competition should not lead executives to focus only on competition in markets—there are four important levels of competition.

The first form of competition any firm encounters is **competition for relevance**. In other words, is there a relevant customer need that the firm can address? If the customer sees no relevance in an offering, then the game is over before it even starts. Many products are developed that do not meet customers’ needs. Some of these are even launched. Consider, for example, famous failures like New Coke or the Apple Newton—these products were not relevant at the time of their launch and, as a result, demand was insufficient. Alternatively, offerings may suddenly no longer be in fashion or no longer of use—floppy-disk manufacturing is just not a good business these days.

Each and every firm has a weak spot in terms of relevance that can put it out of business. The pharmaceutical industry invests billions in the development of cancer treatments, but any such treatments will become irrelevant if a vaccine is developed to prevent cancer. Major slaughterhouses, like Danish Crown, will become irrelevant if humans adopt vegetarianism on a widespread scale. Universities find themselves challenged by online course providers. For every firm, there is a scenario in which the firm and potentially all established competitors would go out of business.

This “killer scenario” may be very unrealistic, unlikely, or even unthinkable. Yet, it exists. My experiences from discussing this issue with top managers suggest that the killer scenario is often closer than management wishes to believe. One firm was a proud market leader with no threat of a substitute. However, a quick discussion highlighted the fact that a single major incident could lead politicians to change the law, making the entire business irrelevant.

The second form of competition is actually against customers. Customers may satisfy their needs by themselves without using suppliers. Thus, firms **compete for dependence**—customers must depend on suppliers to fulfil the need. Otherwise, a market will not exist. Restaurants will close if home cooking becomes all the rage. Likewise, baby-food producers will have a hard time if parents turn to homemade options. Fitness studios suffer when people train at home, and travel agents struggle when customer plan and book their trips themselves.

This second level of competition arises not because customers have no need—the needs are in place—but because customers do not always involve a supplier to satisfy that need. The main questions for executives are therefore: What will motivate customers to turn from suppliers and toward “own” production? How likely is such a shift? How can it be avoided?

The third form of competition is the classical one—**firms compete against other firms to be customers’ preferred suppliers**. When customers have a need and accept that suppliers will fulfil that need, different suppliers can compete in the market. This level of competition takes much of the executives’ attention, and is the focus of competitor intelligence, value analyses, and gap analyses. Although such attention is necessary, it should be supplemented by a focus on the other levels discussed here.

The fourth form of competition involves the firm competing against itself. This is the ongoing struggle against complacency and the status quo. At this level, firms **compete to achieve excellence** and against the arrogance of success. Firms have to continually reinvent themselves and challenge their own businesses through cannibalization in order to stay competitive. This competition is typical among market leaders—they compete against themselves because no other benchmark is available. It is a struggle against the belief that a good revenue stream will continue forever.

| Areas of competition | Key question | Key issue |
|---|---|---|
| **Relevance**<br><br>Competing for customer needs and against obsolesce | "What will kill our business?" | Convincing customers of the significance of their needs |
| **Dependence**<br><br>Competing for customer outsourcing and against self-supply | "What makes customers trust in suppliers?" | Convincing customers of outsourcing advantages |
| **Preference**<br><br>Competing for customer preference and against competitors | "What is the key difference between us and our competitors?" | Convincing customers of the comparative advantage of the firm's own value proposition relative to competitors' value propositions |
| **Excellence**<br><br>Competing for cannibalization and against complacency | "What can we do better tomorrow regardless of the fact that things are good today?" | Convincing customers and the firm's own organization of the need for continued innovation |

*Table 17.1: The Four Levels of Competition*

Thus, executives need to extend their views on relevant competition beyond apparent competitors in their current market. They need to capture trends on all levels in order to develop their firms' competitiveness. There is no reason to be the best in a market that has no customers. Similarly, there is no need to celebrate a leader that could have done much better. Along these lines, the table below can be used at a strategy seminar, where it might helpful for structuring a discussion of the four levels of competition. My experiences suggest that the likelihood of uncovering surprising insights is extremely high.

With these closing remarks, I hope you find the book to be a valuable input in your discussions. Never stop competing!

| Level | 1<br>Relevance | 2<br>Dependence | 3<br>Preference | 4<br>Excellence |
|---|---|---|---|---|
| Which **event** will trigger a significant impact on this level? | | | | |
| How **likely** is this event? | | | | |
| What trends **increase** the likelihood of this event? | | | | |
| What trends **decrease** the likelihood of this event? | | | | |
| How well **prepared** are we to deal with such an event? | | | | |
| What can or should we do to **improve** our position? | | | | |

*Table 17.2: Discussing the Levels of Competition*

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Business model innovation, business model development, and business model revitalization are hot topics in many, if not all, firms. A central challenge for all firms is aligning the various parts of their business models. In fact, getting the pieces of the puzzle to fit seems to be the major issue. Regardless of whether the firm is looking for investments, submitting a project proposal for board approval, conducting a strategic business review, running a strategy-development workshop, or introducing the business to colleagues and friends, executives must be able to describe the business model in a short and precise manner. In addition, they need to be able to explain how the various parts connect, how the ends meet, and how the entire business model is aligned.
The book offers several tools useful for finding answers to the central questions executives face:

- How can I best describe my business?
- What are the central elements of my business model?
- How do I analyze whether the parts fit together?
- How do I identify business-optimization and business-development opportunities?

For more than 10 years, CBS Professor Thomas Ritter has analyzed and described the business models of small, medium and large organizations active in a wide variety of industries, including air travel, manufacturing, chemical engineering, and retail. This work has led to the development of the “business model alignment square” – the book’s key tool. The book offers tools and frameworks for analyzing and developing all central elements of the business model. Each of these tools can be easily included in firms’ workshops and meetings.

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