Business Model Battles

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Introduction

The market's need for true transformation is driving a competitive war that pits legacy business models against the innovators

Forty years ago, juggernauts such as Accenture, CSC, HP/EDS, and IBM dominated the global services industry. Over time, they gave way to India-centric firms such as Cognizant, Infosys, and TCS. Now those Wall Street darlings find themselves pushed from the technology headlines by upstarts such as Blue Prism and IPsoft. Few predicted that IBM would report negative growth for the 17th consecutive quarter in April 2016. HP absorbed EDS and then, after moves to scale down the services business still fell short of expectations, split the company. It is now spinning the core services unit out and merging with CSC (who just completed splitting off its federal government business as it struggles to sustain profitable performance). The upstart-to-leading labor arbitrage-based firms (mostly India-centric) now face attack from automation solutions that threaten their core value levers. The landscape is anything but static.

Meanwhile, customers thirst for more flexible, agile service solutions, embracing pricing constructions that align their spending with consumption and often accelerate value capture by orders of magnitude.

This picture is anything but business as usual. The dynamic landscape represents a battle of business models that has emerged over the last decade and is accelerating as customers drive to tap the benefits that some new approaches deliver. Prospering in this vibrant environment requires nimble service providers that eagerly challenge the core of what created their legacy success. Failure to recognize that business models change, or just tweaking legacy practices, is perilous, as customers (and shareowners) vote with their wallets.

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As keen observers of the global services marketplace, we watch enterprise customers' rising expectations of their service providers, whether they are internal or third parties. Clearly, the principles of theoretical economics are playing out. Service providers are either changing to meet the evolving needs of their customers, or their customers are turning to non-traditional players that have tuned their approaches to new market realities. The degree and pace of change required, however, is unfolding at a surprising pace. Moreover, we see the greatest impact occurring where customer transformation is in the mix, sparking a competitive war not at the service-offering level, but at the fundamental business-model level. This battle of business models is increasingly apparent in a number of ways:

- Customer needs evolving rapidly and new entrants changing the game
- Technology-driven disruption creating new challenges and opportunities
- Leaders realigning organizations to new realities
- Traditional business models responding to attacks

Today's – and tomorrow's – marketplaces are full of major challenges and opportunities. Those service providers that demonstrate vision, conviction, and creativity can prosper. Those that resist change and try to defend their former strongholds are consistently losing ground. Business model change is hard. Not changing is dangerous.

Business Model Battles – Inside and Out

Evidence of the business model battles is unfolding across the global services landscape. Enterprises and service providers alike are taking action to prosper as disruption emerges, transforming their approaches or seeking new partners to make sustainable improvements in performance.

Evidence of the business model battles is unfolding across the global services landscape. Enterprises and service providers alike are taking action to prosper as disruption emerges, transforming their approaches or seeking new partners to make sustainable improvements in performance. The examples that follow illustrate the value levers that proactive business leaders are pulling to take advantage of the industry changes.

Example 1: Customer needs evolving rapidly and new entrants changing the game – creating a new entrant inside

Leaders of multi-national service providers perhaps have the clearest understanding of the need for flexibility and adaptability in meeting marketplace challenges. In the lightening-paced, technologically savvy global economy, a company must respond with fresh products and services almost the instant a new demand appears. This frequently requires upending previous business models and adopting new paradigms.

Consider one service provider that created a renaissance solution. The firm opened the drawbridge and left the fortress, discovering they can make it up on volume. This large US-based insurance company faced a series of business challenges fueled by market changes stemming from the financial market crisis. It had outsourced a number of its IT activities, including much of its centralized IT infrastructure. As business units revamped their strategies to survive and return to post-crisis growth, the IT organization found itself in a situation common in many large enterprises. Its users were turning to software-as-a-service solutions and even directing their business applications to cloud-based platforms. In fact, the users began driving development to the cloud, which was perceived as costing less and proving to be faster and more flexible.

Saddled with a nearly decade-long outsourcing agreement with a multi-national service provider, the IT organization (under pressure from its business users) started turning to Amazon, Google, and Microsoft for solutions that began siphoning off "incremental" volumes. The service provider found its legacy (asset-heavy) account was severely threatened – what had been a stellar performer just a short time ago was now suffering a runoff of volumes that threatened not only financial performance but also fundamental relevancy in the account.

The service provider leaders recognized that the scenario playing out with their loyal insurance customer was the "canary in the coal mine." If it did not take decisive action to address the user needs quickly, they would lose the battle. In fact, the service provider was fighting similar battles across multiple fronts. The insurance customer was not alone in its quest to realign its service model to tap the benefits of as-a-Service solutions. Customers in nearly every market were taking similar initiatives. Defense of the legacy models in the accounts was proving unsuccessful, causing many renewals to be unbundled. As a result, the service provider captured a small fraction of its legacy scope – so much so that growth disappeared and margins struggled to stay in the black.

The service provider, however, reversed course with its insurance customer and embraced the market trends. It leveraged recently acquired cloud capability to formulate a solution competitive with the as-a-Service alternatives that had begun capturing volume across the enterprise. Structuring the solution to deliver all of the benefits, the service provider enabled the insurance company's IT organization to influence the business unit IT to aggregate volumes into the new environment and agreement. It became a win-win-win scenario as the business users got the speed and business alignment they needed, the IT organization reasserted a value-driven role in the enterprise, and the service provider ended up with a growing, profitable revenue base that is actually larger than the legacy relationship.

There were several keys to the service provider's success in embracing the customer and market trend rather than fighting it. At the heart of its ability to reshape the solution and the relationship was recognition that its competition was executing a different business model. It saw that trying to adjust their legacy business to meet the market's new requirements would fatally compromise the model. The recognition that a new business model – reinforced by a distinctive organization structure, processes, and policies to complement the supporting technology – would actually free leadership to act more quickly and decisively. Specific keys to its success included:

- Acquiring capability rather than trying to build it
- Focusing on mindset, not skillset
- Aligning expectations to a different financial model and sales motion

Though the service provider could have easily assembled the technical, sales, and other skills required, tuning the model would have taken too much time and the temptation to "leverage" legacy approaches would have broken the new model's keys for success. Every aspect of the new acquisition was protected – talent model, incentive systems, sales process, financial/investment policies, innovation approach, etc.

Embracing customer desires and market trends rather than fighting them is now a foundational element of the service provider's future growth engine. The business unit with the new model is growing at a 30 percent rate, far outpacing the service provider's legacy units.

Mobilizing to repel an attack from a new business model is a challenge many legacy service providers face. Enterprises that consume services also face major change to (re)align their businesses to the increasing pace of today's competitive environment.

Example 2: Leaders realigning organizations to new realities – overhauling your business model to win

Analyses on the need for nimbleness and adaptation often focus on high-tech manufacturing. But businesses that produce and deliver raw materials also need service providers that demonstrate agility in sectors such as IT.

Consider a global natural resources firm, which was swept up in the bust of the commodities market driven by China's slowing growth. The company recognized that change was imperative for its business processes and supporting IT activities. The company's IT organization acknowledged that it must fundamentally change its relationship with the natural resources firm or, someone would do it for them.

The IT leadership formulated a transformational vision to align end-to-end processes, including supporting IT, with the business. In the energy and mining industries, this has compelling implications. The sector operates in a "boom-or-bust" environment. Investments, supply, demand and cost structures can swing from record highs to bargain basement lows, all within relatively tight (and accelerating) time spans. To accommodate this reality, the enterprise needed to restructure the key applications and end-to-end processes to flex with the business cycles, while enabling continuous innovation to support operations. For example, the vision's strategic intent included configuring the ERP stack on a per-user manner – from infrastructure to applications to end-user support bundled together in a way that enabled the business to adjust its consumption, integrate the most recent capability on demand, and strip out redundant IT "overhead" from legacy horizontal-oriented delivery models.

This global enterprise already worked with a portfolio of service providers across multiple IT towers and geographies. It recognized that a service provider would require significant organizational context to underpin the ambitious new vision for IT support and, thus, asked several of its "strategic" service providers to propose solutions to achieve this intent. Several players tweaked their traditional offerings to meet the enterprise's needs but one quickly separated from the pack by formulating a fundamentally different approach.

The successful provider understood that to fulfill the enterprise's strategic intent, it must do far more than upgrade traditional models. Starting with a clean sheet, the provider re-envisioned a delivery system that enabled rapid adjustments to consumption patterns and the continuous innovation that the enterprise highly valued. It restructured its "supply chain" to create an ecosystem of partners (software, hardware, and services) for select parts of the delivery model. It configured its resources for key parts to add distinctive value and manage the overall approach for the enterprise. Supporting this solution required changes across the service provider's business model. Its key operating metrics, investment views, target talent profile, and organization and supporting systems (e.g., incentives) all changed. As a result, it created an innovative solution that met the flexibility and responsiveness requirements of the enterprise at a cost that beat competitors' legacy solutions by a wide margin.

This global services consumer's pivot to a fundamentally different model has created both winners and losers.

Example 3: Traditional business models responding to attacks – tactics fall short

The unsuccessful bidder for the natural resources company's business illustrates the risk of underestimating the degree of change necessary to compete effectively against the emerging as-a-Service model.

Given the identical problem statement by the global natural resources firm, an India-based service provider decided that its labor-advantaged model could deliver a compelling value proposition with only modest adjustments:

- Structure the pricing model to align with an as-a-Service, consumption-based approach
- Modify contractual terms to simulate an as-a-Service delivery model.

The India-based service provider believed its proposal to provide a small army of people in what was positioned to be a flexible model at attractive rates would win the day. This solution, which really changed little in the delivery model, added "features" to the contracting and pricing models that the provider thought would appeal to the enterprise decision makers. It was quickly exposed in the solution evaluation. Important concerns emerged about the sustainability of such a model and whether it simply locked in a legacy model with slightly better terms.

The service provider did not interpret the direct challenges to its proposed approach as serious, responding instead with unit price reductions. It did not recognize the fundamental strategic intent behind the transformation that the natural resources firm was pursuing. This led to missing value to the business that the transformation solution would deliver, disadvantaging the provider's proposal by a wide margin in terms of economics, business alignment, and speed.

For many stakeholders in the global services environment, the status quo is not a viable option.

Example 4: Technology-driven disruption creating new challenges and opportunities – necessity *is* the mother of invention

Flexibility is perhaps most needed by companies that handle process outsourcing for other businesses. Failure to adapt to emerging trends and demands can result in an outsourcing firm finding itself slipping in the marketplace. In such cases, company leaders can look back at, and reimagine, past successes in order to ride a wave into the future.

A business-process outsourcing firm built a successful position in transaction-intensive market segments over the course of several decades. At the center of its "secret sauce" was an approach to driving productivity that delivered exceptional value to both its customers and shareholders. In fine tuning the formula, the firm's leaders applied technology to improve the effectiveness of their workers – embedding tools and proprietary processes into their solutions.

As the second decade of the millennium turned, the service provider faced declining margins and renewal rates. Its labor productivity was not the compelling story of earlier years, as labor arbitrage-based firms "moved up the value chain" and entered the firm's core markets. The enhanced productivity was being undermined by lower cost labor – yet another clash of business models.

As the BPO firm examined what its customers wanted and how the labor-arbitrage specialists were attacking, it also noticed that pesky software firms were capturing customer mind share with new propositions that challenged even the arbitrage-driven models. For example, automation was making inroads in what might be the next wave of business model transformation.

An awakening emerged as the BPO firm's leaders recognized that the productivity enhancements in which they had invested over the last decade had resulted in a set of internal tools and capabilities that were at least as strong as those offered by small automation software firms. Lo and behold, the BPO firm had actually invented and achieved production at scale of a powerful, effective automation suite – in its own operations. The light bulbs lit up brightly as the opportunity to commercialize these capabilities unfolded.

Commercialization of internal capabilities will require a different business model that differs from than the legacy BPO business along most dimensions. How quickly the firm can pivot to take advantage of the rapidly emerging automation marketplace is unclear. The opportunity, however, to cannibalize its customer base and launch a full-scale attack on its competitors' vulnerable markets and business models is too promising to hold back. Game on!

Lessons

So, how should service providers devise strategies to win the war? How should enterprises position themselves to take advantage of those winning the war?

Our experiences – both from observing the industry from afar and from being in the trenches with business leaders as they seek to navigate the treacherous battlefields of business model transformation – have enabled us to evolve a set of frameworks that help diagnose the kind of change challenges facing an organization, as well as perspectives that serve as mileposts for the journey.

Business model framework

At the heart of the business model battles that are emerging are very different approaches to managing sales and operations (Exhibit 1).

EXHIBIT 1

Business Model Framework | IT Services Example

	Transactional	"As-a-Service"	Talent	Risk shifting
Product	Appliances			
Unyielding standard		• IaaS • OaaS (RIMO) • SaaS		VDI
Customized leveraged		Enterprise ITaaS		• Asset recovery • Infra outsourcing • Managed exchange • Managed print • Industrialization
Certified skills	• Deployment • Installation • Technical support		Staff augmentation	
Pyramid sensitive			• Consulting (apps, BP, infra, security) • Apps development • FTE-based RIMO • Sys integration	Applications outsourcing

As service offering innovation has occurred, we observe a range of different sales management models defining how businesses approach the market. For example, different sales motions are apparent across four distinct models in IT services, each with distinct attributes as outlined in Exhibit 2.

EXHIBIT 2

Sales Management Model Attributes

Attribute	Transactional	"As-a-Service"	Talent	Risk shifting
Contractual terms	No contract, annual license/maintenance fees	No contract month-to-month revenue stream	Project-based Time and materials	• Long term contract • Effort/resource-based revenue
Sales motion	Product knowledge	• Domain expertise and offering • Highly qualified leads	Domain expertise and capability knowledge	• CIO agenda, RFP-driven • Horizontal expertise augmented with SMEs
Provider sales incentive	• P x Q • Sell volume	• P x Q x T • Drive customer adoption	• Annual contract volume (ACV) • Enlarged project scope	Total contract volume (TCV)
Account management	Product-oriented sales channels	One-to-many relationships focused on customer experience/adoption	Project-based management of engagement	Ongoing day-to-day management of service delivery
Accountabilities	• Warranty • Support response times	Uptime	Contractual terms	Service Level Agreements (SLAs)
Asset ownership	Buyer	Buyer	Buyer	Provider
Innovation	Product-focused innovation	Product-focused innovation augmented with customer experience	Process and capability	Process, location, risk
Investment need	Product-focused, scheduled release	Offering focused, ongoing investment, frequent updates	Capability investments	As contracted
Service renewal cycle (innovation)	Scheduled	Ongoing/rolling to establish/maintain market leadership	As needed to remain market-relevant	As contracted
Provider success imperatives	Offering innovation	Customer adoption	Relationship	SLA management
Customer value proposition	Feature functionality	• Timeliness • Feature functionality	• Industry expertise • Best of breed	• Horizontal expertise • Integrated providers

The business model framework also recognizes at least five distinct operations or delivery management models in practice:

- Product
- Unyielding standard
- Customized leverage
- Certified skills
- Pyramid sensitive

Product-based models typically are more tangible in nature. Most often sold in a transactional model, the buyer gets exactly what the seller provides at the point of purchase. The nature of the solution is apparent at the time of sale, and the buyer typically takes responsibility for any modifications.

Unyielding standard models are constructed for delivery in a one-to-many mode. While there may be extensive configuration, the buyers must change their approaches to consume what the service provider delivers, not vice-versa. These standardized offerings provide value by leveraging scale and offering price points that enable buyers to access services they otherwise could not afford. The "catch" is that buyers have to conform to the offering. The proliferation of "as-a-Service" solutions typically falls into this type of delivery model.

Customized leverage models use a service delivery approach that captures efficiencies from a core of assets or capabilities while providing a tailored wrapper of services that align with the buyers' unique needs. Many traditional managed services typify this type of delivery model. Buyers get the customization that conforms to their processes and perceived distinctive requirements, but capture value from the service provider's ability to leverage underlying assets and capabilities (for example, centralized data centers) across multiple customers.

The certified skills model offers predictable quality and price for capacity. Many staff augmentation relationships fall into this category. Buyers access capacity (such as large pools of IT talent with specified skills and experience) at prices that reflect market demand, skills, and experience.

Finally, pyramid-sensitive delivery models provide solutions with an optimal mix of resources designed to produce a specific outcome. Application development, application maintenance and support, systems integration, and IT consulting are characteristic of models that provide a mix of skills and experience levels focused on outcomes-based deliverables.

Implications of distinctive business models

We began to note the shifts in the landscape, as we started to help our service provider clients deal with attacks by upstart competitors that seemingly came from nowhere and made inroads with even the most satisfied customers. Some executives were perplexed about why a customer would turn to a firm that only a few months ago was literally working out of a garage (or in the most-cited case – an abandoned shopping mall) for important, high-value IT services. While they might have shook their head in dismay, these executives had the insight to recognize that the pesky small players were actually the canary in the coal mine – demonstrating that traditional business models were not evolving quickly enough to meet changing customer needs.

The dilemma compounded due to the underperformance of the traditional providers' proactive "lean and mean" initiatives, which were intended to replicate the techniques of the upstarts. Growth of the initiatives not only fell short of projections for new offerings, but they were left in the dust as the successful upstarts continued to grow at rates several times faster than the incumbents' efforts. As the gap widened, our clients asked us to figure out why.

As mentioned at the beginning of this paper, enterprises occupying different zones of the business model framework game board face very different challenges. The "old guard" that built their businesses around customized leverage and pyramid-sensitive delivery models and risk-shifting sales/go-to-market approaches have found those models have evolved into mature, almost commodity spaces. Challenged by the labor arbitrage-fueled players who play primarily in the four lower right cells of the game board, the old guard now faces attack by upstarts in cloud and mobile computing, which are characterized by consumer-like offerings (unyielding standards) and "by-the-drink" pricing and contractual approaches (as-a-Service models).

As the "old guard" providers made early forays into the new models – and underachieved – we discovered that their attempts to replicate the upstarts' solutions were flawed. For example:

- Attempts to leverage existing assets (and sometimes skills) were based on false assumptions about economies of scale and scope

- Approaches to utilize existing channels, such as having their existing sales force sell the new solutions without fully recognizing the unique differences of the different models

- Fundamental differences in pricing models, investment cycles, and innovation time frames conflicted with policies that could not adapt quickly

In short, the new solutions that are winning in the marketplace require changes in every important part of the overall business model. As incumbent providers try to quickly introduce offerings to compete, their attempts to leverage existing business model components actually dilute the fundamental advantages that are the heart of the new offerings. It harkens back to the story about how it took decades for the superior disc brakes on automobiles to replace old drum brakes because of embedded investments in auto manufacturers' supply chains and factories. Modern IT service providers stuck in their current model find that efforts to adapt are stymied by what made them successful in the first place. Performance suffers accordingly because even when they retain the business, it comes at prices and margins that are much lower than the "good old days." Meanwhile, customers continue to vote with their spending, which enables rapid growth of those with "pure" new economic models, whose businesses continue to gain credibility every day.

Faced with the need to remake their business models or accept participation in an industry segment with declining fortunes, some traditional providers are taking steps to shape a different outcome. Some have acquired new-age companies and have diligently worked to preserve the business model distinctiveness that is at the core of the value creation engine. Others have created pseudo-independent entities to be managed in a venture capital-type mode to enable innovation and speed as well as pure business models to create footholds in new solutions and markets. Still others have chosen to hunker down and protect the not insignificant parts of the market that don't align well with the levers that the new solutions pull (although the jury is still out on whether this approach will enable attractive returns over the medium-to-long term). And many more are still coming to grips with the reality that the new solutions are more than old delivery and sales models with a new coat of paint. This group continues to miss expectations with restructuring events becoming a regular rather than extraordinary event.

Conclusion

As the increasingly globalized economy moves well into the second decade of the 21st century, the need for re-thinking business models grows increasingly apparent. Companies large and small are learning – sometimes painfully – that sticking to well-established commercial practices is a recipe for lost customers, shrinking market share, and chronic subpar performance.

Intellectual flexibility and the creation of agile service models are crucial to success in this period of rapid economic transformation.

Intellectual flexibility and the creation of agile service models are crucial to success in this period of rapid economic transformation. A service provider's leadership team must always be open to the possibility of re-thinking not only its target market and the manner in which it serves its customers, but also all of its business model components. When the need arises to move in a different direction, the leadership must wholly embrace the new model. Efforts to hold on to the legacy business will stifle innovation and dilute the power of the new business model, often resulting in dire consequences for the company.

Steps needed in such scenarios include:

- Unwavering commitment from senior leader champions
- Creation of a distinct organization structure, processes, and policies that drive the new business model
- Recognition that time is of the essence – the speed in acquiring capability often proves better than building it from scratch
- Focusing on developing a new mindset, not merely a skillset, among team members in order to create sustainable change
- Synchronizing expectations with laser-sharp focus on a few key metrics that will gauge tangible progress of the transformation to the new sales and financial models and the effort's impact

For many, the first impulse is to resist change and stick with well-tested, comfortable experiences – sticking with what you know is a natural response. But given the speed with which customers – and by extension, capital – can move from one solution to another, maintaining a static business model is not an option. Enterprises that wish to excel must boldly plot and execute strategies that will meet the changing needs of the marketplace.

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