CMO Perspective: How CMOs Can Reboot Business Models to Drive New Growth

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Many CMOs are expected to play a key role in defining and driving growth strategies through business model innovation. Use three lenses to rethink business model assumptions, create new sources of value for customers and capture new sources of profitable revenue.

Upshot

Business model change can be extraordinarily painful and disruptive to current-state operations. Many industries, however, are now under attack by new entrants seeking to disrupt categories and markets by rethinking business model assumptions. This means that even traditional organizations need to learn how to play by these new rules to ensure they’re the disrupters in their industry, not the disrupted. CMOs are increasingly expected to drive or substantially contribute to company innovation. Much of the time, this innovation spans products, services and customer experiences. It even includes the business models that define how value is created and delivered to customers, and how it’s captured for company shareholders.

What You Need to Know

Gartner surveys suggest that innovation is now among the top areas of increased expectation of CMOs by senior leadership. This is no surprise when you consider that traditional competitive advantages — and often business models themselves — are under attack. In virtually every industry, incumbents are subject to disruption by new entrants that seek to upend the governing assumptions of your value proposition, your category or your entire industry.

To stay relevant in an increasingly volatile marketplace, CMOs can help reimagine their current business model thereby considering three distinct lenses:

- **Lens 1: Levers of a business model** — Business model innovation is about finding ways to positively impact some combination of the three drivers of business advantage and shareholder value: cost, revenue and risk.

- **Lens 2: Practices for business model innovation** — Brands that successfully innovate their business model put customer needs first and look outside their comfort zone for inspiration.
Lens 3: Patterns for business model innovation — Ideal business models will vary based on the nature of your industry and the profile of your market opportunity.

Analysis

Lens 1: Levers of a Business Model

Discussion of business model innovation can quickly become arcane and complex. Don’t lose sight of the fact that at the heart of any business model are three levers that impact a company’s ability to create shareholder value. Business model innovation is about finding ways to positively impact some combination of these three levers to maximize shareholder value:

- **Cost** — Shifting the economics of a business model to grow margins, sometimes dramatically, to improve business or competitive advantage via profit taking and/or price reduction.
- **Revenue** — Unlocking new revenue streams by monetizing new, existing or underutilized assets in new or existing markets.
- **Risk** — Mitigating or transferring business, technology and/or economic risk to other participants in the value chain.

For CMOs, the goal is to optimize a combination of these three levers in the design of brand new, modified or optimized business models that contribute new sources of profitable revenue for the business.

Lens 2: Practices for Business Model Innovation

Optimizing the three levers of shareholder value is easier said than done, particularly for companies with a history of success and those under pressure to deliver on near-term performance goals. Balancing these short-term revenue goals against the need for longer-term transformation can hamstring business model innovation efforts. Also, the systemic overhaul required for implementing business model change often requires the painful acknowledgment that the current business model is no longer adequate. If changes are not proactively imposed, then the long-term viability of the business is at risk.

The following practices may help you and your teams to break through this dissonance:

- **Start with the customer.** Deeply understand challenges your customers face. Reframe problems in their terms to unlock hidden opportunities for innovating your product, service and the business model itself. Such opportunities begin with an understanding of customer needs, motivations and goals.
- **Embrace design thinking.** Set aside pre-existing assumptions and constraints, focusing instead on your customers’ needs and goals. Prioritize the divergence of new ideas over convergence on easy solutions. Doing so will help you create distance from the legacy perspectives that can stifle fresh thinking.
Look outside your industry. Explore adjacent or even wholly unrelated markets where you’re granted the opportunity to discover ideas already put into practice and proven at scale. These ideas may be "me-too" in the context of their native market, but they become novel or even revolutionary when applied to your industry or market.

Flip your business model. Share your existing business model assumptions and your organization’s governing beliefs. Doing so can expose how the process of suspending — or inverting — previously inviolable assumptions can create fertile ground for innovation.

**Lens 3: Patterns for Business Model Innovation**

Although the business model you design will vary based on the nature of your industry, the characteristics of your business, flexibility of your product portfolio and extensibility of your value proposition, there are specific applications proven by companies that are worth emulating. Consider the eight patterns noted in Table 1, and described below.

<table>
<thead>
<tr>
<th>Business Model</th>
<th>Definition</th>
<th>Ideal Consideration for</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct to Consumer</td>
<td>Selling products directly to the end user, thereby disintermediating channel partners, in whole or part.</td>
<td>B2B and B2B2C companies needing direct consumer relationships to compete in crowded markets and to unlock valuable first-party data.</td>
</tr>
<tr>
<td>Monetizing Customer or Audience Data</td>
<td>Selling access to or insights from customer/user data as a replacement or extension to product/service revenue.</td>
<td>Companies with access to substantial customer and/or audience data.</td>
</tr>
<tr>
<td>Marketplace</td>
<td>Aggregating and matching customer demand and supplier inventory.</td>
<td>Companies with strong supply- and demand-side relationships.</td>
</tr>
<tr>
<td>Untethering</td>
<td>Replacing direct ownership of certain aspects of the value chain with partnerships and/or outsourcing to change the cost economies of a business model.</td>
<td>Companies with relatively extensible value chains and alternative sources of fulfillment.</td>
</tr>
<tr>
<td>Vertical Integration</td>
<td>Assembling well-designed, often simplified &quot;whole solutions&quot; that are better targeted to a customer need.</td>
<td>Companies with customer needs and preferences shifting toward full or managed service offerings.</td>
</tr>
<tr>
<td>Unbundling</td>
<td>Disaggregating a value proposition to serve narrow or new markets.</td>
<td>Companies with relatively flexible and separable product offerings.</td>
</tr>
<tr>
<td>As-a-Service</td>
<td>Shifting to subscription- or usage-based pricing and on-demand delivery.</td>
<td>Companies with customers seeking lower TCO and more flexible, on-demand usage and consumption models.</td>
</tr>
<tr>
<td>Freemium</td>
<td>Giving away products/services as an upgrade path to commercial usage.</td>
<td>Companies with separate product offerings and a clear commercial upgrade path.</td>
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Source: Gartner (October 2016)
Direct to Consumer

Many traditionally B2B and B2B2C companies are building direct-to-consumer channels as an extension of their indirect channel strategies. Although incremental revenue and diversifying revenue sources are often drivers, for many companies the primary motivation is customer insight. These insights can help brands better understand consumer behavior and preference for product and experience design, planning of media, and demand patterns to drive supply chain efficiencies. This sort of direct engagement also enables brands to build closer consumer relationships to influence loyalty and advocacy. For example, many P&G brands have initiated direct-to-consumer commerce strategies. Microsoft and Samsung opened flagship retail outposts to boost direct contact with consumers.

Monetizing Customer or Audience Data

Customer data has always been a crucial asset to every marketer, primarily for designing the right products and services, planning and targeting media, and improving the customer experience. But the economic benefits of this data were, more often, indirect. Many companies monetize customer and audience data directly (often in anonymized form) by sharing it with aggregators and brokers and directly with advertisers themselves. For example, SAP recently introduced SAP Consumer Insight 365, which provides access to aggregated and anonymized location-based data from mobile carriers. Some companies are also experimenting with low- or no-cost offerings subsidized by advertising revenue or sale of customer data. These companies may also monetize data by allowing others to reach the company's customers through targeted advertising, co-marketing and co-selling. Of course, any strategy in this area must be executed with data privacy explicitly in mind, ensuring there are clear policies for opt-ins, permissions and the use of personally identifiable information.

Marketplace

Marketplace enablers create value and generate revenue by brokering relationships between buyers and sellers. These services aggregate supply and demand, making it easier for buyers and sellers to find each other. These marketplaces make money through revenue share and referral fee arrangements associated with the transactions they broker. Beyond connecting these parties, many marketplaces also open up new sources of supply or capacity. Airbnb and Uber, for example, are well-known examples of services that broker relationships between buyers and providers while also unlocking untraditional sources of inventory. Companies such as Thumbtack and TaskRabbit also create new marketplaces for existing services to be more easily discovered and purchased.

Untethering

Branchless banking is a well understood idea in the world of financial services, where shifting demographics and consumer preferences may call into question whether the overhead of physical infrastructure is essential to consumer banking. Ally Bank and Simple are among a new generation of banks that are completely branchless. Other, more traditional institutions such as Bank of Montreal are experimenting with smaller, smarter, "tellerless" branches that are fully automated, but provide an experience beyond an ATM. Many manufacturers now focus on brand, partnering with contract providers to untether design and/or manufacturing processes. Similar thinking can be
applied to other industries where untethering from costly, risky or undifferentiated elements of a value chain can favorably shift the economics of a business model. Also, it can better position the company for future success with new demographics from changing behaviors and preferences.

Vertical Integration
Apple's Steve Jobs' often controversial decisions around the interoperability of Apple products mapped back to his vision for software, hardware and applications designed to work together, as elements of a holistic user-friendly solution. This idea of vertical integration — sometimes referred to as a full stack business model — is making a comeback, in part due to rising consumer expectations for a well-designed, thoughtful and seamless customer experience. Starbucks is well known for its comprehensive ownership of all parts of its supply chain and experience. Companies such as Netflix and Amazon have jumped into creating original programing. Google has bet big on solar to support powering its enormous infrastructure. Not all companies will own each element of this vertically integrated value proposition, but they remain responsible for the orchestration of seamless and integrated whole-solution experience.

Unbundling
The opposite of vertical integration is unbundling. In many cases, consumer preferences have become more specialized, forcing companies to disaggregate previously bundled offerings to serve narrower use cases. iTunes, for example, is both a marketplace and one of the highest profile examples of the power of unbundling, where the music industry shifted from the traditional album format to distribution of tracks. Unbundling isn't limited to digital products. It can be applied wherever a product can be decomposed into a set of discrete subproducts that provide stand-alone value to new or existing markets. In some cases, unbundling can cannibalize short-term revenue. But, like as-a-service transitions, these economic losses are often more than covered on a longer horizon as flexible packaging and distribution options open up new market segments and remove friction from the buying process. In other cases, unbundling can unlock new sources of incremental revenue without cannibalization. For example, many airlines have unbundled aspects of the experience itself, charging for bags, priority boarding, etc.

As-a-Service
In competitive markets, customers will always favor the most flexible options — products and services that help mitigate the risk of making the wrong choice and allowing cost to be closely aligned to how and when the value is received. Traditional on-premises software companies are now forced to an as-a-service model that makes software available on demand and on a subscription basis. This sort of as-a-service model is now widely applied to industries as diverse as media and entertainment (Netflix, HBO Go, Hulu, Spotify, Pandora) to industrial and medical equipment, to even jet engines (GE, Siemens, Philips Lighting), which are shifting from selling capital equipment to selling access to a service based on subscriptions or metered usage. Such thinking can be applied broadly to any digital or analog product or service. And while it changes the profile of revenue acquisition and recognition (often unfavorably in the short term) on a longer horizon, it can lead to more profitable and predictable revenue streams. Adobe is among the higher profile
examples of a company that has successfully made a wholesale shift to an as-a-service business model, which has led to record revenue after an initial (expected) period of declines.

Freemium

Freemium companies provide limited access to product or service at no charge to build a self-identifying pipeline of prospects that they convert into paying customers over time. Services such as Spotify and Pandora provide free, ad-supported use of their service, attempting to convert users to ad-free options. Services such as LinkedIn offer a free general-purpose service and an upgrade path to richer features for more specialized usage. Media companies such as The New York Times use soft pay walls that offer an allowance of content consumption before users are forced to upgrade. Games commonly offer a variety of in-game purchase options, upgrades and other offers to monetize their free products. Freemium models can be an efficient way to acquire new customers. However, the freemium model is hardly foolproof. Companies that succeed here are relentless about product and user experience design, ensuring a frictionless free product that requires zero support and a clear and compelling upgrade path.

Some combination of these patterns may inform your future business model. However, it’s important to remember that business model innovation is more often of evolution than revolution. Extensions to existing business models are more achievable than a complete overhaul, and attempts to fundamentally transform a traditional business overnight are often doomed to failure.

But don’t confuse incremental change with incremental thinking. This evolutionary approach is about assimilating change into the mainline organization, where the vision for longer-term change is often big, bold and even revolutionary in significance, even if its execution follows a more graduated path.

What You Need to Do

Do This First

- Review your company’s current business model. Specifically, how do you create and capture value? How well does your business model match customer needs? How vulnerable is it to competitive attack? What are its performance characteristics and how is this trending over time?

Priority Actions for You

- Diagram your value chain, identifying areas of competitive strength, weakness and caution. Use this to initiate a deeper conversation with your team about target areas for exploration and innovation. Review your value chain with an eye toward Lens 1.
Priority Action for Your Team

- Conduct customer and market insight studies with an eye toward Lens 2. Explore customer needs and learn from the practices of companies outside of your industry.

- Conduct an in-depth competitive assessment extended beyond your standard competitive watch list. Reframe competitive intelligence to customer need. This will help broaden your competitive awareness to include emerging threats and alternative approaches needed to fulfill these needs. Also, look outside your industry. Applying known or even well-established ideas to an entirely new context is often a shortcut to creative inspiration.

- Use the target areas in your value chain diagram to identify areas for deeper exploitation (strengths), fortification (weaknesses) and deeper analysis (cautions). Use Lens 3 to brainstorm potential business model patterns that may leverage your strengths, mitigate your weaknesses and help you forge a path to protect your franchise and/or accelerate growth.

Gartner Recommended Reading

*Some documents may not be available as part of your current Gartner subscription.*

"CMO Perspective: How to Define Innovation in the Marketing Organization"

"CMO Perspective: The Dual Modes of Marketing Innovation"

"CMO Perspective: Focus Marketing Innovation Efforts on Your Customers, Culture and Creativity"

"Take Advantage of Emerging Digital Commerce Business Models for a Competitive Edge"

Evidence

This research was created based on insight from client inquiry, conversations with Gartner analysts, consultation with secondary sources and expertise from industry experience.
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