Which business models can deliver growth in developed countries?

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Nowadays, many Western groups have a portfolio of businesses with a significant component tied up in slow-growing regions and businesses. In order to grow, these groups will have to shift their portfolios into faster-growing segments.

In emerging countries, this is a matter of adapting the business models that worked so well for these groups during the post-war boom years in Europe, the USA or Japan.

In developed countries, they will have to develop new business models that complement or are completely different from past models. The main driver of growth consists in positioning the business in the fastest-growing segments by developing suitable models for these segments.

The more developed a market is, the more segment-specific requirements there are. The traditional model, whereby companies develop over time, is in most cases no longer suited to the new market paradigm: specific approaches are required.

In simple terms, there are seven business models that a business can adopt in order to grow and to continue to deliver strong growth. Other than specific models (e.g. service or disruptive innovation models), these vary depending on the level of direct marketing investment (high or low intensity and marketing relationship) and the level of investments that influence end users (high or low levels of investment in marketing, advertising, services and lobbying etc., pitched at the end user) (see table 1).

Seven growth models

Each model is tailored to specific market types and structures, and requires the control of different levers for competitiveness. With the appropriate adjustments and access methods, these models can be applied in all sectors.

1. The low-cost model

The low-cost model is usually applied to entry-level market segments. It has developed in response to the polarisation of customer behaviour. In fact, in most mature markets (consumer goods and services, capital goods etc.) we see growth at the two extremes of the range, at entry level (based on price) and at the top end (based on service and product differentiation), at the same time as a decline at mid-market level (traditionally based on innovation, brands and volume retail distribution).

This model relies on low gross margins and competitive operating costs (product manufacturing, delivery of a service) at all levels (product design, manufacturing and marketing, and company structure). It is the strategy applied by low-cost players such as the airline operator Ryanair, food retailers Lidl and Aldi, and Chinese electrical equipment or power tool suppliers.

It can be highly profitable when the market is growing or if a company has developed sustainable competitive advantages: a technological lead generating a substantial cost differential, significant scaling of manufacturing or distribution that benefits the market leader, control of upstream supply in industries involving rare resources, etc.

For a mid-market leader, the options for developing this business model are limited but the choice is complex: either it develops a specific, independent manufacturing model (and benefits negligibly from its size) in order to position itself in this entirely separate segment, or it develops its business defensively and opportunistically in order to bar new entrants and to protect its mid-market model (with negligible growth), or it decides not to enter that segment, developing other models or other businesses in order to grow. By nature these choices vary depending on the segments (either product segments or geographical segments).

The worst thing to do is to try and grow significantly in that segment using an outdated mid-market model: the risk is that the company will pull the rug from beneath the profitable mid-market sector while being unable to compete with players that have developed a specific and suitable manufacturing model.

2. The push or distribution service model

The push model is based on an efficient, competitively priced distribution service. This service consists of a segmented, attractively priced product range, kept up to date by the addition of new lines and minor (and therefore cost-effective) changes, promotional supports to boost distributors' sales, and efficient logistics to help retailers cut their working capital requirements and avoid running out of stock. It does not seek to influence the end user as to whether to buy the product. It leaves this role to the distributor. It relies on average gross margins and average distribution costs.

It is suitable for cases where:

- For the end users, there is little to differentiate between the products (innovation, status, image, service etc.);
- The management of the product or the service to be delivered is extremely complex: in the product range's definition, promotion, speed of stock renewal, logistics etc., that would justify distributor clients outsourcing this function (in comparison to the industry model).

  If this condition is not met, the low-cost model should be used.

This is the strategy used by many of Walmart's non-food product suppliers, in particular white goods suppliers such as Maytag.

It is also used by Li & Fung, a service provider for Western brands and distributors. It acts as an intermediary between low-cost Asian manufacturing and Western large-scale distributors or brands. With neither factories nor shops, Li & Fung has been growing at a rate of almost 20% per annum for over 20 years, with a profit margin in excess of 20%, by offering Western brands and distributors a one-stop service: product design, optimising outsourced manufacturing, sourcing raw materials, scheduling production, supervising production, administration (insurance and export formalities) and optimising logistics, etc.

The model developed by industrial gases producer Air Liquide for this diffuse industrial segment also falls into this category. Profitability is linked to local market share. This is gained through investment in local marketing and promotions: sales force, product support for customers, grouping of deliveries for low-value items etc.

3. *The pull or innovation/communication model*

The pull model is a model that focuses its investments on end users using two major levers: innovation and communication/advertising.

It is based on the principle that the product or service on offer is so superior that distribution will not be able to capture a significant part of the margin, as demand is "pulled" by the two levers. This type of distribution does however make it possible to get products to market quickly and at a competitive cost.

This is the model traditionally used by major consumer goods brands: L'Oréal, for example, spends almost 40% of its costs on marketing and R&D.

The same strategy is also used by Qualcomm for its microprocessors for mobile phones. The company spends almost 20% of its revenues on R&D. Separate R&D teams work simultaneously on identical problems with a dual aim: increasing the chances of coming up with disruptive innovations, and cutting time-to-market for new products (approximately once a year for products whose development times are generally 18–24 months).

This model requires:

- Capacity for innovation in mass-market products, which is possible if the products so allow and if the company has put an adequate process in place;
- Product universes that enhance brands (and justify advertising and promotional budgets), either because of the products' personal nature (such as cosmetics) or critical nature (such as bicycle derailleur-gears manufacturer Shimano).
- The use of non-specific bulk distribution channels that are unlikely to capture part of the margin.

Frequently however, this model drifts towards a push-pull model in order to strengthen its position vis-à-vis distribution or to offset a loss of relative competitiveness vis-à-vis competitors that have developed other models.

4. The push-pull or symmetrical attack model

The push-pull model relies on two complementary strands:

- Investments in innovation and marketing (pull) to convince the end user of the superiority of the product and to pull demand;
- Investment in distribution, or in sales forces or agents in order to 'push' the product and convince the distributor to highlight and promote the company's products.

To a certain extent this model displays the principal characteristics of the two previous ones. It is often a logical development of the previous model, where the pull strategy is flagging and the attraction of the product and the brand for the distributor has to be boosted by offering complementary services.

This model's levers of competitiveness are product innovation, active management of the range through frequent product renewal, control of complexity, and distribution channel management such as advice, training, merchandising and efficient logistics.

This is the model used by mid-market foodstuff distribution brands (fresh products such as Danone, garments such as DIM, beers such as Heineken and Kronenbourg) or suppliers of electrical equipment to installers, such as Legrand (low voltage) or De Dietrich (boilers).

For example, Legrand has developed a model for its low-voltage products based on four levers:

- Product innovation with a strong product renewal strategy whereby it leads the market (product design and ongoing improvements), and focussed disruptive innovations (that reinforce and differentiate the brand);
- Advertising that targets end users in order to pull demand (even if they are not Legrand's direct customers);
- Support for installers (training, a helpline, technical manuals, sales visits etc.) to encourage these installers to recommend the products to end users;
- Selling to distributors or solution integrators using a "push" approach that builds the specifics of these customers into the model in order to simplify the use of the products.

This makes it possible to continue to grow in developed countries while maintaining healthy profit margins.

5. The pull-push or user encirclement model

In comparison to the "pull" model, this model introduces an additional level of added value vis-à-vis the end user in the marketing of the product or service: a "push" vis-à-vis the end users.

This push may take various forms: paying distributors to promote the product and explain its advantages, or to launch the product; employing product demonstrators to test the product on customers, a customer management approach with dedicated telephone numbers; specific websites to help users or create online communities, etc.

It is usually effective for complex products (or services), or for customers that require convenience of purchase, especially for up-market products.

This is the strategy put in place by Harley Davidson, and by the leading automatic espresso machine manufacturer, Jura (machines for domestic use that feature an automatic grinder and cost up to €4,000).

This company invests in the quality of its products (more than in innovation) and advertising, and has developed services for its end users, such as support for using the espresso machine (and its plethora of functions), monthly, annual or multi-annual servicing, or the development of numerous accessories. In Germany, more than 20% of the company's end users travel to Jura's servicing centre in northern Germany each year.

With this model, the company is no longer selling an innovative, differentiated product or service promoted through its distribution channel. It is selling an experience, ultimately designed to give the user of this product or service the feeling of belonging to an exclusive club or community.

In a similar vein, GE Medical pursues a three-pronged strategy that combines innovation and product reliability, recommendations and references, and support for end users (hospital and clinic doctors and medical staff).

6. The service model

In the service model, the product is merely a pretext to offer and sell high-margin services. This is the strategy pursued by lift manufacturers. There is fierce competition in the sale of the equipment. Margins are low or even negative, depending on supply and demand in the market. However, servicing charges are high and are, in general, directly associated with the products. For a lift that sells for €50,000 in Europe, the annual servicing charge is usually around €5,000.

This model has a substantial effect on the geographical scope of market participants' competitiveness. It sets up significant barriers to entry for new players from low-cost countries, which may be competitive on product price but are unable to recoup margin on services, as these require a fully-fledged local network.

In many industries such as capital goods, the development of this model also helps to smooth out fluctuations in revenues and to reduce the volatility associated with investment cycles.

Another variant of this model is to move away from selling products paid for at the launch of the service, to selling all-in packages with a monthly payment that covers the product and associated services such as financing, servicing, advice, training etc. This is the strategy pursued by IBM, which moved from selling products to selling services comprising consulting and the outsourcing of IT functions.

This makes it possible to reach a broader customer base, as customers are able to receive a service in exchange for a low monthly payment, whereas they might have been reluctant to pay for a product with a high unit cost.

7. *The disruptive model*

Disruptive models are generally based on a novel approach to the market. They re-segment the market according to a new paradigm and break away from the usual practices:

- Shortening of the industry's value chain by cutting out certain unnecessary steps and intermediaries that create costs or additional lead times (in-house distribution strategy applied by luxury brands such as Louis Vuitton or Hermès, online C2C sales websites such as eBay, etc).
- Technological disruption of an access procedure or method that significantly reduces the cost of contacting customers (selling insurance over the telephone, as per Direct Line, or direct selling of products by the manufacturer to the consumer, etc.);
- Broadening the approach by moving from a product-based approach to a solution-based approach (iPhone or iPad with the development of iTunes, integrated solutions from burglar alarm manufacturers such as Securitas, etc.);
- Focusing on a customer group that has specific needs and requires a tailored approach (Max Mara's segmented approach in up-market off-the-peg clothing, etc.).

These models generally deliver high profit margins and growth, as they are based on features that differentiate the products, are hard to replicate and are of high first-to-market value.

They necessitate a change of perspective in relation to the generally accepted view of the market. They are complex, as they depend on behavioural change and on new economic realities. They generally require an adaptation and adjustment phase before they take off.

Conclusion?

Defining a growth strategy in developed countries necessarily involves identifying and implementing a number of business models that profitably capture the growth of promising segments.

It is not usually enough to focus exclusively on the traditional model, even if adapted. At best, it makes it possible to maintain market share. It does not usually result in strong growth.

However, this is a complex issue, for a number of reasons:

- *Failure to identify segments correctly, and positioning in a structurally weak growth segment.* The choice of the portfolio of segments is critical. There is no point developing a new model on a strategic segment that is structurally unattractive in terms of growth and profitability;
- *A business model not suited to the growth segment.* The choice of business model must be consistent with the requirements and the levers for competitiveness of the segment. We frequently come across companies that think they can change the business model without changing the fundamentals. This is simply not possible;
- *Organisation unable to operate different business models within the same group.* Each business model requires an organisation that focuses exclusively on its strategic issues. This focus must vary depending on the business models. As a result, it is difficult to pursue each strategy within a single organisation. There is a risk of "homogenising" the various approaches (and costs) and ending up with uncompetitive models. Volkswagen managed to run different business models concurrently with brands positioned at different market levels, by using common platforms and components;
- *Failure to invest sufficiently to develop a new model.* To be profitable, a business model must be based on features that contribute to the erecting of barriers and the generation of high profit margins. To be effective, this requires a level of investment in keeping with the company's ambitions. Being positioned on the right segment with the right business model without sufficient investment generally leads to a dead end. Long-term, substantial investment – both financial and human – is required.

Growth is a major preoccupation for companies. To create value a company must grow over the long term. This is a choice, first of all. It is rare for suitable approaches with the right levels of investment to arise spontaneously.

This choice involves applying a systematic, finely detailed approach. It requires tools that go beyond managers' hunches: identifying growing segments in which the company can invest over the long term in order to build a dominant position; defining the business model appropriate for the segment; investment consistent with the company's ambitions and the nature of the business model; defining the organisation to be put in place to ensure that the business model is effective, and that all the company's business models can co-exist.

September 2010

Estin & Co is an international strategy consultancy based in Paris, London, Geneva and Shanghai. The firm assists the boards of major European, North American and Asian groups in their growth strategies, and private equity funds in analysing and improving the value of their investments.

- Table 1 -

Seven business models for growth in developed countries