

Three new business models for “the open firm”

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Spurred on by a raft of new technologies – such as cloud computing, social media, superfast broadband, wireless and remote mobility – firms in most markets today are operating with greater openness. In these more open business ecosystems, the borders between the firm and its stakeholders – customers, suppliers, workers, innovators and managers – have become much more permeable and reconfigurable. New market mechanisms and intermediaries are arising as stakeholders discover new ways to cluster together for the purposes of production, consumption or innovation. The sharp distinction between “customer” and “producer,” for example, is increasingly eroded as consumers engage in forms of co-production, either with firms or other like-minded consumers. Innovation is shifting from the corporate laboratory to a global community of researchers as firms draw on the creative capacities of the “global intelligent crowd” to fire their innovation engines.

In short, a new model of the firm is evolving, from that of an organization with well-defined borders toward that of an interconnected enterprise – “the open firm.” In this new model, with new configurations of capital and talent and unfamiliar sources of competition, many business leaders are exposed outside their comfort zone and are daunted by the complexity of relationship management, attenuation of organizational control, threats to intellectual property and even dilution of brand.

Businesses need to be able to maximize the benefits of openness while limiting the risks. We propose three models based on our research, experience and observation:

- The harbor and fleet.
- The demand forum.
- Multivalent sourcing.

1. The harbor and fleet

In this business model, one firm – the harbor – provides a platform to which other firms become moored for mutual economic gain, much like a fleet of ships in a seaport. The services provided by the harbor company – such as IT networks, logistics and distribution, or supply-chain management – would be expensive for the individual companies to provide independently.

The companies in the fleet, typically small or mid-sized businesses, gain because their fixed costs are drastically reduced, thus enabling them to price their offerings attractively and profitably. The harbor company, usually a large enterprise with significant excess capacity in the service or infrastructure provided, gains by drawing off a portion of the revenue streams.

The Internet giant Amazon is perhaps the pre-eminent example of a “harbor” operator. Its success was founded on efficient warehouse management and procurement excellence.

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Having built a strong portal to reach its own consumers in the 1990s, Amazon realized it could extend that system to other businesses. Because its profit margin has always been based on its ability to procure and deliver products more efficiently than its competitors, it did not matter to Amazon if it sold its own products or captured margins while helping other companies sell theirs.

Harbor-and-fleet models are springing up in other industries too. For example, Athenahealth, a company that provides practice-management services for physicians, pioneered the use of cloud computing to replace paper-based medical-record systems with a much faster and more efficient electronic system for the 31,000 healthcare providers in its network.[1] Healthcare providers – the fleet – contribute a percentage of practice revenues to Athenahealth, creating a healthy funding model.[2]

The harbor model is also gaining ground in areas such as the management of global-supply chains, particularly as businesses give greater attention to ethical sourcing and sustainability in purchasing decisions. As global-supply chains snake across the world, supply-chain monitoring and certification have become particularly onerous for smaller companies, creating costs that can act as a barrier to market entry.

The supply-chain-tracing firm Historic Futures has created an infrastructure to provide information on country-of-origin of products and sustainability features. It has developed an online application called String that enables users to monitor products along the supply chain. In effect, Historic Futures acts as a supply-chain referee, allowing smaller companies in its fleet to drastically reduce their fixed costs of supply-chain monitoring and certification.

2. The demand forum

In 2008, at the height of the global downturn, two entrepreneurs, Vin Acanti and Jim Moran, spotted a market opportunity: what if they could aggregate the deals on a whole range of different collective buying sites to offer customers a much wider range of goods and services? They formed Yipit, a firm that bundles daily deals from some 130 other collective-buying sites such as GroupOn and Tippr, thus widening consumer choice as well as extending the potential market for suppliers and other buying sites. Armed with a much larger customer base, Yipit acquired the ability to target deals to particular customer groups. Yipit is an example of a “demand forum.” It can be thought of as a clearinghouse that brings together the buyers and sellers in a market for mutually beneficial exchanges.

Another example of the demand forum model, One Block Off the Grid (1BOG), a community-based program to promote solar energy, aggregates groups of city homeowners that want to use solar power. Signing up to 1BOG is free for the consumer; the company negotiates discounts with solar installers on behalf of consumers and captures payments from solar installers in exchange for customer referrals and volume purchasing. Any city in the United States is currently eligible – all that is required is one hundred willing consumers.[3]

Some demand-forum strategies go a step further, actively engaging their community of users in the design of offerings and products. Polyvore, for example, founded in 2007 in Silicon Valley and now one of the web's largest fashion communities, attracts some 6.5 million individual users every month.[4] Polyvore enables fashion fans to create and share digital collages of clothing, accessories, and lifestyle products from many different retailers

and brands.[5] The benefit for fashion industry firms that open up their boundaries to Polyvore is the opportunity to learn what taste-making consumers like and increase consumer engagement with their brand.[6] Polyvore website visitors have created more than 20 million fashion sets on the company's website and social networks.[7]

3. Multivalent sourcing

A third open-firm strategy is based on the supply of materials, talent, innovation or capital required for production. This "multivalent sourcing" strategy reflects the multiple bonds of connection that are formed by all the stakeholders involved in production. The benefits are twofold: enhanced bargaining power in input markets and informational advantages in sourcing innovation and capital.

Improved bargaining power: Prime Advantage, a business-to-business company, offers group-buying services to small and mid-sized industrial firms. By negotiating group-purchasing discounts with a number of different vendors, it provides its members with access to raw materials, components and business services at significantly lower rates than would otherwise be possible. Prime Advantage makes a profit via a subscription fee from members, while suppliers benefit from access to a larger pool of customers.

The model also serves to enhance bargaining power in the sourcing of other inputs, such as employee benefits. For example, SOI, a professional employer organization, manages an employee-benefits-pool of hundreds of companies representing thousands of employees. By establishing partnerships with healthcare and financial-service providers, it can create economies of scale and harness its collective buying power to negotiate better rates for member companies in areas such as health, retirement, and workers' compensation.

Overcoming informational gaps: By connecting those that have goods, services, ideas and capital with those that need them, and doing so in an efficient way that yields competitive prices and low search costs, multivalent sourcing models can offer a way to overcome informational challenges in sourcing inputs and factors of production. Such models can also efficiently connect innovators with firms that have the capital and infrastructure to convert innovations into commercially viable goods, services and business models. Open-innovation models have taken root in industries such as pharmaceuticals, where rising costs and expiring intellectual-property patents have propelled a search for more efficient ways of sourcing ideas and solutions to scientific problems. An early pioneer in the field was InnoCentive, the first global hub designed to help connect "seekers," companies with challenging research problems, and "solvers."

Another example, Napkin Labs, a consulting company that specializes in crowd-sourcing of innovation, handpicks a group of 100 potential innovators for a particular project to ensure quality of ideas.[8] New ideas and product concepts are then evaluated and voted on by the larger community, with Napkin Labs applying a set of algorithms to identify and reward the best innovations.

Multivalent-sourcing strategies are also springing up for sourcing capital. Social-networking platforms are increasingly used to connect would-be entrepreneurs with potential investors. One example is GrowVC, a community-based social-networking platform that brings together startup companies with providers of seed capital, thus lowering search costs for investors and startups, while increasing the information available to investors.

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International implications of using open-firm models

For international managers seeking to improve performance across diverse geographic locations, the three new open-firm models bring important practical benefits, including:

Scaling across borders: By enabling suppliers to piggyback on costly infrastructure platforms provided by bigger organizations, the harbor-and-fleet model can effectively lower entry barriers to new geographic markets and open up opportunities in unfamiliar localities. In addition, the harbor-and-fleet model also enhances standardization in logistical support, keeping supply-chain risks at bay for suppliers with limited logistical capacity.

Tapping into a bigger reservoir of regional or global demand: In China, for example, there are currently more than 2,000 collective buying websites.[9] With online consumption on the rise across the globe, the demand forum provides a mechanism to help businesses tap into this expanding reservoir of global purchasing power.

Improving the quality, cost, and availability of factors of production: Increasingly, the distribution of productive resources – capital, talent and ideas – is widely distributed across geographical borders. Multivalent sourcing offers a channel to tap into these dispersed resources and tailor them to the needs of individual businesses, connections that can improve product quality and lower costs. Multivalent sourcing can also improve supply-chain efficiency through targeted matching of suppliers and buyers.

Addressing the challenges of managing open-firm models

However, implementing open-firm models entails managing several challenges, many of which stem from cultural, social, and regulatory differences across national borders. Some common ones are:

- **The quality and character of local networks.** Open-firm models are essentially network-based; international managers therefore need to pay close attention to the nature and quality of networks in overseas markets. Is there a tradition of collective consumption or business co-operation through informal networks? Are there deeply ingrained habits of consumption or production that are hard to change, such as a preference for physical-transaction modes? Does the infrastructural capacity exist to create virtual networks? Is there a critical mass of users present to create deep markets for production, supply or consumption? When facing complex and unfamiliar relationships that hinder the cross-border transfer of competencies, it is crucial for firms to create the right networks and identify key stakeholders.[10] These include the suppliers that provide critical inputs, the distributors that effectively link the firm with its customers, and the competitors with which to potentially form alliances or joint ventures.
- **Complex patterns of local demand:** when an open firm expands beyond national borders, the heterogeneity of consumer preferences and purchasing power can be more complex than in the firm's home market. There are two strategies that can help open firms to overcome this unfamiliarity. The first is through more sophisticated customer groupings, using purchasing power and cultural background, rather than simply focusing on commonly used criteria such as geographic region or language. The second is to adopt a “hybrid” approach by incorporating some level of physical presence. Having a physical presence is not only an effective way of gathering consumer information, improving data analytics and testing consumer preferences, but also helps to facilitate trust among unfamiliar consumers by “breaking the ice.”

- **Business-model replication:** A somewhat more prosaic challenge for many open-firm models is the risk of having its business model replicated in local markets and losing elements of intellectual property, particularly in jurisdictions where intellectual-property provisions may be ambiguous or poorly enforced. A challenge facing collective-buying sites in some emerging markets has been the mushrooming of local versions that can often negotiate better deals with local suppliers.

Deciding which open-firm strategy works best for your business

As technological advances spur firms toward an era of greater openness, companies will increasingly need to examine the potential economic benefits of digitally linked clusters of businesses. The summary framework set out in Exhibit 1 can help executives decide which type of open-firm model can work best. Some of the key points to consider are:

- **Define and protect the firm's competitive advantage.** What should be opened up to the ecosystem and what should be kept integral to the firm? What is really core intellectual property and how can it be protected in a more open system?
- **Build the right networks and hone the skills to manage them.** The ability to establish and maintain appropriate networks is central to the success of open-firm strategies. Open firms must manage complex webs of relationships with many different firms, customers or input suppliers that have varying degrees of attachment to the core business. Given these circumstances, they will need to put an increasing premium on managing relationships in

Exhibit 1 Overview of open-firm strategies

<i>Model</i>	<i>Function</i>	<i>Economic benefits</i>	<i>Complexity of relationship management</i>	<i>Ceding of control</i>	<i>Duration</i>	<i>International implications</i>
Harbor and fleet	Making services with a large fixed-cost component feasible through better utilization of excess capacity in infrastructure or other critical services	• Reduced average costs • Increased service standardization • Accelerated asset turnover	Low	High	Medium to long term	• Greater ease of geographic market entry • Greater certainty in supply-chain management • Improvement in risk profile
Demand forum	Creating access to a bigger and better demand platform (more customers)	• Increased market exposure • Improved demand information • Quality certification and reputation building	High	Low	Episodic	• Expansion in demand • Refined market segmentation • More efficient and timely product design in line with local market preferences
Multivalent sourcing	Providing better access in terms of cost, quality, or location to factors of production such as talent, capital, or knowledge	• Access to specific talent • Improved innovation and knowledge-diffusion • Collective bargaining power • Access to corporate finance	High	Low	Episodic	• Enhanced organization of dispersed resources – talent, capital, and ideas • Greater connection with local networks (R&D, venture capital, etc.) • Improvement in supply-chain efficiency

their approaches to recruitment and staff development, alongside more traditional technical and business skills.

- **Maintain organizational identity and loyalty in an open ecosystem.** As the borders of the open firm become increasingly permeable and connected to fluid ecosystems of people, firms and ideas, organizational identity and loyalty might become attenuated as the ties of common purpose loosen, at least initially. Core values will therefore become more important in binding together employees and, increasingly, ecosystem partners.
- **Manage reputation and brand in a system of open-market relationships.** Traditionally, firms sought to exert tight control over their brands. But with open-firm strategies, such control will be more difficult and possibly even counterproductive. Firms need to learn to engage with customers and mobilize the brand in non-traditional channels, reducing costs associated with traditional communication channels such as print and television.
- **Manage increasingly complex informational flows from a multitude of stakeholders.** As “open” firms engage with consumers and clusters of suppliers, producers, and innovators, the volume and complexity of information that firms need to manage is burgeoning. While partners in the ecosystem will be critical to helping firms manage such flows, organizations will also need to develop the ability to sift and protect the most valuable and competitively important information, with a greater premium on advanced analytics for critical insights.

Notes

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