

## Embracing Open Business Models -- Even innovative companies can use a helping hand or two Henry Chesbrough

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Everyone knows that innovation is a core business necessity: Companies that don't innovate will die. But effective innovation increasingly means to do so openly, using transparent business models.

Implementing an open business model represents a significant cultural break from most corporate traditions. Indeed, it may even seem counterintuitive-especially for CIOs who work diligently to protect the information resources and intellectual property of their organizations.

Until recently, innovation was a function of tapping into internal intellectual resources and nurturing the business while protecting it from outside exposure or interference. Companies have fiercely guarded their patents, trade secrets, and other intellectual property to leverage the most value from their own innovative efforts. Open innovation, by contrast, calls for companies to make much greater use of external ideas and technologies while sharing their unused ideas with others. This requires each company to open up its business model to let more external ideas and technology flow in and more internal knowledge flow out.

By adopting these models, organizations can bring innovations to market more quickly and less expensively, thereby securing a competitive advantage in an increasingly dynamic global economy. It's critical for CIOs to understand these models' disruptive implications and provide the infrastructure necessary for their companies to thrive in the new landscape.

Generally speaking, a business model performs two important functions. First, it creates value by defining a series of activities that ultimately delivers a product or service to end users. Second, it captures value by maintaining unique resources, assets, or positions within that series of activities, allowing the seller to enjoy a competitive advantage. An open business model accomplishes both functions through what I call a division of innovation labor.

Qualcomm is an open business model in action. At one time, the company made its own cell phones and base stations. But as other strong players entered the extremely competitive field, it shifted to making chips and selling licenses to its technologies. Today, every phone using Qualcomm's technology is sold by one of its customers, not by the company itself.

To accomplish this shift, Qualcomm had to redefine its target of opportunity. The company identified new customers-organizations it might have previously regarded as competitors-and started to collaborate intensively with them. By exchanging ideas, Qualcomm deployed its chip technology in a way that enhanced the innovative elements of these customers' offerings. Sharing intellectual property led to the creation of new, shared innovation, which looped back into the open business model to create and capture more value more quickly.

### The framework

Qualcomm's approach could work for you, too. In fact, your business model may already be more open than you think. To help you make that determination and refine your innovation strategy accordingly, I've designed a business-model framework that identifies six types of companies based on how open their business models currently are.

- **Type 1: Undifferentiated.** Most businesses fall into this category. Type 1 companies compete strictly on price and availability, and sell goods and services that vary little from those of competitors. Mom-and-pop businesses are prime examples of such commodity-based models.

- **Type 2: Somewhat differentiated.** Companies in this class sell products and services with some degree of uniqueness. Such businesses can serve a market segment that's less congested than that of Type 1 companies by targeting performance-oriented customers, for example, as opposed to buyers whose sole criteria are price and availability.

Unfortunately, Type 2 companies often lack the resources and staying power to invest in the innovations necessary to sustain differentiation. The IT industry has seen many such one-hit wonders. These have included Ashton-Tate, maker of dBase; MicroPro, maker of WordStar; and VisiCorp, maker of VisiCalc.

- **Type 3: Segmented.** This category comprises companies that compete in different market segments simultaneously. The price-sensitive segment provides the base for high-volume, low-cost production, while the performance segment supplies high margins. Other niches can be addressed to create a stronger presence in the distribution channels. The business model is more distinctive and profitable, letting the company to plan for its future using product and technology road maps.

But while its greater level of planning helps the Type 3 company avert the one-hit wonder syndrome, problems remain. The Type 3 business is vulnerable to any major new technical shift beyond the scope of its current business and innovation activities, as well as to major shifts in the market.

Think of a mature, vertically integrated industrial company as an example. This was the situation Xerox faced in the 1980s, when it was fighting off Japanese copier companies and struggling to use the computer technologies it had created at PARC. The resulting shifts that capitalized on GUIs, the Ethernet, and LANs largely eluded the company that had funded much of the development of these technologies.

- **Type 4: Externally aware.** In this business model, the company has started to open itself to external ideas and technologies in the development and execution of the business. This unlocks a significantly greater set of available resources.

The road maps of the Type 4 company provide a shopping list of needs for external ideas and technologies. Relationships with outsiders help identify external projects that fulfill some of these needs. These projects reduce the cost of serving the business, cut the time it takes to get new offerings to market, and let the company share the risks of developing new products and processes.

In this model, internal road maps are shared with suppliers and customers on a frequent basis, letting the business make much more systematic use of innovative ideas from suppliers and customers. It also lets suppliers and customers plan their own activities in concert with the innovative activities of the company.

Type 4 companies would include an ERP vendor that creates external APIs for companies to build on top of its code.

- **Type 5: Integrated with the innovation process.** Here, the business model plays a key integrative role within the company. Suppliers and customers enjoy formal institutional access to the company's innovation process and reciprocate in kind. They share their own road maps, providing much better visibility into the customers' future requirements.

Type 5 companies begin to experiment more directly with the business model itself. They take the time to understand the supply chain all the way back to the raw materials as they look for major technical shifts or cost-reduction opportunities.

In addition, they closely study the customer's customer to ascertain the deeper unmet needs and opportunities in the market. They conduct experimentation on alternative distribution channels, and indeed, upon alternative configurations of the business model. In IT, shifting from products to include services as well, or offering one's own capability to others as a turnkey solution, would exemplify this integrated model.

- **Type 6: Fully open and adaptive.** The Type 6 business model is even more open and adaptive than Types 4 and 5, requiring a commitment to experimentation with business-model variants. This experimentation can take a number of forms. Some companies use corporate venture capital to explore alternative business models in small startups. Others create spin-offs and joint ventures to commercialize

technologies outside their own business model. And there are those that create internal incubators to cultivate promising ideas that aren't yet ready for high-volume commercialization.

Amazon, for example, has created a business unit out of its IT back-office operations to offer as a service for others wishing to use Amazon technology to sell online themselves.

In a Type 6 scenario, key suppliers and customers become business partners, entering into relationships in which both technical and business risks may be shared. The business models of suppliers are integrated into the planning processes of the Type 6 company. That company, in turn, has integrated its own business model into those of its key customers.

A key integration enabler is the company's ability to make its technologies a platform of innovation for the value chain. The company can draw others into its business by sharing the tools, standards, intellectual property, and other know-how needed for these supporting players to implement the platform successfully. For many years, Intel and Microsoft achieved this with the Wintel platform. More recently, Apple's iPod is attracting substantial third-party investments in everything from iPod accessories to new office and medical-software products that employ the iPod as a new class of productivity device.

### **Worth the effort?**

The more companies learn about open business models, the more they realize how much they have to change their own innovation activities to take full advantage of these paradigms. It's not simply a matter of searching for new technologies. To thrive, companies must adapt their business models to make them more open to external ideas and paths to market.

No doubt, doing this will entail hard work, challenging CIOs to rethink organizational processes and IT systems. However, the potential rewards are compelling: lower costs for innovation, faster times to market, and the chance to share risks with others. These enhancements can unlock new sources of organic growth and revitalize your company. Instead of facing the prospect of stale offerings and an obsolete business model, your company can get a new lease on life. Companies that move ideas from the inside out, letting others use their own unused ideas, will realize a new way to capture more value and sustain themselves in these times of increasingly global markets and competition.

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