

Viewpoints on Change

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Business Model Innovation

New paths to creating growth
and delighting customers

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EDITORIAL

Why not?



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We are involved in a project for a global growth company where we have recently carried out a project with focus on developing products faster and more efficiently. The project was, in our opinion, a success. The client company, which is recognised as one of the world's leading experts within their area of expertise, was, basically, satisfied. However, because they act the way they do when clients are at their best, they ask anyway: Seeing that we are capable of reducing the lead time of a project from 600 to 300 days, why not reduce it to 100 days?

It is, of course, quite the partykiller in a situation where we had expected to get a pat on the shoulder for our efforts. But he is right. Why do we consider good results as final when we are fully aware that in 12 months from now, we will be able to create the same percentage improvements one more time and once again 12 months later? Why do we not change our mindset radically, raise the bar and reap the full benefits now? And once again – not in 12 months, but in six months?

Recently, we had the pleasure of discussing strategy with Roger Martin, Dean of the Rotman School of Management. According to Martin, today, most strategic work suffers from a gap between analytical and intuitive thinking. This is primarily caused by the fact that strategy has become an analytical discipline where predictability is rewarded more than

results. Rather promise little and surprise positively than reaching for the stars and risking not quite reaching them – analogously to the above example.

However, large innovations solely based on analyses of the past are rare. For even though the analysis is imperative in order to being able to understand and generalise and, thus, scale, the tempo and complexity in our surrounding world have reached a level where we need to change the balance between value creation and our need for predictability. Those of us who think analytically must learn to speak an intuitive language, and those who think intuitively must learn to communicate in an analytical mindset. Both sets of competences are absolutely necessary. Even though innovation and intuitive thinking are closely linked, it is only when rationality and analysis are involved in the process that the large-scale commercial and business breakthroughs take place.

Companies such as Apple, Google and Just Eat are good examples. Their development has been unpredictable, but their value creation has been immense, because they have been able to combine intuitive and analytical thinking. Whether we, as Roger Martin, call it Design Thinking is of minor importance. We **MUST** be able to combine that which is rational and analytical with that which is intuitive and irrational. In this cross field, limitations turn into opportunities. This is also where the most successful companies operate and the best employees thrive, develop and generate most value.

Thus, the question presented in the beginning of this article is just a logical consequence of the reality we live in and a question that we – who are well on in years – must get used to being asked: Why not?

Create growth through innovative business models

Understanding the why, what and how of business model innovation
by Morten Hejlesen

Short-term competitive advantage is created by exploiting existing business models. However, in the long term, all markets mature, competition intensifies and turbulence increases. Consequently, new sources of growth must be explored, and fresh answers to enduring success must be found. The answer used to be innovate or die. But research shows that pouring more money into pure product innovation does not lead to improved performance. We need to dig deeper.

To succeed in innovation and to seize new opportunities, the scope of innovation must be expanded to encompass the full business model, and new processes must be mastered. This article explores how an innovative business model is linked to customer value creation, defines growth opportunities and presents key success factors to exploit the potential of business model innovation.

Rethink customer value creation

Delighting customers is the heartbeat of every business

While pundits claim that the only constant in the world of business is change, one factor remains unchanged and stable. At the heart of any busi-

ness should lie the aspiration to delight customers. It might seem deceptively simple, but, in reality, this core tenet is challenged every day.

Outside pressure from investors triggers the desire to focus on short-term optimisation putting long-term customer and, thus, shareholder value creation at risk. Diverse stakeholder groups compete to capture attention

and influence key decisions through rhetoric or regulations. Inside impediments come in many shapes. Actions of the past such as investments and strategic choices create commitments that are hard to escape when customer needs are changing. Often, the understanding of customer needs lacks depth or is based on false assumptions, thus limiting capabilities to conquer a differentiated position in the market-

WHAT IS CUSTOMER VALUE?

The idea of "delighting customers" can be translated into the equally simple idea of "creating value" for customers. But what exactly is customer value, and how can it be defined?

Firstly, customer value cannot be equated with low price. More precisely, value creation is a trade-off between certain benefits and costs associated with the value proposition over its entire life cycle. The total value of ownership must be calculated to assess the value creation potential.

Secondly, value lies in the eye of the beholder. Value is subjectively judged by the customer, which means that we must identify perceived benefits and costs. All insurance companies know this fact as they, in reality, sell products which, hopefully, are not used. Value is not related to product attributes, but rather customer benefits.

Thirdly, the value creation potential must be adjusted for the riskiness of the value proposition. All innovators know this by heart. New products that are relatively unknown are always harder to sell than well-known products because of a higher perceived risk.

Taken altogether, customer value can be expressed as:

Customer value = (perceived benefits – perceived life cycle costs) x (1 – perceived risk)

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place. Management incentive structures are aligned with a strong focus on "running the business" rather than "developing the business". Mental blinders tend to pop up resulting in a bias to run business as usual, and new ideas are judged unattractive due to the risk of cannibalising the current business. And the list continues.

Altogether, the simple goal of delighting customers is not that simple at all. Even though it has been proven time after time that customer-centric organisations are the most successful, it is complex and challenging to walk the talk. Moreover, the ways in which organisations deliver valuable customer experiences have dramatically changed in the past decades.

Focus on customer benefits - not product attributes

A quick glance at the history of delighting customers shows that focus has expanded from fulfilling simple needs to addressing the full range of advanced customer needs, and the scope of innovation has been widened from basic products to integrated solutions. In other words, the key driver has been growing attention to manipulating all parameters of the business ecosystem in order to deliver customer value.

In the days of mass production, customers were delighted by simple products fulfilling basic needs and wants. Henry Ford famously dictated in 1909 that customers could have the functional benefits of his Model T, while he cared less about fancy colours: "Any customer can have a car painted any colour that he wants so long as it is black". Cars were black and nothing but black.

However, excess post-war production capacity and a frugal culture created the perfect storm, motivating companies to find new ways of reaching the heart of their customers. Increasingly, generic products were differentiated and associated with emotional and social benefits. The rise of branding and segmented marketing strongly indicated a shift towards a broader concept of customer value creation. The shift is beautifully portrayed in the TV series *Mad Men* about the American flourishing advertising industry in the 1950-60s and the boom of Madison Avenue ad agencies.

In parallel, the strong focus on tangible products was replaced with the idea of comprehensive value propositions and selling total solutions to customers. Solution selling emerged as a discipline

in the 1970s and is still an effective approach to customer-centric sales. In fact, many businesses are still on a journey from delivering products to creating solutions composed of both tangible products and intangible services. The trend has also been dubbed *servitisation* of manufacturing, which also highlights the shift towards designing all aspects of the customer experience as well as tailoring the experience to individual customer needs. Customer delight was no longer perceived as a result of simple products, but integrated solutions with a carefully designed and value-adding layer of experiences that surrounded the core product.

In the 1990s, Joe Pine and Jim Gilmore portrayed the rise of the experience economy in which they claim that work is a theatre and every business a stage.

WHO IS YOUR CUSTOMER?

Simple questions usually turn out to be tough ones. Theodore Levitt asked: "What business are you in?". We also need to ask: "Who is your customer?". While the examples mentioned show the importance of the end user, value creation should be managed for all touch points that your offerings have before reaching the final customer.

In the insulation industry, Rockwool has analysed and designed value propositions for all customers involved with their core product. The chain of customers includes building owners, architects, contractors, sub-contractors, installers and distributors. Moreover, a careful evaluation of different segments within each customer group needs to form the basis for the design of different value propositions for every group.

In the case of fast-moving consumer goods, all companies face similar challenges. Value creation cannot only focus on the end consumer, but should also consider the needs of the shoppers buying the goods, the retailers selling the goods, the wholesaler distributing the goods and even external partners responsible for production. Before pouring a simple glass of milk, customer needs must be served appropriately many different places in the total consumption chain.

Accompanied by branding strategies that engaged all five senses and even experiences designed around the idea of catalysing personal transformations, the experience-centric thinking supplemented past logics of value creation. On the one hand, products developed into solutions. On the other hand, fulfilment of functional needs was accompanied by addressing more sophisticated customer needs.

Recent developments in the ways of delivering customer value might be considered as a counter-reaction to the mainly narcissistic attempts to achieve

experienced-based differentiation. Fuelled by financial meltdowns, rising awareness of human impact on the environment and increased global interconnectedness, most organisations are now consciously evaluating how to fulfil altruistic benefits for customers. In other words, how to incorporate elements of selfless concern for the welfare of others in their value propositions, e.g. cradle-to-cradle principles and the ambition to safeguard the planet for the coming generation through company-wide social responsibility, plays a still more vital role in order to delight customers (figure 1).

Develop experience-based solutions to gain competitive advantage

As a consequence of increasing competition in mature markets, new opportunities in emerging markets and near-constant disruptions at the fringes of most industries, focus on delighting customers plays a key role in gaining a foothold in a competitive marketplace. Although the notion of creating blue oceans is appealing, real-life experience often shows that competitors quickly invade uncontested space and capture market share.

To carry on delighting customers on a continuous basis, advanced manners of delivering value and creating competitive advantage are needed. Add to that the dramatic consequences of recent technological developments such as the internet that has created an unprecedented range of opportunities to interact with and deliver value to customers. By leveraging the power of emerging technologies, entirely new markets have been made accessible, and novel manners of interacting with customers have been created.

Consider Danish telecom TDC that bundles telephony subscriptions with free access to millions of music tracks through the TDC Play service or the rise of internet-based portals for long-distance microfinancing and interactions with African entrepreneurs such as MYC4 and Kiva. Since Kiva was founded in 2005, 636,949 lenders have invested USD 255 million in poor entrepreneurs in remote areas of the world. The entrepreneurs have grown their businesses and repaid 99% of the loans. Both examples highlight the recent explosion of colours on the palette of delivering valuable customer experi-

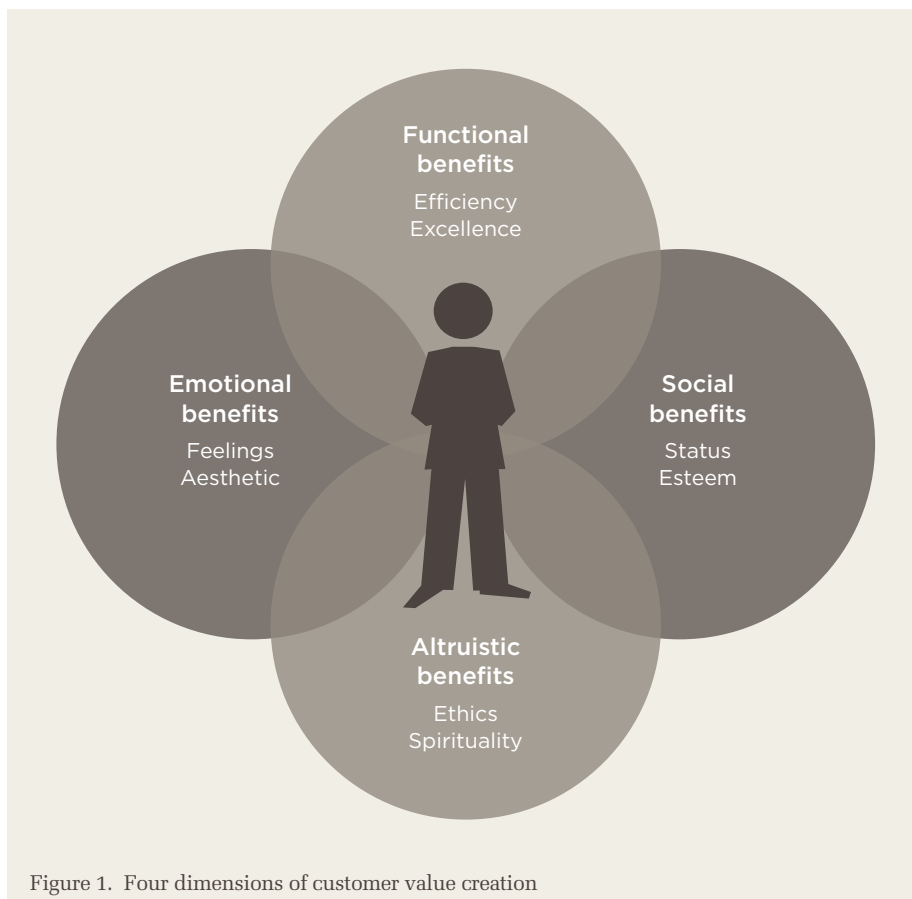
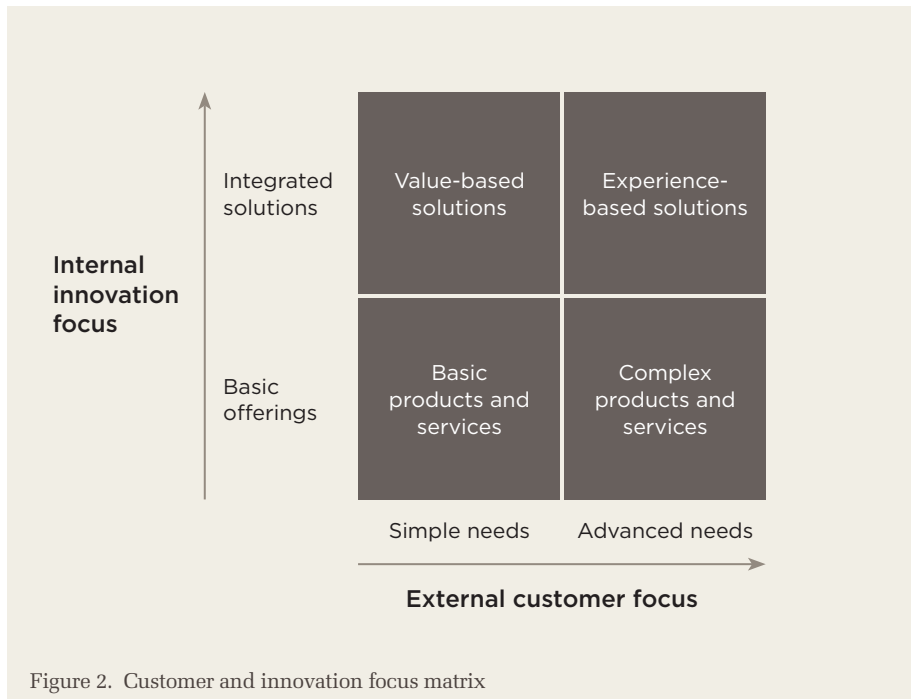


Figure 1. Four dimensions of customer value creation

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ences. The message to old Ford is simple: Black is no longer the only option.

While the shift can be described as an overarching trend, it is evident that success can still be found in all quadrants (Figure 2). Customer needs differ across segments and markets. Industries compete on different factors. In some cases, an attractive opportunity can be exploited by developing simple and convenient products that attract non-users and, thus, expanding the current market. In other cases, advanced experience-based solutions can be leveraged to capture the profitable high-end of an existing market. However, it is clear that competitive advantage as a rule of thumb is more sustainable when solutions are hard to imitate as well as based on deep and enduring customer relationships.

Above all, the uniting discovery across the spectrum of opportunities is the recognition of the need to carefully consider and design all elements of the business model to address the specific needs of the particular customer segment. The explosion of colours on the design palette has created an unprecedented range of opportunities to be explored in order to find the right fit between the value proposition and the customers.

Develop new business models

Innovate your business models to reap superior returns

In essence, the scope of creating customer value propositions and, thus, competitive advantage has been ex-

panded from delivering basic products to crafting advanced business models.

Professor Michael Porter captured this paradigmatic shift back in 1996 when he noted that a strategic fit among many activities is fundamental – not only to competitive advantage, but also to the sustainability of that advantage. Porter argued that it is considerably harder for a competing firm to match an array of interlocked activities than it is merely to imitate a particular sales force approach, match a process technology or replicate a set of product features. Therefore, positions built on systems of activities are far more sustainable than those built on individual activities.

Consequently, we have to revise the old dictum of “building a better mousetrap” to make the world beat a path to our door. Although more than 4,400 patents have been issued by the United States Patent and Trademark Office for new mousetraps, and it is the most frequently invented device in history, the driver of long-term success resides not only in the mousetrap itself, but in the complete business model.

The business model view resonates with research on how to profit from innovation. The mousetrap approach clearly plays an important role. A tight regime of patents, copyrights and trade secrets is one component of the equation, but to commercialise an innovation or exploit a new business strategy, complementary assets are needed such as manufacturing capabilities, distribution channels, specialised services and a sales force.

What is a business model?

In brief, a business model describes how an organisation creates, delivers and captures value. More precisely, a business model articulates the content, structure and governance of the activity system that delivers a value proposition to the customer and enables economic value creation for all activity system exchange partners.

A simple example of customer needs being fulfilled by radically different business models is car transportation. Getting from A to B and the freedom to choose when to go can be served by a car that is bought, leased, rented or even shared with co-owners through car sharing services. The core product is essentially the same, while the activity system underlying the product covers a spectrum of business model design options. In all cases, value capture

is enabled by the organisation's ability to standardise and industrialise operations across the activity system. The aim is not to add complexity, but to enable scalability through simple, but effective activity systems.

The activity system can be illustrated using Alexander Osterwalder's business model canvas consisting of 4 dimensions and 9 building blocks.

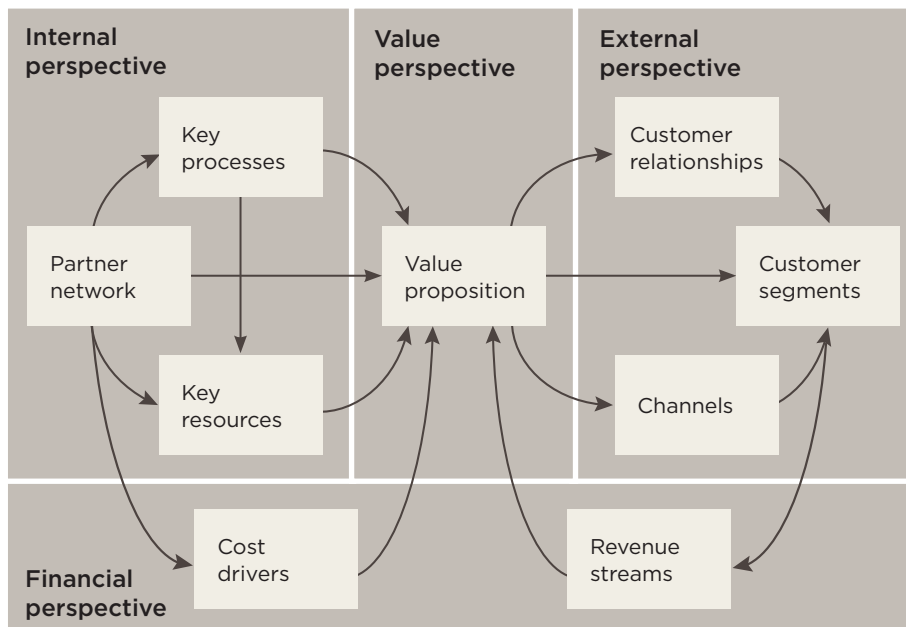
The value perspective describes the total market offering provided by the company. It consists of a value proposition composed by an integrated solution of products and services. Typically, the core offering is linked to complementary offerings to create a comprehensive customer experience. E.g. car manufacturers have recently begun to offer leasing contracts, which has proven to be an important complementary service to the core product that drives growth.

The external perspective describes how the value proposition is delivered to the targeted customer segments. To reach the customers, the value proposition is distributed and communicated through a set of channels, and to establish long-term customer relationships, ways of building the relationship have to be identified. E.g. car manufacturers have established a number of customer clubs – both online and offline – to build close connections to their customers.

The internal perspective describes how the market offering is produced. A number of tangible, intangible or financial key resources must be leveraged to create the value proposition through a range of key processes. Strong brands are important intangible resources, and the design of processes both in back and front office functions is vital to economies of scale. Often, an external partner network is a key component of the value proposition, e.g. the financial service providers involved in the car leasing contracts mentioned in the example.

The financial perspective describes how profit is made by identifying revenue streams and depicting the cost structure. Revenue comes in many shapes as the car example illustrates, and both financial components should be carefully designed to maximise profits and customer value.

The activity system is generic and can be used to systematically visualise and redesign any business model. Furthermore, it creates a unified language around the elusive business model concept that can be used across organisational functions and units.



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Operating margin growth in excess of competitive peers

Per cent compound annual growth rate over 5 years

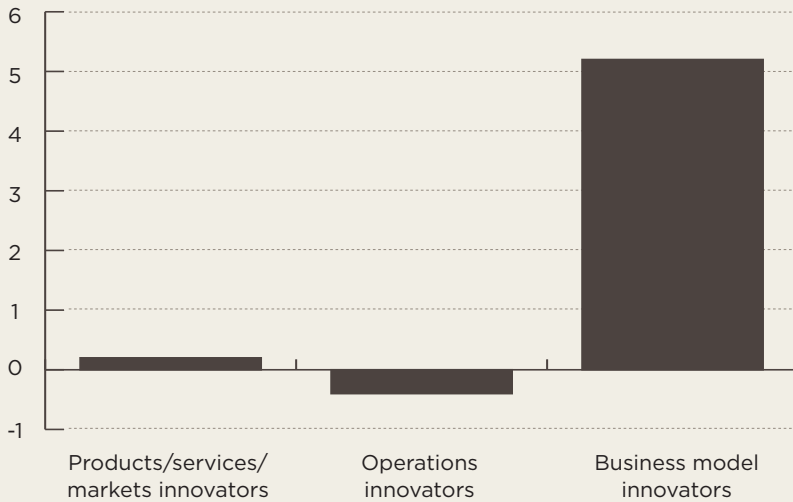


Figure 3. Business model innovation outperforms other types of innovation

Research undertaken by academics, global consultancies and our experience proves that a business model-centric look at value creation is imperative to business success. An IBM study from 2006 found that innovating across the business model had a much stronger correlation with operating margin growth over a five-year period than both product/service innovation and operations innovation. See figure 3.

A 2010 survey of the world's top 150 companies confirmed the findings and discovered, furthermore, that a single-minded focus on product development

tended to be a slippery slope. To increase investments in R&D proved to be fruitless, while a dual focus on both innovating the business model and delivering superior products actually enabled lowering the R&D spend. Apple – often described as business model innovator par excellence – has managed to significantly lower R&D spend as a percentage of sales while growing enterprise value at an extraordinary pace.

When executed in the right manner, business model innovation quite simply delivers superior returns to both customers and shareholders.

Decide on what game to play before innovating the business model

Obviously, all companies have a business model. Therefore, the key question is whether all elements of the business model deliberately have been thought through in a customer-centric way? Does your company purposefully design all elements of the business model, or are you focusing most of your innovation on improving the core product?

The complexity of grasping the entire activity system often leads to both overlooked areas as well as activity systems with designs purely based on the dominant logic of the industry. Consequently, in many cases, all eggs are put into the product innovation basket searching for differentiation through superior products while failing to see opportunities in other parts of the business model. In these cases, business model change is limited and fundamentally responsive. Large changes occur when changes in the environment require action and response. However, taking a closer look at the business model on a continuous basis in a proactive manner leads to a number of potential opportunities for customer value creation and growth. A proactive focus holds the promise of harvesting first-mover advantages, but obviously also the risk of designing a business model that does not deliver as expected.

Scrutinising the business model to discover new business opportunities places the customer centre stage by asking if the fit between current activities and customer needs maximises value creation for both customer and company.

Four areas should be investigated to

	RESPONSIVE BUSINESS MODEL ORIENTATION	PROACTIVE BUSINESS MODEL ORIENTATION
What are the sources of differentiation?	Products, services and processes	The entire business model
What business model designs are used?	Standard designs and exploitation of the dominant logic of the industry	Best fit with customer needs and exploration of alternative design patterns for the business model
When does the business model change?	Reactive change based on articulated needs of the customers	Proactive change based on latent needs of the customers
What type of innovation strategy is pursued?	Fast follower or late mover	First-mover advantages
What are the key risks in relation to the business model?	Disruptions from entrants, weak protectability and intense competition	Novelty in approaches, complexity and unprofitable niche markets
How sustainable are competitive advantages?	Short-term due to weak protectability	Long-term due to strong protectability

Figure 4. Proactive and responsive business model orientation

establish a systematic overview of opportunities to exploit business model design to enhance customer value creation. See figure 5.

Adjust the current business model to exploit opportunities in existing markets:

Changing needs of existing customers and a turbulent environmental context present the opportunity to adjust the business model on a continuous basis. While competitors are focusing on improving products, simple incremental moves in other areas of the business model can be exploited to achieve important business goals.

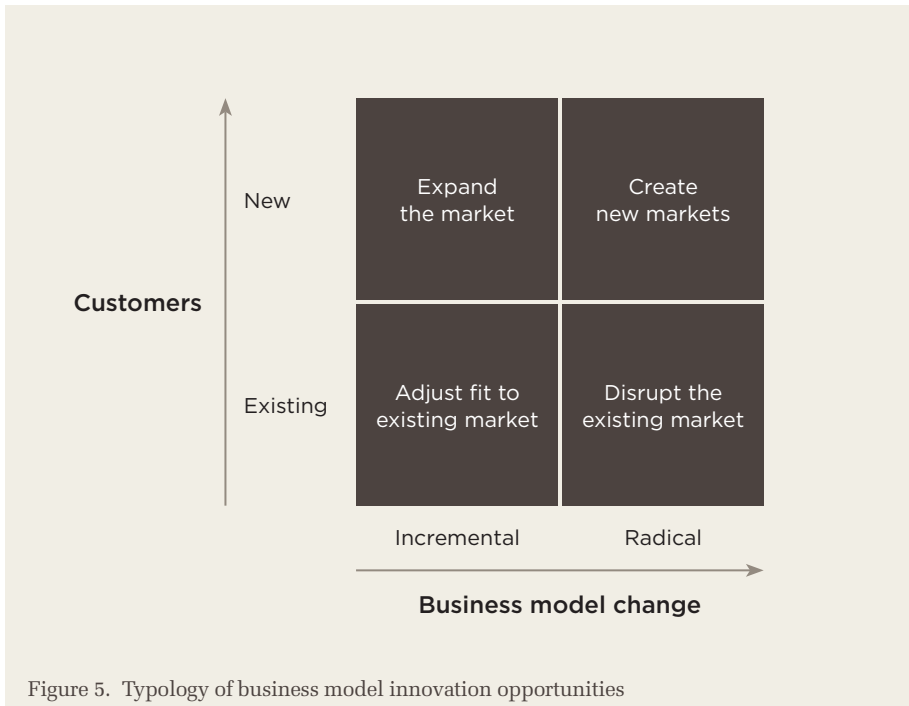
Launch a sticky value-added service, acquire customers through smart pricing models or partner with great companies to leverage their brand power.

Consider the role of value-added services in the telecom industry where TDC's launch of the previously mentioned free music service TDC Play reduced churn by 50% for existing broadband customers back in 2009. The core product is essentially unchanged, while adding a service layer on top based on partnerships with the music industry changes the "stickiness" of the business model dramatically. Few people are

emotionally attached to their broadband provider, while the composition of a music collection is fundamental to signalling who we are and what we like. Adding a complementary music service has helped reduce loss of market share through improved customer loyalty and satisfaction in a highly competitive market.

As shown in the opportunity matrix, business model innovation does not have to be radical. Simple moves can achieve great results in existing markets and discover new differentiation factors.

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Redesign the current business model to expand the market: Incremental change in the current business model can be leveraged to expand the market by attracting non-customers. For example, the practice of serving products in small and affordable sizes is a widely used strategy by global consumer brands to enter emerging markets. Seven out of ten Filipino smokers buy their cigarettes by the stick rather than by the pack, and as much as 68% of Procter and Gamble's shampoo business in the Philippines is generated by sachet sales. The core product is left unchanged, while innovative distribution setup and packaging changes are keys to success.

Attracting non-customers can sometimes be achieved through small

changes, and, thereby, a latent demand can be converted into real demand. Typically, non-customers are those who are either unaware of your offering or meet some sort of barrier to consumption. Understanding and removing the barriers are keys to expanding the market. Understanding commonalities in the non-customer segments paves the way for redesigning the business models.

Launch a new business model to disrupt the existing market: Investigating the needs of current customers in some cases leads to the discovery of attractive sub-segments which are not appropriately served by the current business model. The discovery of underserved or overserved customers leads to important managerial deci-

sions. Should all segments be served by the same business model while running the risk of opening a flank for competitors? Or should a radically new business model be designed to serve attractive sub-segments while cannibalising the existing business model?

The dilemma is well-known in the telecom industry where a range of low-cost players with no-frills value propositions based on online self-service have disrupted the market several times. Recently, Danish low-cost mobile telephony provider Onfone was acquired by TDC after having captured a large share of the low-end market populated with customers looking for convenient, simple and cheap telephony. No-frills solutions, innovative pricing models and technology-driven automation are classic ways of conquering the low-end of an existing market. Ryanair and Google's free web services spring to mind.

At the other end of the spectrum, the high-end of a market can be equally attractive to explore through new business models. Consider the makers of automated espresso machines powered by easy-to-use coffee capsules such as Nespresso. By removing the risk of failing to brew the perfect cup of coffee and reducing the time it takes to make a nice single-shot espresso, an attractive niche of espresso drinkers has been identified. Whereas high-end disruptions typically are based on a technology leap, low-end disruptions can also be achieved by simplifying and lowering costs.

Launch a new business model to create new markets: Designing radically new business models can be leveraged

to create entirely new markets where large groups of customers have been locked out. In some markets, minor business model tweaks such as sachet marketing are simply not enough. A complete overhaul or even a new business model is needed to commercialise a value proposition for a new market. New markets can be defined both geographically such as bringing products from developed markets to emerging markets and as needs-based such as fulfilling emerging customer needs.

A business model currently under development illustrating the idea is the current debate concerning designing a house for the poor that can be constructed for under \$300 which keeps a family safe, allows them to sleep at night and gives them both a home and a sense of dignity. It is a grand challenge that surely can only be solved by thinking innovatively about the entire business model. The potential is huge. 2.5 billion people at the so-called bot-

tom of the pyramid live on less than \$2.50 per day and are by far the largest global socio-economic group. Furthermore, fulfilling the vision leads to value creation that, by far, goes beyond pure economic value creation.

New market creation demands innovative business models. Moreover, these emerging markets are often judged unattractive to well-established companies, because they start out small and do not meet the expected growth rates to attract ordinary innovation investments. However, these markets often become large and profitable, and patience for growth pays off.

The four generic growth opportunities (see figure 6) can be explored and exploited by any company to sustain growth and delight customers. The common denominator is a proactive posture that recognises the need to cover all components of the business model – both when strategising at busi-

ness unit level and when developing new market offerings. Obviously, new business models are not launched out of the blue, but rather closely aligned with overarching strategic growth ambitions of the company. In other words, a diagnosis of the strengths and weaknesses of current business models needs to form the basis for any attempt to pursue one or more of the four opportunities.

Combine diverse knowledge perspectives to create new business models

Becoming a business model innovator can be compared to an artist shifting style from painting with monochrome colours to using a palette with all the vivid colours of the rainbow. Options explode, and the number of possible solutions for designing the next market offering increases. However, in order to be successful, the colours on the palette need to be picked carefully. Not all colours can be used for the next breakthrough. In other words, the articulat-

	ADJUST FIT TO EXISTING MARKET	DISRUPT THE EXISTING MARKET	EXPAND THE MARKET	CREATE NEW MARKETS
Customers	Existing	Existing	New	New
Level of change	Incremental	Radical	Incremental	Radical
Characteristics	Improve the existing business model to attract and retain customers in existing markets characterised by intense competition	Develop new business model to exploit opportunities in either underserved high-end segments or overserved low-end segments	Improve the existing business model to fit needs of customers in unserved markets or segments of non-customers	Develop new business model to exploit opportunities in new markets or segments of non-customers

Figure 6. Generic growth opportunities

experiences what he or she already knows and lacks knowledge about different options. The customer's frame of reference is severely limited, and usually customer ideas cannot be used to leap-jump competition. They tend to be incremental and result in me-too products. Secondly, the knowledge that can be accessed easily by asking the customer will most likely not be very unique. All competitors will have access to the same knowledge through analyst reports and industry market studies. One exception is the so-called lead users who typically represent a tiny fraction of your customer base. They are characterised by their eagerness to tweak, modify and rebuild your products. Looking at their modifications can be helpful to identify emerging demands, since they are usually "ahead" of the mass market.

Instead of asking the customers what they want, the best approaches for discovering unique insights are to listen and observe customers in their real-life context. To get under the skin of the customer, ethnographic research methods must be used, and data should be interpreted systematically to find the surprising insights which pave the way for innovation. While high-level quantitative analysis of customers can set the direction, deep qualitative studies are the best option to find the latent needs to exploit. Sharpen knowledge through exploring the full upstream chain of customers and understanding needs in all phases of the customer journey from initial consideration to disposal of a market offering. Put simply, get out of the building and meet the customers.

Context: The context perspective offers both constraints and possible so-

lutions. On the one hand, a number of constraints can be identified by analysing macrofactors such as legal regulations, economic factors and societal trends. Often, constraints can be turned into great opportunities, which producers of outdoor ashtrays discovered when indoor smoking in public buildings was prohibited in Denmark some years ago. A simple change in regulations caused an instant boom in demand. On the other hand, many potential solutions can be discovered by studying the context. Both microtrends and macrotrends can provide answers to great experience design.

Due to the explosion of small digital sensors embedded in many consumer products, it is easy to measure almost everything that we do. Nike and Apple partnered and designed the Nike+ tracking device for runners. Fitbit has developed a personal tracking device collecting real-time data on every step taken, stairs climbed and calories burned. Both examples illustrate the booming interest in measuring and quantifying your everyday life. New technologies shape trends and can also be mapped to identify design options. A key area of interest should be emerging technologies and careful analysis of their possible implications for future business models. A simple but powerful exercise is to map 20-30 important technology-based trends and conceptualise a set of new solutions on the basis of each of those trends.

Competition: The competition perspective should without a doubt be explored. Competitive analysis can be used to single out those customer wants and needs which are not currently satisfied in the marketplace.

Furthermore, an analysis of close competitors can be used to spot industry orthodoxies and mental models that could be challenged. Whirlpool observed that all white goods were designed and sold with women in mind, and they used that piece of competitive insight to create a new product line for men and their garages. While the idea might seem a bit sexist, business for Gladiator® GarageWorks is flourishing, and American men are eager to install designer fridges in their garages.

To identify and break out of industry orthodoxies, the analysis should not be restricted to close competitors when bigger and bolder ideas are wanted. Just as lead users and emerging technologies can inspire the discovery of new business models, so can research into analogous industries. Looking across industries helps identify emerging business model design patterns that can be imported from one industry to another. Danish playground producer Indu basically copied Google's business model by offering ad-supported playgrounds to schools and communities for free. Looking across the industry value chain can also be used as a tool for identifying shifts in the industry profit pool. Small changes in the location of high profits in the value chain can be used to anticipate important changes and growth opportunities. The message is clear: When innovation ambition levels are high, an ordinary competitive analysis will not be sufficient.

Capabilities: The capability perspective is used to explore both internal and external capabilities and resources. Firstly, a mapping of internal capabilities and resources can provide insight about underused resources or underexploited

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business capabilities. For instance, the service business of many manufacturing companies has been professionalised in recent years. At Danish wind turbine manufacturer Vestas, the service business is growing, while the total turnover growth is under pressure. Services accounted for EUR 214 million in 2006 growing to EUR 700 million in 2011 out of a total turnover of EUR 6.4 billion.

Secondly, resources and capabilities of the business ecosystem should be mapped to identify partnering, collaboration and integration opportunities. A highly profitable business model in the publishing industry is to license forgotten comic book characters to toy, movie and computer game producers. In that way, resources are exploited in a new context through smart partnering agreements. Consider Marvel Entertainment's lucrative licensing of Spiderman and X-men to Hollywood studios. If partnering opportunities are lackluster, a business ecosystem can be designed when the right incentives are present. External app developers play a vital role in Apple's iPhone and iPad success. More importantly, the use of external developers and their resources reduces the risk of failure for Apple and increases the speed of innovation at the same time. Bad apps die, while Apple survives, and barriers of entry in the app market are so low that a 12-year old app programmer can achieve significant success. Apps are all about survival of the fittest, and in the heat of the battle Apple's business model just gets stronger and stronger.

Altogether, new business opportunities are discovered at the intersection of the four knowledge perspectives.

Know your options before innovating. A broad and diverse foundation of knowledge simply makes it easier to be both innovative and goal-oriented. However, the deep dive into emerging technologies, latent customer needs and inspiring business models should always be timeboxed and balanced with the innovation challenge at hand. There is no need to boil the ocean to design a simple service business on top

of a product line. But bold moves do require a decent amount of knowledge and inspiration upfront.

The bottom line is that analysis must always serve a purpose and enable you to challenge world views. That also means that research efforts guiding business model innovation must be designed to build surprising hypotheses as opposed to just testing and

WHAT ARE THE CHARACTERISTICS OF A GREAT BUSINESS MODEL?

Not all business models are created equal, and some key factors must be considered when evaluating different design options. A delighted customer is the ultimate goal of your business model, but to survive in the long run as a business, the challenge is not just creating customer value, but capturing value as well.

To capture value, your design must provide a high degree of protectability through either legal or natural barriers. Legal barriers could be patents, trade secrets, copyrights or non-disclosure agreements. Natural barriers could be difficulty in reverse engineering your offering, switching costs or tacitness of relevant technology. To capture value, you must also have some degree of control over so-called complementary assets. Such assets are for instance manufacturing capabilities, an effective distribution setup, a portfolio of strong brands, innovative services and leverage of shared technologies. In other words, the strength of your protection mechanisms and supporting assets will determine your ability to capture value.

At the end of the day, great business models are based on solid financial models. To support your efforts in discovering the right financial model, consider some of the questions below:

- Do high switching costs create effective lock-in of customers?
- Can you easily scale your business model?
- Does your business model produce recurring revenues?
- Can you design the financial model so that you earn before you spend?
- Is it possible to exploit a partner network to reduce your costs and risk?
- Does your business model exploit protection mechanisms?
- Can you take advantage of existing assets and capabilities?
- Can you redesign the cost structure to change the rules of the industry?
- How can you rethink the in- and outflow of cash throughout both development and launch of the business model?



CREATE GROWTH THROUGH INNOVATIVE BUSINESS MODELS

validating predetermined hypotheses. Without the will to deconstruct orthodoxies, a desire to scan the periphery and proactive leverage of analogies from distant business models, your innovation success will be based on pure luck. We have to question our assumptions to change the rules of the game.

Build capabilities for business model innovation

Expand the scope of innovation and build capabilities for high growth

The first step in your journey to become a business model innovator will be to expand the scope of innovation to include all components of the business model. A key point is to actively manage all resources put into innovation. While the product development department is important, it is essential to uncover and coordinate all innovation work undertaken across departments. These investments in innovation tend to be hidden in budgets, but very important in real life. In marketing, they design great websites to support product launches. In supply chain, they invent new production methods. In business development, they identify potential targets for acquisition to create synergies. As an alternative to departmentalised work without coordination, companies actively pursuing the benefits of business model innovation open up silos and coordinate key activities. To get started, roles and responsibilities must be defined, and a process enabling coordination needs to be designed.

When innovating, there seems to be a hidden gravitating force pulling all ef-

forts towards small incremental moves. In many companies, you will find portfolios crowded with line extension work and customer request projects that extend the past into the future. Obviously, these efforts are important to be able to exploit current opportunities. However, the second step in the journey is to think about innovation like great investors. They purposefully design a balanced portfolio of opportunities and put their scarce resources to work by calculating risk versus potential return. Experience and research show that a balanced approach has the largest payoff potential. Add to that the positive branding effects and employee engagement created in companies that are actively "changing the world" as opposed to those companies just doing "more of the same". To get started as a business model innovator, management anchoring, innovation capabilities and a learning mindset have to be developed.

Create a strong innovation intent: A simplistic view of business states that you get what you measure. Hopefully, this is not always the case, but on the other hand, the saying has some merit. Especially when it comes to risky bets, organisational incentives have to support business model innovation. No one in the organisation will take on the risk of failing if corporate culture dictates that failure is not an option. Therefore, innovation goals must be backed by strong top management support and a very clear recognition that risk is an integral part of the game. When designing new business models, incentives should be aligned with fast learning and not fast growth. Harvard professor Clayton Christensen has put it nicely by saying that you want to promote impatience for profit but patience for

growth when it comes to business model innovation. Particularly in the cases of large disruptive moves. Focus on early profitability pushes the innovation efforts to find the markets in which unique capabilities will be uniquely valued. Focus on fast growth makes you slip back to well-known business models in well-known markets.

A company exhibiting strong top management support for innovation is the Danish pump manufacturer Grundfos. The company's innovation intent explicitly states that Grundfos in 2025 intends to employ 75,000 people compared to 16,000 in 2011, and that 50% of growth will come from new technology platforms. The ambitious intent has been decomposed to a number of strategic innovation platforms, and to support the realisation, different innovation processes have been designed for low-risk and high-risk bets. Low-risk projects are managed according to traditional stage gate development processes, whereas high-risk projects are rewarded for fast learning before scaling up the business. In some cases, companies seeking new growth beyond the core even decide to establish separate organisational units to support the very different ways of working as illustrated in the case of Grundfos. A strong innovation intent and a top management team walking the talk are pivotal to success.

Ask yourself if you have a clear management agenda for both renewing and reinventing the business model.

Establish entrepreneurial front-end innovation teams: As more than 70% of the total life cycle cost of a product is determined within the early stages of

the innovation project, innovators can substantially influence the outcome by focusing on the front end of innovation. Success and failure are determined at a very early stage, so spend a little to learn a lot.

Firstly, the front-end innovation process must be extremely well-defined in order to ensure the right focus. Often, the front end is notoriously fuzzy, which is a classic stepping stone to failure. Instead, focus on installing a solid discovery-driven process where cross-functional and multidisciplinary teams led by heavyweight project managers are working on well-defined innovation challenges derived from the innovation strategy. Demand that teams are proactively looking for major customer

problems to solve and actively exploring the four knowledge perspectives described above. If teams are eager to focus on creating myriads of ideas to begin with, they run the risk of creating "solutions looking for problems". This approach is counterintuitive and will lead to frustrations when they discover that there is no or little match between market needs and product ideas.

Secondly, it is important to recognise the need for establishing a shared vocabulary and toolbox when bringing people together with diverse competences. Innovation flourishes through cross-pollination, but without a common "language" communication stifles. Therefore, entrepreneurial project managers with great people skills are

a prerequisite when forming innovation teams. Common tools are also a key ingredient in and enabler of knowledge sharing and shared purpose. For instance, everyone in the team needs to get tools which bring them "out of the building" to meet the customer and users in order to observe, interview and co-create with them. Simple tools will give your team a head start. If possible, teams should be co-located and even work on the same weekdays in order to maximise effectiveness. Framed by clear ambition levels and well-defined deadlines, such teams will power your innovation engine and be the key to identifying new paths to growth. To support customer focus and business model innovation, the discovery-driven innovation framework can be used.

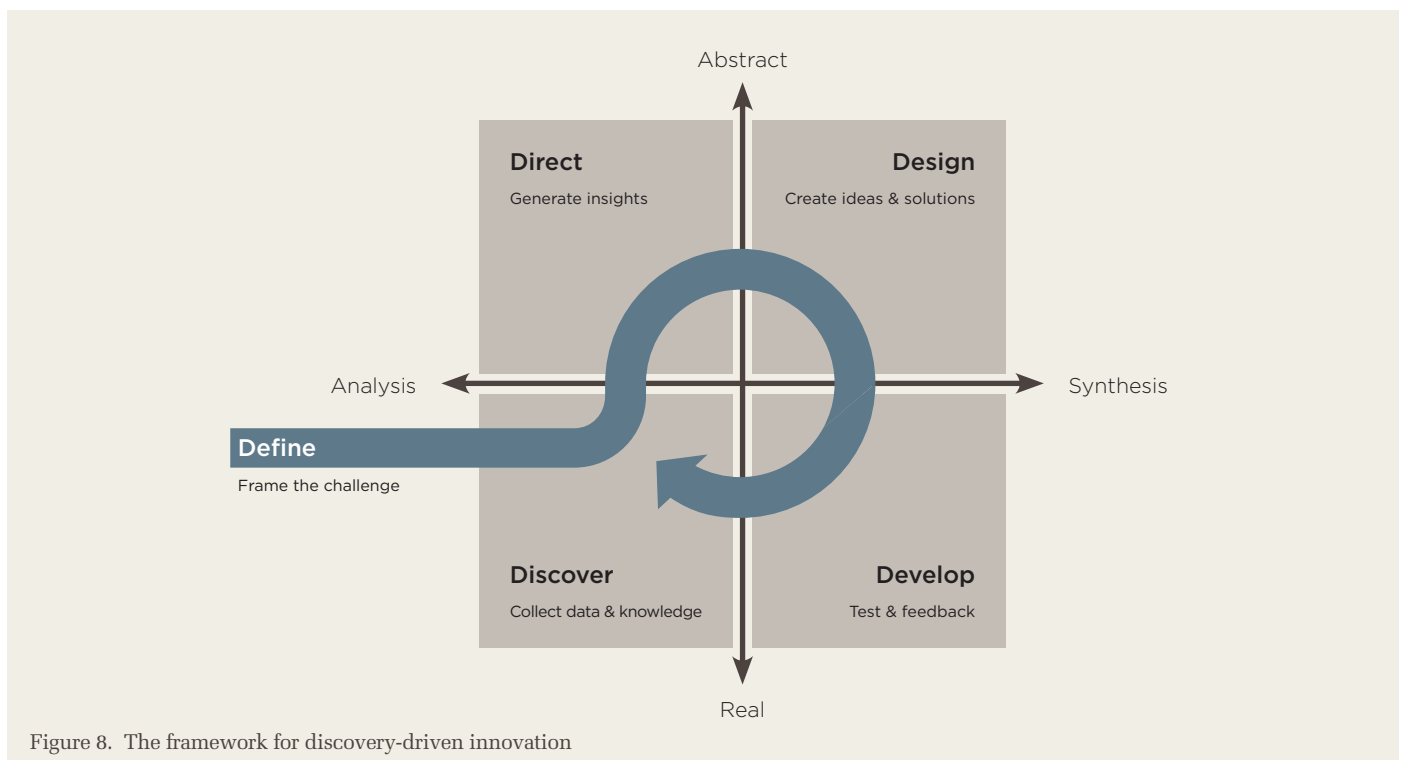


Figure 8. The framework for discovery-driven innovation

CREATE GROWTH THROUGH INNOVATIVE BUSINESS MODELS

Each step of the framework is supported by an advanced toolbox and innovation best practices.

Ask yourself if you have strong innovation teams dedicated to exploring and exploiting new opportunities following a well-defined and well-anchored process.

Master learning-based implementation: Having defined a strong innovation intent and formed entrepreneurial teams enable creation of new business opportunities. However, the tricky part of the equation is often a successful launch – in particular, if you are venturing beyond the existing business model. Simply put, you must use a different approach based on fast learning cycles where you plan to learn.

All new business concepts are fundamentally an interlinked set of assumptions which must be proved to hold true. But the assumptions are associated with different levels of risk, and instead of doing a full launch to test everything at once, you should learn systematically about your assumptions.

Define assumptions for each element of the business model, identify the level of risk and start by testing the most risky assumptions. In the early phases of innovation, testing rough prototypes and lots of iterations with customers will take you further, while test marketing and learning launches are used at later stages. Moreover, it should be a fundamental principle in your innovation process to work on competing solutions at the early stages. Developing concepts in parallel will not only enable learning about individual opportunities, but also enable you to combine

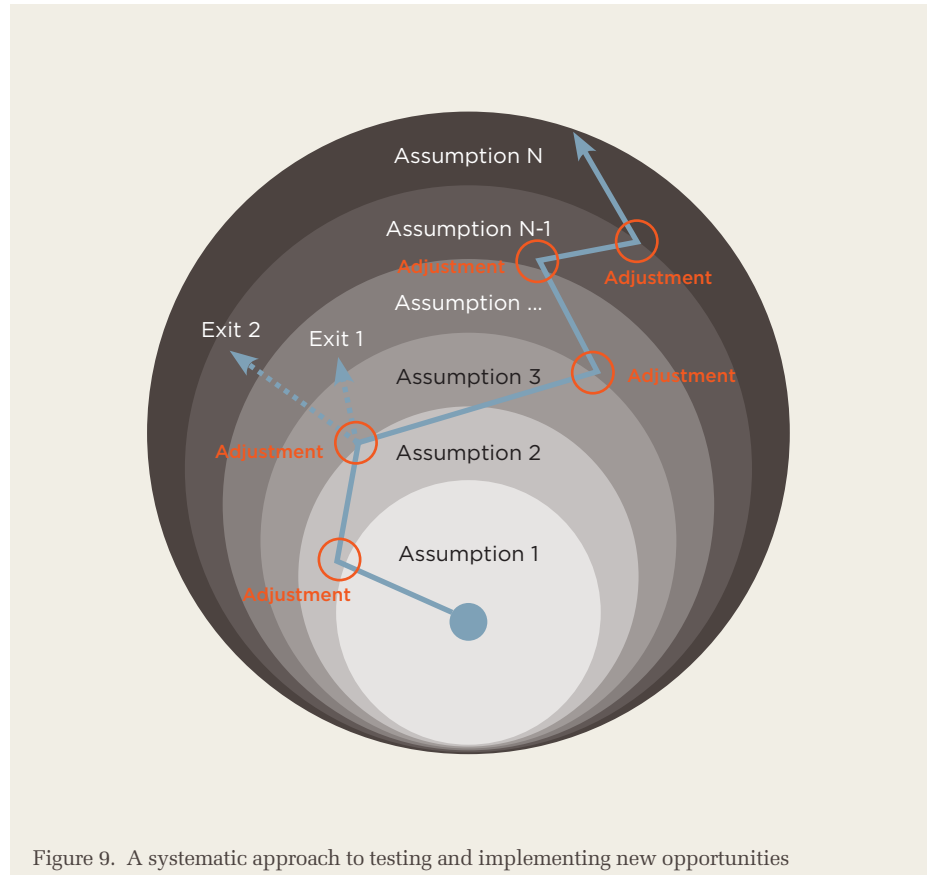


Figure 9. A systematic approach to testing and implementing new opportunities

feedback and extract new insights. A guiding principle for business model innovation efforts should be to reduce time-to-learning and increase the rate of customer feedback. Figure 9 illustrates how prioritised assumptions are tested and followed up by adjustments of the original concept – or even exit if the concept does not prove to be a valid solution.

Apple is often touted as being a revolutionary, but taking a closer look at Apple also reveals careful learning-based strategies behind every move at a higher level. The success of Apple

was not created overnight, but rather through a step-by-step roadmap taking Apple from personal computers into the tablet market. The first step away from the old core was the iPod, and when success was ensured, the second step was the launch of iTunes. Hereafter, Apple ventured into mobile phones, copying the successful iPod razor and blades business model – expensive product and recurring revenues through sale of cheap music tracks – with the invention of the App Store. Thereby, the risk of failing was intelligently outsourced to app developers. Apple created a solid core

product and a strong dual-sided business platform – a meeting place for Apple's customers and app developers – while much risk was placed on the shoulders of app developers trying out different options. Apple was safe, while a lot of apps failed.

Apple's "open innovation" approach with strong reliance on a thriving ecosystem also points to the fact that partnering opportunities should be carefully considered when implementing new business models. Often, a great partner can both fortify competitive advantage and create a shortcut by leveraging their assets. Furthermore, different partnering options are also a possible way of escaping the invisible mental blinders of the core business.

Ask yourself if you have a strong learn-

ing orientation and proactively manage high-risk opportunities with the goal of learning as fast and cheaply as possible.

Altogether, the three principles should inform and guide all business model innovation efforts, and, obviously, the importance of the principles is correlated with the level of risk. On the other hand, all innovation activities and growth initiatives can benefit from gaining a fresh perspective from business model thinking and from rethinking your business model through the lens of discovery-driven innovation.

In a world characterised by exponentially increasing turbulence, expanding your innovation horizon to encompass the entire business model is timely and needed for gaining long-term competi-

tive advantage. However, to stay true to the principles, we should not get caught up in too much theorising, but just do it and learn along the way. Close the laptop, get out of the building and learn from your customers to discover your future business models.



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ARTICLE BASED ON INTERVIEWS AND DISCUSSIONS WITH EXECUTIVES FROM LEADING RETAIL BANKS IN DENMARK

Facing the New Normal of Retail Banking

Regain customer trust and financial performance through innovative business models based on simplicity, agility and transparency in every aspect of customer interactions

by Nicky Overgaard Pedersen

The new normal: A disrupted industry

The term “financial innovation” has a certain ring to it that instantly brings the root cause of the current world economic turmoil to mind.

When presented with this particular term, the average retail banking customer is left with a reluctant and cautious mind, thinking of lost pensions, enormous bailout plans and plain and simple unfairness caused by “too smart investment bankers”.

It just does not smell right, and the imperative customer experience metrics are suffering just as the general public perception of the entire sector has taken quite a beating.

Financial innovation as the remedy

On the other hand, financial innovation is exactly what retail banks need in order to comply with “the new normal” they are facing. But how can one apply financial innovation without losing even more of the precious customers’ confidence?

The answer to this is not about adding even more complexity to the financial products and services – quite the contrary.

It is about making potentially radical changes to the manner in which banks operate and engage with their customers. It is about designing new innovative business models with the ability to delight the customers by leveraging the banks’ core capability of putting money to work in a productive manner – without increasing the risk.

Characteristics of the new normal

To fully understand the challenges that retail banks are facing and why this has disrupted the entire financial services sector, consider this:

- **The Occupy movement started in Spain in May 2011 as a protest against the political system**, unemployment rates and corruption. Less than six months later, in September 2011, Occupy Wall Street was formed, and since then the movement has evolved into a worldwide protest against power vested in the top 1% income earners and general economic inequality. And it is all to be blamed on the banks.
- **The disintermediation trend is challenging the traditional role of banks as intermediaries.** Today, it is not unusual to see private enterprises with higher credit ratings than the average bank. Boerse Stuttgart is taking advantage of this by offering bonds issued by mid-cap companies, effectively opening up for cheaper

THE IDEA IN BRIEF

The world economic turmoil has disrupted the entire financial services sector, creating a new normal characterised by increased regulatory demands and a severe loss of trust from the average retail banking customer. More than ever, the industry will have to innovate in order to prosper and rebuild the damaged image.

However, the traditional sources of innovation cannot be tapped this time as they themselves have played a major part in getting to where we are now: risky and complex products.

To make up for the past and fit into the new normal, retail banks must expand the scope of their strategic innovation efforts. They have to look beyond products and services and look at their entire business model to regain trust and financial performance.

In order to succeed, three essential design principles must be applied to every dimension of future business models:

- Simplicity
- Agility
- Transparency

and alternative “business-to-business funding”.

- **Some banks are now considered to be systemically important financial institutions.** They have been categorised as being “too big to fail” by policy makers. Currently, the total capital ratio must not be lower than 8%. Once Basel III has been fully implemented in 2014, that number will reach 13-14% depending on the size and systemic importance of the bank. This alone will potentially lead to a decrease in ROE between 4-5% – if nothing is done.

In other words, banks are forced to act just to maintain their ROE. Regulatory demands are tightening, and the cost of being a regular bank customer is increasing – all in all, something that does not go easy with low market confidence, changed customer behaviours and expectations.

Fight for freedom to innovate

As a consequence of ROE being under pressure in the years to come, all sails are set to deleverage the books because without proper earnings, credit ratings will be lowered, funding of capital will go up and products will become more expensive to the end customers, which essentially affects the customer experience in a negative way.

The fact is that a lot of retail banks are in urgent need for deposits, and Amazon-like promotions have begun popping up, urging customers to “start saving now and get an instant giveaway or bonus!”.

Not all countries and regulations allow for such instruments to be applied, so instead focus is shifting towards private

MANAGING THE CAPITAL COST OF RISK IS CRUCIAL

Right now, it is all about survival by trimming the balance sheet. ROE and credit ratings are imperative to our ability to deliver superior customer experience.

Going forward, we will see that only those with a solid financial performance will have the freedom to innovate: It is very expensive to play the role of first mover.

Developing new products is a risky business, and mitigating financial risk is the largest obstacle for innovation – but also the largest driver.

The banks that find ways to manage this catch-22 will have a clear advantage.

*Ken Adrian
Head of Segment Household
Nordea Danmark*

banking and cash management – areas in which the customers bring their own money to the table, so to speak. Still, this is not enough. There is a strong need for even more innovative thinking.

The traditional sources of innovation cannot be tapped this time

For decades, innovation in the financial sector has been more or less trivial. There has been a heavy focus on optimisation of internal processes to reduce operating costs per customer as well as to be able to serve the custom-

ers faster. And to some extent, this has proven to be a viable path.

However, the primary focus for strategic business development has been on the product side. Developing the right set of products and services capable of both serving existing customers as well as attracting new ones seemed to be the one and only truth.

Over time, this product-oriented focus has not only spawned increasingly complex and risky products, but ironically enough also made it even harder to implement cost-effective straight-through processing solutions in the back office operations.

Truly, this depicts an unfavourable situation where the striving for higher profits from the product side is jeopardising the agility and transparency of customer interactions.

Reduce risk through product innovation

Rest assured, product development will continue to be a central topic as the risk and complexity are bound to be reduced, thus requiring radical changes to products and product structures.

An example of this type of innovation is the changes to the price and product structure of home mortgage financing recently introduced by Nykredit and Totalkredit:

1. Under the new price structure, prices differ according to risk.
2. For a combined mortgage, the loan-to-value ratio of SDOs has been lowered from 80% to 60% for retail customers.

FACING THE NEW NORMAL OF RETAIL BANKING

TOO RISKY, TOO COMPLEX

Traditionally, one of the primary sources of innovation has been calculators and engineers in product development, spinning off increasingly complex and risky products.

For obvious reasons, this can no longer be the case. The new normal forces the entire industry to rethink our offerings and business models based on transparency and simplicity.

*Ove Feddersen
Head of Product Strategy
Nykredit*

Look beyond the products to increase the customer experience

As a direct outcome of the current economic turmoil and the derived changes to the products, terms and conditions, a great deal of existing retail customers are not only finding themselves in a hard position, but, even more importantly, they are having a difficult time assessing the consequences of this new situation.

This implies that retail customers in particular are becoming heavily dependent on superior advisory services, and if anything positive has come out of the financial crisis, it is the wake-up call to every retail bank constantly reminding them to consider the needs of the customers in every touch point, channel and type of interaction, while bearing in mind that there is a crucial discrepancy between what customers think and say they need and what they actually need and really want. This difference is best illustrated with the

quote by the late Harvard professor Theodore Levitt:

“People don’t want to buy a quarter-inch drill. They want a quarter-inch hole!”

This falls well into line with the current perception among leading retail bankers in Denmark. The products are becoming hygiene factors, i.e. nobody looks at them as stand-alone differentiators in the battle for market shares and customer attention. Instead, the bank advisers’ ability to transform knowledge and insights into viable solutions by communicating 1:1 with the customer has become a crucial trait to be displayed in every customer interaction.

FITTING INTO THE NEW NORMAL REQUIRES CHANGE

We are witnessing a global paradigm shift in which banks need to find new ways of operating in order to regain customer trust and financial performance.

The regulatory framework used to “only” dictate the direction in which we could innovate our business. One could say that the framework was “larger than us”, i.e. still giving us room to operate.

With the regulatory demands we are facing from Basel III etc., the framework will become “smaller than us”, so unless we change radically, we simply will not fit into the new normal.

*Ken Adrian
Head of Segment Household
Nordea Danmark*

Innovating the business models

Clearly, financial products have not lost their strategic importance, but, going forward, it is clear that retail banks need to give a lot more credit to the services – and the entire business model – surrounding the products.

If they fail to do so, providing complete and compliant advisory at the lowest possible risk based on the individual customer needs becomes almost impossible.

In other words, banks need to rethink their business models and find new ways of creating, delivering and capturing value.

Already now, retail banks are facing competition from new entrants and innovative business models. While many of the new entrants are still operating on the fringes of the industry with low growth rates and market shares, they should be taken very seriously.

Many of the players exhibit disruptive potential and possess the power to radically alter the rules of the game by targeting small niche segments in the existing market. Basically, the new players are exploiting attractive sub-segments which are not appropriately served by current business models. In some cases, entirely new markets are created for customers who have been totally locked out of existing markets in the past.

Look out! New kids on the block!

An article by Rita McGrath states that one of five large business trends in



2012 is that oblique competition will become ubiquitous, emphasizing that enterprises traditionally were competing within industries, whereas competition can now come out of the blue and take over entire markets.

Take the average German consumer. He or she controls a total of six deposit accounts, but only two of those are placed in a bank. The other four are placed with iTunes, DIY stores, PlayStationNetwork, third party logistics providers etc.

Now consider this: Apple has more than 200 stores worldwide – stores that are well-recognised by high-end consumers. More or less all placed on

high streets. Besides that, Apple has a rather large amount of capital available.

The question that banks should ask is: When will Apple open a bank near us? Perhaps not a traditional retail bank as we know it, but “just” some sort of add-on service that provides credit on the fly to purchase products in the store.

Another example of a potential challenger to retail banks is Facebook with staggering 800 million registered users. In 2009, something called “Facebook Credits” was introduced rather silently. Anyone could buy 50 credits for the price of \$5 “to buy things (i.e. game-related content) on Facebook in an easy and safe manner”.

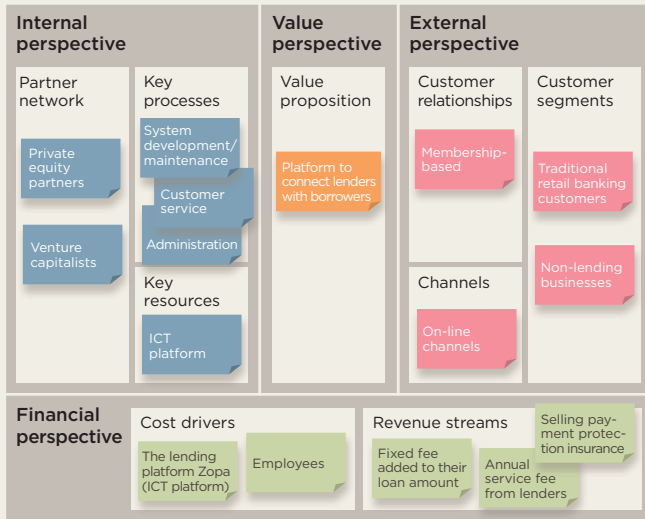
In 2010, users could buy theatre tickets for Harry Potter, and, over time, Facebook Credits may actually end up being the preferred currency for buying any media content over the Internet. The obvious question remains: Where will the retail banks be in that set-up?

Examples of new business models

Rather than risking instant “paralysis by analysis” and complicating things by trying to figure out how to innovate your business model, simply start by looking at what is already going on within – as well as outside – the financial sector and let that be an inspirational guideline for challenging your conventional wisdom. See examples on the next page.

FACING THE NEW NORMAL OF RETAIL BANKING

Peer-to-peer lending by Zopa



“At Zopa, people who have spare money lend it directly to people who want to borrow. There are no banks in the middle, no huge overheads and no sneaky fees, meaning everyone gets better rates”.

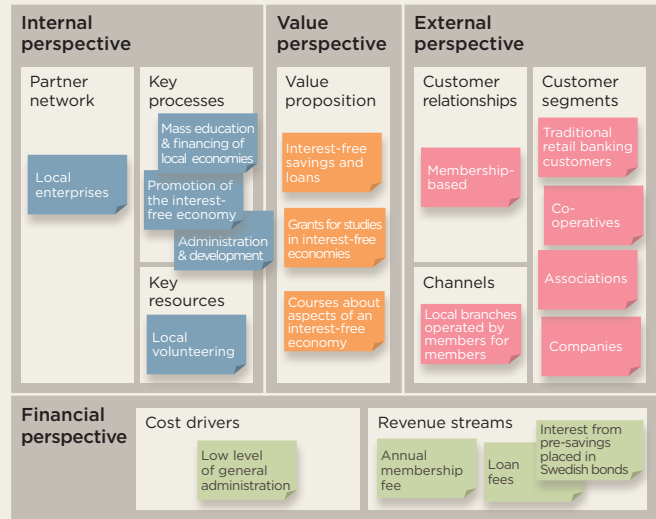
The lending platform Zopa (an Internet marketplace) is offered to members, making it possible for them to connect traditional lenders with borrowers and save them both money by “cutting out the middleman” (banks).

The business model allows depositors to have a higher return on investment by becoming direct lenders, hence accepting risks normally taken by banks/VCs. At the same time, the risk of lending e.g. £1,000 is reduced by splitting the amount into chunks of £100 each going to different borrowers.

To reduce the risk even further, Zopa offers their lenders free-of-charge assistance in chasing up missing payments on behalf of the lender.

The revenues are coming from charging borrowers fixed fees added to their loan amount, charging lenders a 1% annual service fee and selling payment protection insurance to borrowers.

JAK – operating an interest-free savings and loan system since 1970



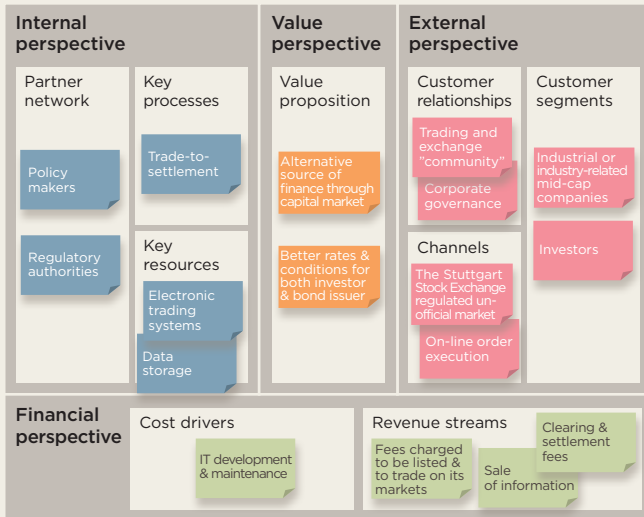
“We regard receiving money in exchange for labour as legitimate, however, we do not consider it legitimate to earn money simply with money. In our opinion, it is unethical to lend money against interest”.

JAK operates like a not-for-profit bank enterprise, trying to make one million SEK annually to add to equity, by offering interest-free savings and loans through a total of just three products.

JAK is primarily driven by volunteer members for other members, and through grants and JAK Schools they are offering courses where participants receive more information about how JAK works, discuss different aspects of an interest-free economy and get tips on how to present JAK in public.

Currently, JAK has approx. 34,000 members, and the number is increasing every year.

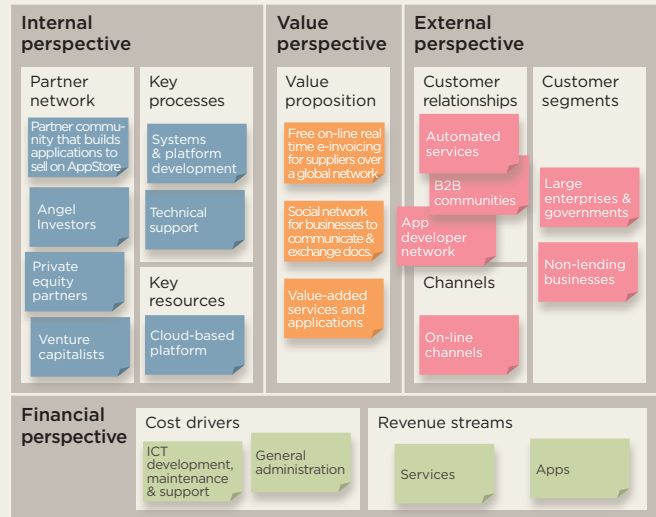
Boerse Stuttgart is offering mid-cap companies a new way of accessing capital



With the launch of Bondm, the Stuttgart Stock Exchange has introduced a new segment for bonds issued by industrial or industry-related mid-cap companies in the upper segment of the range in the need for finance.

The bond issuer gets access to another source than the traditional bank offerings, and retail investors, on the other hand, get the opportunity to participate directly in the bond subscription (primary market), which was originally reserved for institutional investors.

Tradeshift provides an on-line invoicing service and an instant payment feature



Tradeshift is basically a social network for businesses to connect, communicate and exchange documents in real time. They provide an on-line invoicing service and an instant payment feature. TechCrunch sees this as a potential disruptive game changer – on the same scale as Skype which managed to disrupt the telecom industry.

Compared to the traditional charge per transaction or conversion, Tradeshift offers free on-line real time e-invoicing for all suppliers over a global network. In return for free transactions, they offer their customers additional non-free services like master data subscriptions. Besides that, the revenue stream also includes financial services such as instant payments and exchange rate hedging. Finally, they have implemented a two-sided Apple-like platform around an AppStore fed by a partner community developing and selling apps.

The list of customers includes prominent enterprises and organisations like ADETEF (the French international assistance agency of the Ministries for the Economy, Budget and Sustainable Development) with their 300,000 suppliers and UK National Health Service (the 5th largest buying organisation worldwide).

FACING THE NEW NORMAL OF RETAIL BANKING

Regain customer trust and ensure sustainable financial performance

Keeping in mind the root cause of the financial crisis combined with the characteristics of the new normal, retail banks must demonstrate superiority in customer service, capital risk management and operational excellence by applying three essential design principles to every dimension of their business model:

- Simplicity
- Agility
- Transparency

Simplicity

Retail banks should strive for becoming an integral part of their customers' life. Every customer interaction is a chance to provide advice, build a relationship and, above all, learn about the customers' personal needs driving the financial needs.

In that sense, complexity is a real killer. Not only with regard to operational efficiency or the ability to rapidly change and react to changes in customer needs and trends, but, more importantly, complexity makes it difficult for the customers to keep a high amount of daily interactions with their bank.

Besides that, simplicity is, by far, the hardest (product) attribute to copy and potentially also a real game changer.

A business model to be inspired by:

Google Docs which disrupted the market for home office applications by providing a "good enough" product experience for free.

The lesson is that even the best and brightest product eventually becomes a commodity, and the only thing left is how the value proposition is being served.

Agility

Being a first mover is expensive – especially when the development of products and services that you provide is framed by tight regulations. And tighter regulations are exactly what retail banks are facing these days.

The largest uncertainty is not about the amount or scope of the coming regulations – it is about not knowing the consequences of those regulations. No one can foresee how the market will change nor feel safe that the regulations will not take away the last bit of possibility to differentiate between the individual banks.

The uncertainty characterising the financial sector right now calls for "just-in-time" strategies, and as such this emphasises the need to be extremely agile. Besides the strategic aspect, agility in terms of reacting to customer demands is a notable trait.

A business model to be inspired by:

Inditex which is one of the world's largest fashion distributors. They have completely changed the game of the market for affordable fashion by pursuing a high degree of vertical integration. The turnaround time from idea to launch is 2-5 weeks versus 3-9 months for more traditional retailers, making it possible to dispatch new designs to stores twice a week.

Compared to fashion retailers, banks have a long history of ITC-driven inno-

vation, which is something to be built upon. Already, banks around the world have begun to utilise the Internet for more than simple Internet and mobile banking services: "The social web", i.e. the sharing and exchange of information, is being utilised for customer interactions, real time problem solving and improving the customer experience.

"Social CRM" is definitely something that should be thought into a sound innovation framework. A great example of this is **Danske Bank** which has co-developed their iPhone and iPad mobile banking app through a Facebook page where users can propose features and provide feedback directly to the team behind the app.

Transparency

To restore the confidence in the industry as a whole will require more than changed behaviour of the individual banks. Currently, not everybody is adapting to the new capital requirements in a viable way, and that affects the entire industry.

On top of that, disintermediation is gradually pushing banks into unfavourable market positions where more and more business is diverted into areas such as peer-to-peer lending and business-to-business funding.

In order to recover properly, the industry needs to start "playing with open cards" – externally to regain trust and internally to be able to act even more agilely and to ensure complete and compliant processes. Apparently, this would be achieved by breaking down the functional and organisational silos. However, the thing is that even if break-

ing down the silos has been a mantra for many years, there is an important twist to it: Knowledge, insights and professionalism thrive in functional silos, and those traits are imperatives for a great customer experience. As a customer being serviced, we do not want to experience the lag time caused by the silos – we only want to experience the optimised process.

One way of increasing the transparency in the processes of the business model is to make use of the enormous amount of (large) data stored in the back office systems – as well as in the minds of the customers – for “real-time analytics” during customer interactions.

A business model to be inspired by: PatientsLikeMe.com has managed to design a viable (disintermediating) business model based on patients handing over their personal medical

records to them in return for a platform where they can bypass expensive medical bills by getting advice from similar patients.

Seize the moment

Retail banks are in the middle of a perfect storm. The entire financial sector is under heavy fire from regulatory authorities and policy makers, and their modus operandi is bound to change in order to survive.

Just like amber flushes up on the beach after a storm, so do new entrants, and innovative business models emerge when an industry is being forced to innovate. Unfortunately for the incumbents, both amber and new entrants are hard to spot by others than the trained eye – and that may very well prove to be lethal for those who are

not paying attention.

Traditionally, innovation in the industry has not been disruptive. Much has been about incremental changes to products, processes and back office operations, and we are still to witness a radical game-changing move where the business model itself becomes the primary competitive differentiator. As a consequence of the new normal, now is the perfect time to do just that.



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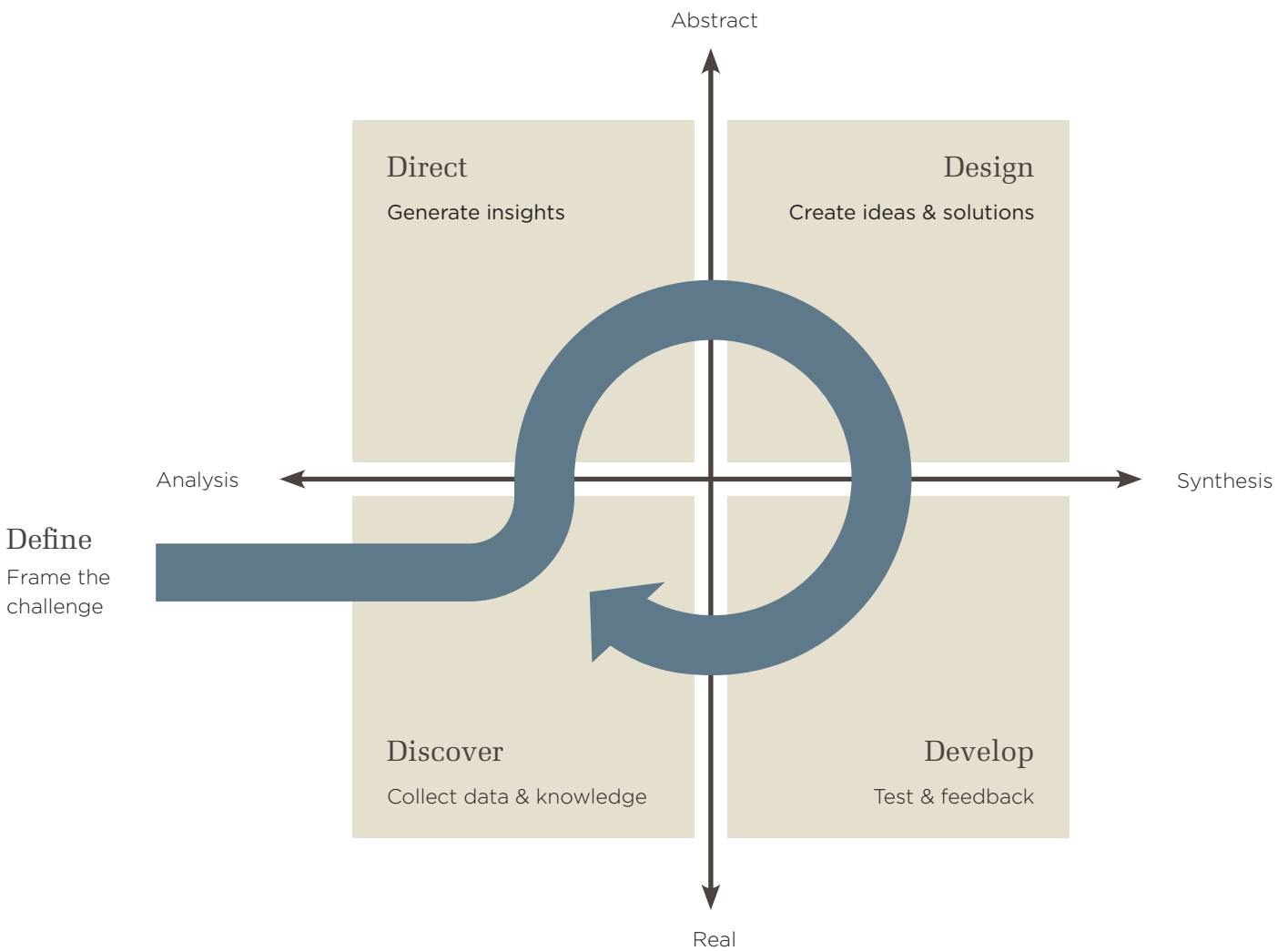
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MODEL

Discovery-driven innovation

A systematic process for designing and implementing new business models



Five guiding principles for discovery-driven innovation:

1) Enable radical collaboration and co-creation

2) Prototype and experiment to learn fast

Define

What? A clear framing of the growth challenge, definition of ambition levels and joint commitment

Why? To align the business model innovation project with the growth strategy and business goals

Discover

What? Research of opportunities within and across context, customers, competition and capabilities

Why? Superior business concepts are formed on the basis of unique insights

Direct

What? Analysis of research findings and creation of growth opportunity maps to focus work efforts

Why? Data needs to be filtered and interpreted into actionable directions and design principles

Design

What? Creative ideation and conceptualisation of new business ideas

Why? To foster creativity and identify novel approaches to driving growth

Develop

What? Iterative concept testing, business modelling and learning based implementation

Why? To reduce risks, new business concepts are adjusted through several iterations and market feedback

3) Focus on
customer value creation

4) Stretch goals and
challenge conventions

5) Balance creativity
and focused analysis

ARTICLE BASED ON INTERVIEWS AND DEVELOPMENT PROJECTS WITH DONG ENERGY

Business model innovation as a response to increased competition in the energy sector

By Thomas Børve and Johan Lawaetz

Increased competition in the energy sector has stimulated many energy suppliers to rethink the way they do business. Because of the growing wish among Danish organisations to do business in a more sustainable way, DONG Energy decided that one of the means to differentiate in the market would be through what would be known as the Climate Partnership concept.

Through pilot projects, the concept soon proved to be more than just a new product in the portfolio as it was able to spur significant business value for customers. But to do so required a new internal setup of the underlying competences and processes related to sales and delivery within DONG Energy.

Changing market conditions in the Danish energy sector

In the past decade, the Danish energy sector has experienced dramatic changes. New EU directives in the 1990s indicated that a new era was soon to come with a new regulatory framework. During 2000-2004, the Danish energy sector was liberalised – the fastest liberalisation of an energy market in Europe.

This dramatically changed the rules of

the game since it quickly led to intense competition, but also expanded the arena in which Danish energy providers should now compete. The market opened to international competitors, and as the industry has matured energy providers have experienced an increased pressure on prices.

In the meantime, societal trends and new customer needs have emerged and gone straight to the top of the global energy agenda. Private consumers as well as business customers are now concerned with CSR, CO₂ emissions and the overall environmental impact in addition to getting a low price per MWh. As electricity is traded with full transparency on Nord Pool (the exchange of electricity), the product itself was already very commoditised, but price competition was further fuelled by the liberalisation. Moreover, shifting energy provider nowadays is much less complex and gives companies an even larger economic incentive to do so. This has further increased the need for differentiation between energy providers and has resulted in an increased focus on expanding product offerings. A number of energy providers have gone from supplying just a single energy source to supplying a broad range of fuels and services which now includes e.g. financial services, price surveillance, energy services, CO₂ quotas and energy savings consultancy.

Despite the increased need to differentiate in the market, energy providers still have limited opportunities to do so. For decades, the energy sector has looked for new ways to offer value on top of an increasingly commoditised product, but there has never been a real breakthrough in new ways to bundle products and innovate the business model – until now.

Climate Partnerships

In May 2007, Novo Nordisk and DONG Energy together launched the first Climate Partnership in Denmark. Since then, DONG Energy has entered into more than 100 Climate Partnerships and developed a unique partnership model with a variety of Danish organisations. Companies, municipalities and other organisations are constantly faced with climate questions, and they all share the common goal of decreasing environmental impact of their activities besides running financially healthy operations. Through the new Climate Partnership concept, DONG Energy set out to help companies do just that.

DONG Energy has a long-term vision of providing clean and reliable energy. Climate Partnerships are an important element in the climate strategy that has been developed to support this

long-term vision. The strategy commits DONG Energy to support a significant reduction in CO₂ emissions stemming from energy production, and at the same time it serves as a strong driver for differentiation.

Providing additional value by combining existing products and services

Based on DONG Energy's many years of experience within energy savings consultancy, the Climate Partnership concept first and foremost aimed at

offering a more comprehensive and customer-oriented value proposition providing significant business value to business customers. The main idea of the concept was for both parties to execute energy savings and support renewable energy sources. DONG Energy's energy advisers locate and help execute these energy savings.

When energy savings are realised, the entire or part of the reduction is used to finance the purchase of renewable

energy. The purpose is to support and strengthen innovation within climate technology, increase the demand for renewable energy and strengthen climate initiatives in private and public organisations.

For the partner, the motivation behind entering a Climate Partnership would obviously be to obtain a reduction in operational costs by identifying and realising energy savings and increase revenue through enhanced differentiation.



Photo: DONG Energy A/S

BUSINESS MODEL INNOVATION AS A RESPONSE TO INCREASED COMPETITION IN THE ENERGY SECTOR



Photo: DONG Energy A/S

For selected large customers with little or no resources available to drive development projects themselves, DONG Energy has, moreover, offered to take on the project and help its customers through the process from establishing a business case, selling the project internally, analysing and discovering potential all the way to building the implementation plan. In short, DONG Energy's Climate Partnership concept bundles the best of its offerings to include sourcing, energy savings, financial solutions and project management into a customised value proposition that responds accurately to customers' new climate challenges, helping them reduce costs and meet a new type of market demand.

Well-defined customer segment

"To us, it was fundamental to be very clear on who was going to use the new approach, and that it would only be for certain opportunities"

Søren U. Schmidt, International Marketing, Director, Business Innovation and Products & Solutions

From the beginning, it was clear that Climate Partnerships would not be for every market or every company. In order to identify the ideal customers to target, DONG Energy put together a simple customer prioritisation model.

First of all, they realised that in order for the concept to be interesting from a business perspective, the target company should spend a reasonable amount of their total costs on energy. In other words, the company should be relatively energy intensive. If not, the

case experience showed that it often proved more valuable for the partner to carry out initiatives related to other typical elements of the CSR agenda such as ethical trade or improving the work environment.

The second criterion was that the company should have a large potential value of differentiating through a renewable profile. This, for instance, included companies exposed to large and strategically important customers with tough demands for a renewable supply chain (including subcontractors).

Together these two criteria highlighted the customers for whom a Climate Partnership would be especially interesting and to whom the market approach should be directed.

One of the key ambitions when DONG Energy launched the Climate Partnership concept was to obtain a strategic differentiation in the business market, but also to some degree in the consumer market, compared to traditional energy providers. By helping businesses, municipalities and other organisations reduce their energy consumption and establish a sustainable profile, DONG Energy aimed at tapping into the growing sustainable consumer trend through intensive marketing of the partnerships' positive effects on both the climate and the business value obtained by the partner.

In a business to business context, the task of differentiation is not merely a marketing exercise. It also involves dramatic changes in organisation, processes and competences.

A more complex sales process required new competences and customer involvement

DONG Energy realised that positioning the idea of a Climate Partnership concept to organisations would impose great changes on the sales process. They understood that they would have to target an entire set of new and more business-oriented stakeholders than what they were used to from selling electricity and gas.

Through initial learning as well as three intensive pilot projects spread out on Denmark and Germany, DONG Energy found that the customers' decision to enter the partnership was being pushed to the executive level. This was due to the large investment of company resources and the high potential business value the concept was offering. Because of this, the decision process grew longer and more complex. The broader and higher involvement of the customer organisation in the sales process meant that DONG Energy's internal sales processes as well as management and sales competences had to be much more focused on selling based on business value in order to meet these needs. Based on this insight, a value-oriented sales process, including tools for i) creating interest, ii) mapping stakeholder value, iii) establishing an initial value analysis with the customer, iv) designing the final proposal and v) preparing for final negotiations at executive level, was developed by a small project group involving the people who would actually have to lead and perform the sales themselves. In order to ensure reinforcement, a management structure, including goals and meeting agendas, was developed and implemented.

BUSINESS MODEL INNOVATION AS A RESPONSE TO INCREASED COMPETITION IN THE ENERGY SECTOR

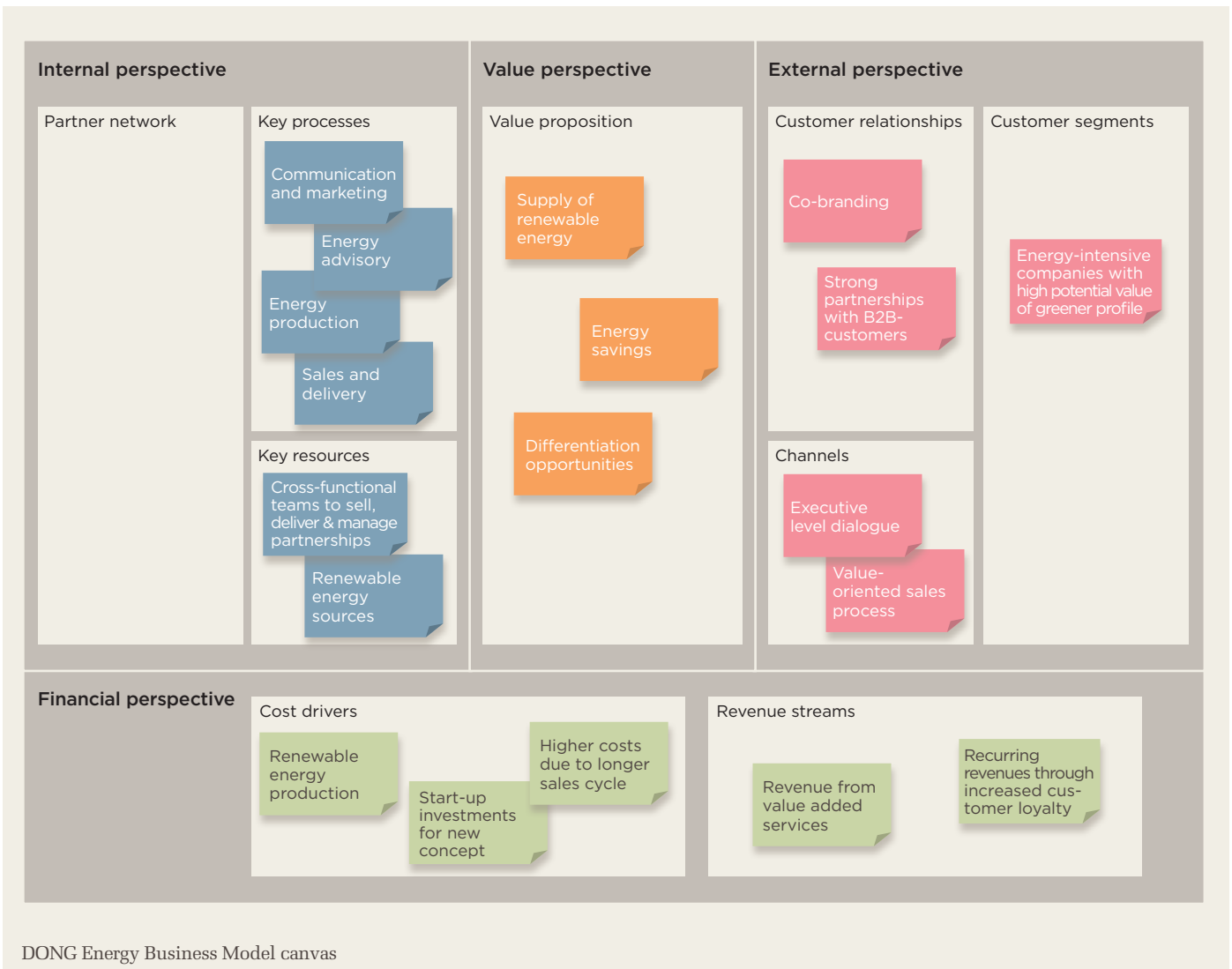
”It is my experience that in the cases where we successfully have applied a solution-centric approach, we have more focus on what the solution does for the customer and quite often even for the customer of the customer”

Søren U. Schmidt, International Marketing, Director, Business Innovation and Products & Solutions

From silos to cross-functional teams

Running the pilots and actually starting the delivery of Climate Partnerships to customers soon proved to pose a significant need for working in diverse cross-functional teams. Over the years, DONG Energy has put a great deal of effort into optimising the processes around sales and delivery. One of the

drawbacks experienced when launching the Climate Partnerships was that a great deal of the optimisation had been done independently across functions and with too little attention to interaction between processes and functions. The Climate Partnership concept quickly forced new ways of combining internal resources to be able to deliver



what was being promised by marketing campaigns and sales. A new setup around delivery of Climate Partnerships was necessary because of the need for experienced people from a range of different functional areas and to ensure a competence match with customers. The team delivering a Climate Partnership would obviously not only consist of a sales person, but also of an energy adviser consultant, a communication and marketing adviser, a project manager and a set of energy specialists. Combining people with such diverse professional backgrounds and competences and having them deliver robust and comprehensive Climate Partnerships for customers have been a key challenge throughout the process.

Having people from various functional departments work together puts forth challenges – not only at an individual level, but also to existing processes and to how these processes were aligned. All the way from the initial energy screening process to realisation and communication of the energy savings projects and the actual change in energy supply.

First of all, a need to align the sales and delivery process evolved. In essence, this meant that the process of identifying potential savings initiatives had to be part of the sales process in order to prove the potential decrease in costs that would go into the business case behind the Climate Partnership agreement.

Secondly, the concept had to include a well-defined process for identifying in depth the potential revenue value from using renewable energy and implementing the new sourcing setup.

Last but not least, a new Climate Partnership also implied a process for DONG Energy to support the new partner in communicating the partnership and the new initiatives. This was done through recommendations as to the communication of the new climate initiatives as well as by delivering ready-to-use marketing material. In specific cases, DONG Energy would, moreover, offer the possibility of co-branding between DONG Energy and the partner as was seen with e.g. Tivoli. In order to increase the probability that the proposed changes for the customer would actually take place, all processes were designed to include heavy customer involvement.

Alternative model to serve Germany

In Germany, a slightly different model of selling and delivering the Climate Partnerships was chosen. The concept would, in essence, stay the same, but as DONG Energy does not sell and supply directly to the end customers, but distributes regionally through 600-700 so-called Stadtwerke, a different approach was needed. Not having a direct sales channel, but instead a vast number of customers distributing energy, DONG Energy decided to establish a third party concept delivering Climate Partnerships directly to the Stadtwerke.

Early on, DONG Energy realised that this meant a tighter conceptualisation and a simpler version of both the solution and the sales and delivery process. DONG Energy initiated a process to develop a Climate Partnership concept suited to the local Stadtwerke and the organisations they would target. To help the Stadtwerke position themselves and sell the idea, a well-defined process and a large ready-to-use tool-

box for both selling and delivering the concept were developed and implemented.

The concept has naturally implied increased costs

”In my view, it is very important as often as possible to revisit the original business rationale throughout a change process in order to ensure that the increased costs deliver the expected long-term gain”

Søren U. Schmidt, International Marketing, Director, Business Innovation and Products & Solutions

Developing, selling and delivering Climate Partnerships have implied increased costs. The concept has a different type and level of complexity to it than traditional services. There is more risk associated with it and a much longer and complex sales cycle than traditional sales of electricity and gas. Thus, higher costs are related to both the sales and delivery of the Climate Partnership concept.

The main reason is that the project binds up more resources that are more expensive due to the increased demand on highly specialised competences. These additional costs have to be seen in the light of the strategic business advantages as well as the new revenue streams which the project has created and will continue to create.

Ensuring new and durable revenue streams

Seen through a DONG Energy business lens, the Climate Partnerships were a way to differentiate, spread risks and ensure new revenue streams. By offering energy advisory and support with

BUSINESS MODEL INNOVATION AS A RESPONSE TO INCREASED COMPETITION IN THE ENERGY SECTOR

the realisation of energy savings initiatives, DONG Energy obtained other sources of revenue than just from supplying energy. But most importantly, the closer relationships with business to business customers built through the Climate Partnerships have already shown an increase in customer loyalty and ensured long-term commitment of customers and, thereby, durable sources of revenue.

“In some cases, we made the hard choice to stop a development process with a customer because there did not seem to be any business value in it for the customer”

Søren U. Schmidt, International Marketing, Director, Business Innovation and Products & Solutions

Implementing the Climate Partnership concept

Great possibilities were hidden in the Climate Partnership concept as a new type of business model. The decision to combine existing products, solutions, competences and resources in a new way helped and is still helping DONG Energy find new ways of tackling the increased competition and price pressure. This has been done by creating significant business value for customers, and by doing so DONG obtains a real differentiation in the market.

The culture of DONG Energy is to a large extent a technical and process-orientated one. Therefore, it was decided that the concept should be managed by a small group of dedicated people recruited from their daily operational jobs. This was done in order to ensure focus and progress and to

avoid the “we have already tried that” attitude that often evolves when large organisations are forced to make more or less radical changes.

“When building the Climate Partnership concept as well as the underlying business model, we became very aware that we had to develop the organisation accordingly. People and processes were tuned at selling and delivering a much less complex solution”

Brian Hulvi Larsen, Head of Commercial & Consumer Markets

A central aspect of the success was the strategy of heavy involvement of external and internal resources. The project was not to be a top-down project. External involvement in the form of customers ensured a valuable outside-in perspective. DONG Energy chose to develop a prototype of the concept and its processes, including roles and responsibilities, and then turned to two pilot customers in Denmark. Over a period of 2-3 months, DONG Energy and the pilot customers tested and co-developed the concept further and gained valuable insight into which parts of the concept worked well and which parts had to be further developed.

Internal involvement was emphasised, especially in order to ensure that processes and tools would survive the transition from development to the operational phase, but also because people from four different functional areas with personal and professional diversity would have to work closely together with them for a long period of time.

“We recognised that a change of this character really would force management to get deeply involved in the pilot projects with customers”

Brian Hulvi Larsen, Head of Commercial & Consumer Markets

Everything from actual content over standard project management tasks such as agreeing on goals, processes, deliverables and KPIs as well as the kickoff and delivery of the pilot projects was done by all project participants. Along the more rational and logical project tasks, the team took a work style preference test which helped ensure a better understanding of each other and promoted teamwork and increased trust throughout the project.

“A key aspect of the success of the development process was that we chose not to let ourselves become carried away with all the possibilities that suddenly arose. I really believe we managed to keep focus”

Brian Hulvi Larsen, Head of Commercial & Consumer Markets

In order to ensure quality of the intense involvement of internal and external resources, an experienced project management team was put together. It was important that a well-planned process was adhered to, for example in order to ensure progress and regular reviews of material and other outputs.

Another important aspect was that the programme manager would have enough organisational power to be able to resist pressure from the line or-

ganisation when they all of a sudden and untimely would be in desperate need to get the resources back in order to handle their daily operational tasks taking time away from the project.

All in all, DONG Energy's Climate Partnership concept has been an exemplary case of how businesses can innovate their business model as a response to significant changes in the business environment. By rethinking the value proposition and working cross-functionally, the Climate Partnerships have resulted in tighter customer relation-

ships, new and long-lasting revenue sources while altogether helping to make businesses both more energy efficient and able to differentiate themselves in the market.

"One of my biggest fears was that we would succeed in creating a fantastic new concept but fail in getting the organisation to adopt it, sell it and deliver it successfully to customers. I am not afraid anymore"

Brian Hulvi Larsen, Head of Commercial & Consumer Markets



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Taking your innovation further

Lean innovation book

IN BRIEF



Title:
Lean Innovation

Authors:
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and Henrik Sonnenberg,
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Publisher:
Børsens Forlag/
UK edition: Springer-Verlag

Web and LinkedIn Group:
www.leaninnovation.eu

Lean Innovation

“The authors really show their expertise and passion, and just as good, they share page after page of great tools and techniques for managing the often-hidden guts of the innovation process.”

*Langdon Morris,
Innovation Labs*

Lean has created very good results within production and administration in organisations all over the world. But what happens when Lean meets Innovation? Does it destroy the creativity required for innovation, or can Lean improve the results in a business?

In *Lean Innovation*, Claus Sehested and Henrik Sonnenberg reveal how the interplay between creativity and efficiency can ensure that top management visions are realised through innovation initiatives. Lean can boost innovation initiatives to a higher level and transform the company's innovation processes into its most important strategic competence.

In their book, the authors of *Lean Innovation* deal with key challenges faced by managers in knowledge orga-

nisations, and present a series of principles that can be used to bring more leadership into innovation initiatives. They also discuss methods for creating a clearer focus on results and learning in innovative organisations' core processes.

Ecco, LINAK, Rambøll Oil & Gas, Exhausto and Coloplast are among the companies that have contributed examples of how this can be achieved.

“Every company should take global competition concerning knowledge initiatives seriously”

“Most companies have a vast potential hidden in their knowledge workers and in their overall innovation system”

“There are leading lights in the form of companies that have created a culture that brings unique solutions to the market”

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