CHAPTER 1

THE CASE FOR OPEN SERVICES INNOVATION

As I write this chapter, the Western world's leading economies (along with Japan's) are in a terrible state. Even before the recession began in 2008, disruptive new forces were at work transforming the global economy:

- Useful knowledge, information, and technology are now widely distributed around the world.
- Increased global competition and higher rates of growth in the developing world are leading to greater wealth and rising standards of living, while stagnation is taking hold in most developed economies.
- The advanced economics are confronting unsustainably high levels of debt that, ironically, are being financed by lending from poorer developing economies.

Let us consider each of these in turn.

The spread of useful knowledge around the globe seems like a good development at first glance. Alert companies have more places to look for useful technology, and people and companies with ideas have more outlets to which they can offer their knowledge. People who live in economies with lower costs of living can use this knowledge as well as many in more expensive areas. Therefore, the advantage of superior technology that used to be the sole province of wealthier countries has given way to a more level playing field, raising the pressure on companies in the advanced economies.

The Great Recession, as many have called it, that started in 2008 ushered in a new era among the world's economies. Most of the top economies in the Organization for Economic Cooperation and Development (OECD) suffered significant declines in economic output. Some economies, including the United States, lost more jobs than any previous economic downturn since the Great Depression. Other leading economies, including Spain, have witnessed unemployment rates of over 20 percent.

Meanwhile, Brazil, China, and India saw little loss of output from the economic upheaval. Rather, each of their economies has grown significantly during the period. Their concern now is that their economies could overheat, creating a new bubble. This growth is bringing hundreds of millions of new consumers into the global marketplace. It is also creating a similar number of companies and workers in developing regions who are increasingly able to compete for jobs in those global markets.

A great deal of wealth creation has shifted as well, away from the advanced to the developing countries. China, for example, now has 98 billionaires, and India has 58.[1] Much of the growth in the foreseeable future will have to come from the developing economies, a remarkable turn of events since World War II.

In an attempt to stave off a deeper economic downturn, many Western economies have stepped up government spending even as tax receipts declined in the downturn. As a result, sovereign debt is at uncomfortably high and unsustainable levels in many of these economies, including Greece, Japan, and Spain. For these economies, growth is at best meager, and at worst negative, which makes it politically far more painful to execute the macroeconomic policy changes needed to reverse the buildup of this debt.

Among the many consequences of these changes is one of concern over the longer term: the impact on new entrants into the workforce in advanced economies. Today young people in countries with advanced economies are finding themselves excluded from the job market as they graduate and look to start their working careers. Even those who find work often must settle for lower wages than they would have earned in the past. Moreover, research shows that many who make this trade-off

will have permanently lower wages than their peers who entered the job market just a few years earlier.[2]

THE COMMODITY TRAP

These disruptive economic forces are creating a phenomenon that I call the commodity trap, which more product-focused companies are finding hard to break out of or avoid.[3] The commodity trap is made up of the following business realities:

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• *Manufacturing and business process knowledge and insights are widely distributed.* It is getting harder for companies to differentiate their products and sustain that differentiation over time. Products are fighting the tendency to become commoditized (commodities are products that are sold on the basis of their cost, not their value). Commoditization is largely the result of success in an industry or the product sector in general. The knowledge and insights that have been developed from work on design and manufacturing processes like Six Sigma, Total Quality Management, supply chain management, and customer relationship management have led to much higher-quality products. However, these methods and frameworks are now well understood around the world and have been encoded into software that is also widely available around the world. When the same approaches and the same tools are available to everyone, anyone can build a good product. No wonder it is getting harder to remain competitive.

• *Manufacturing of products is moving to areas of the world with very low costs.* Computers and networks are spreading product designs and process tools around the world, where products can be produced cheaply. Today Samsung, Hyundai, and LG in South Korea are challenging global leaders in automobiles, cell phones, electronics, and other product categories. These firms were far behind the leading edge in the world just a decade earlier. Even they cannot rest on their laurels, however.

Haier, Huawei, and Lenovo in China are also rising rapidly and will soon become world-leading companies. Clearly the product world is facing severe pressures to produce and sell on the basis of cost, not value.

• As challenging as the spread of best practices around the world is to product manufacturers, another force compounds their predicament: *the shrinking amount of time a product lasts in the market before a new and improved one takes its place.* As a result, even successful products can expect to enjoy an advantage in the market for a shorter time than in the past. In the hard disk drive industry where I used to work, our early products typically sold for many years. With the rise of the PC market and the incorporation of hard disks into every PC, disk drives would sell for perhaps two years. By the 1990s, even a very successful disk drive might sell for only nine months. After that, a new and even better product was available.

In pharmaceuticals, the expected lives of new drugs have also shortened. Food and Drug Administration approval now takes eight or more years for typical drugs. Then as soon as successful drugs come off patent protection after twenty years from the patent filing, generic drug companies copy them. In the largest market segments, successful patented drugs now also must share the market with rival patented drugs, even while the patents are still in effect. At least six different patented statin drugs to control cholesterol are on the market, for example.

Anyone who has purchased a cell phone in the past year can vouch for how quickly product life cycles are moving in that market. New designs and new capabilities are emerging every four to six months, which means that even very successful, differentiated products quickly lose their luster. Competing on such time intervals is like the Red Queen in *Alice in Wonderland* where one must run as fast as one can simply to stay in place. Even small missteps can cause companies to fall far behind.

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Continuing to run on the treadmill isn't going to get us back to growth. We need to confront the limits of product-focused innovation and rethink how to innovate.

THE WAY OUT OF THIS MESS

In order to reverse these difficult economic conditions, Western economies need to grow again, and that is going to take more than changes in fiscal policy at the macroeconomic level. We must rediscover growth and innovation at the microeconomic level, within specific firms in specific industries. Macroeconomic policies help to create the conditions for growth to occur. But it is the individual firms that run the experiments, take the risks, make the investments, and harvest the results that cause innovation to occur.

In order to grow again and compete effectively, businesses must change the way they approach innovation and growth. They first have to confront, and then transcend, the commodity trap. They have to stop thinking like product manufacturers and start thinking about business from a services perspective. Both companies that make products and those that deliver services must think about their business from an open services perspective to discover new ways to generate profitable growth.

It is worth observing that services have been the growth vehicle in advanced economies for some time. In the United States, they have risen from a very small percentage of the economy a century ago to more than 80 percent of gross domestic product today.[4] Services comprise more than 60 percent of the gross domestic product of thirty-five of the top forty economies in the OECD.[5] Growth will come from services in the future for these economies. It is high time to transcend the limits of product-focused innovation and move to a way of thinking that can point the way to future growth.

THE LIMITS OF PRODUCT-FOCUSED INNOVATION FOR COMPANIES

To see the limits of product-focused innovation and the dangers of the commodity trap, let's examine a highly successful product: Motorola's Razr cell phone. When this product was introduced in fall 2004, it was the slimmest cell phone available, and its cool design made it a hot product. More than 50 million units were sold.[6] By any measure, this

was a tremendous success, and Motorola was the top mobile handset manufacturer.

Three years later, however, Motorola's follow-up products and new models of the Razr failed to attract much interest. The reason was that every other handset manufacturer had learned how to make slim, elegantly designed handsets. Motorola continued to develop and market new products with new features, but these didn't seem to catch on the way the Razr had. Today Motorola is struggling in the cell phone industry and has fallen out of the top position to number seven.[7]

It might seem that Motorola was punished severely by the market because it didn't come up with another innovative product to follow up on the success of its Razr. In fact, Motorola's real failure was in its product-focused conception of innovation. Motorola thought about innovation in terms of coming up with another breakthrough product. What it didn't think hard enough about was its customers' experience with its products and what additional services it could wrap around its devices to deliver a superior customer experience.

Nokia, now the leading cell phone manufacturer and the largest handset manufacturer in the world, faces a similar challenge today. Nokia achieved enormous success in the 1990s with its GSM mobile phones. It used its superior products to conquer Europe and then aggressively moved into Asia, Africa, and Latin America. It is the largest handset manufacturer in the world today. Yet what brought Nokia this far will not carry it forward into the future.

For Motorola and for Nokia, coming up with ever better cell phone products is no longer enough. These handset manufacturers face mounting pressures from new entrants like Apple, Google, Palm (now part of HP), and Microsoft, all of them working hard to continue to innovate new handsets, either by themselves or with partners. But each is doing far more than that: they are building platforms that attract thousands of other companies to design applications and services that run on their handsets. Even if Nokia can develop a superior handset (and then continue to lead in producing superior handsets), that is no longer sufficient to provide a superior customer experience. Nokia must focus its innovation efforts on

the applications and services (which support its platform) that will enrich its customers' experience with its phones. If it fails to do so, it will risk being supplanted as Motorola has been.

Nokia's approach to innovation will require radical changes.[8] This company that achieved so much with its product design in the 1990s must develop an entirely new set of innovation skills in order to create, develop, and manage a platform—an ecosystem of other companies that build their offerings on top of Nokia's.

GROWTH AND COMPETITIVE ADVANTAGE THROUGH SERVICES

Innovation in services is a clear and sustainable way to grow a business and fight off the pressures that companies are facing with the commoditization of products. By transforming products into platforms that incorporate internal and external innovations and surrounding these platforms with a variety of value-added services, companies can obtain some breathing space from relentless price and cost pressures. Although they must continue to advance their products, the real basis for competition shifts toward the entire constellation of products and services available to their customers through their product.

To see this, consider one of the Razr's challengers, the Apple iPhone. Introduced in 2007, it too captured the public's imagination. To be sure, the iPhone was a neat device. It had a sleek design, an elegant user interface, and a novel touch screen. However, the iPhone was much more than a device like the Razr was; it was a system that attracted many third-party applications and services to provide users with a wide range of experiences with a single device.[9] The iPhone became a platform. More than 100,000 individuals and companies have created "apps" that run on top of the iPhone, and more than 2 billion apps have been downloaded by customers around the world.

Unlike the Razr, the iPhone shows no sign of being overtaken by competitors anytime soon. And other recent entrants like Google, Microsoft, and Palm are also making significant efforts to recruit

third-party application and services developers to support their respective innovation efforts in mobile telephony. This race will be won by those who can attract the most support and offer the best experience for customers rather than the one who can design the next cool handset device.

A similar race is on in financial services. As the Internet spreads more information to more places, many services companies now are taking on the role of aggregating this information for their users. Instead of simply creating their own mutual funds or exchange-traded funds, these companies provide up-to-the-second data on a wide variety of such products for users to consider for purchase. Others are offering commentary and analysis on these sites, providing users with a range of opinions and investment advice to guide their actions. In this way, sites such as Yahoo Finance, Mint.com, and Schwab.com are becoming platforms themselves.

Clearly platforms are important for services as well as products, a point we return to in Chapter Nine.

Companies that are making cool products must think beyond the product to turn it into a sustainable, profitable business platform. A veteran Silicon Valley venture capitalist made the point this way: "Whenever we see a business plan for a new device, we immediately ask, 'OK, where's the service associated with that device?'"[10]

THE CHALLENGE OF DIFFERING BUSINESS MODELS

Product-focused companies face another challenge in thinking beyond the product. For companies that already make products in an industry, services may represent a challenge to the traditional product-based business models employed in their industry. The role of the customer, the interaction between customer and supplier, and the design of the supply chain may have to change in a services-oriented business model. This shift toward services, which can be a saving grace from commoditization, can also engender significant conflicts within the organization. As we will see, conflicts can arise between product-based business models and

services-based business models. (Apple had an advantage in this regard. It was a new entrant into cell phones, so it was not constrained by legacy business models in that industry.) We examine these conflicts in detail in Chapter Five, but an example can clarify the point.

One example of these conflicts is how to charge for services versus how to charge for a product. When selling a product, a salesperson often bundles in some service items in order to complete the sale, and usually without changing the price of the product. A product might come bundled with a warranty for a specific period of time, or free installation and training. But when a company shifts to a services-based business model, these ''freebies'' that were bundled in now become separate items that have their own prices. Much more sales training is needed to sell these options to customers who were accustomed to getting them for free. More fundamental, a product is usually a lump-sum purchase, while a service is typically sold as something that is consumed over time, as with a subscription or some other ongoing revenue stream. This creates a need for a different kind of sales and distribution process and also different kinds of salespeople. We will see a number of these approaches to charging for services, and some of the organizational changes they require, in Chapter Five.

SERVICES BUSINESS MODEL INNOVATIONS: THE PACKAGE SHIPMENT INDUSTRY

The discussion so far has looked at the need for products to be used as platforms to deliver a superior customer experience that entails services. But this kind of thinking is equally valuable for services businesses as well. And, perhaps ironically, incorporating some degree of ''product-ness'' in a services business can make the business better able to grow without creating too much complexity.

One such service innovation is the FedEx online package tracking system. This is a capability that is like a product in that every customer sees the same initial screens to generate the shipping labels for sending packages by FedEx. The customer enters information for a requested

delivery into the FedEx system and receives a label (again, a kind of product) to place on the package. That same label is then scanned at various intermediate points along the destination route by FedEx. At the same time, the customer can track the progress and eventual delivery of the package through this system.

This wasn't always the case. Customers who shipped parcels via FedEx used to have to verify that the packages had reached their arrival destination by contacting the intended recipient. If those parcels did not arrive, customers understandably were concerned and needed to know where the parcel was and when it would be delivered. The online tracking system was a valuable innovation for FedEx customers. It made shipping a product much more standardized and, hence, scalable. By scalable, I mean that this process continues to perform effectively even when more transaction volume is put through this system. It doesn't break down if this volume becomes too large.

By deploying its online tracking system and making it available to its customers to query directly, FedEx responds to customers' needs rapidly, and without any human intervention on FedEx's part. For their part, the customers who enter all of the required information do not mind the time that this takes because they get up-to-the-minute accurate and authoritative information from FedEx.

Innovation has delivered real bottom-line benefits here. FedEx saves money on having to update and notify customers when packages will arrive, and customers are much more satisfied because they can obtain highly accurate information whenever they need it. The result of this innovation is higher customer satisfaction, lower costs, and better scalability. FedEx has innovated a system that can increase the volume of customer inquiries it is able to handle without breaking down and without sacrificing quality in the process. It also empowers users to take more control of the process, from entering the initial shipping information directly, to monitoring the status of the shipment whenever desired. In this sense, FedEx is letting users further into its own processes, a process we explore in Chapter Three as an example of co-creation.

OPEN SERVICES INNOVATION: THE FRAMEWORK

We need much, much more of the FedEx kind of innovation—the open services kind of innovation—to escape the commodity trap. To understand how we can get there, four foundational concepts must be established that together create the driving framework offered in this book:

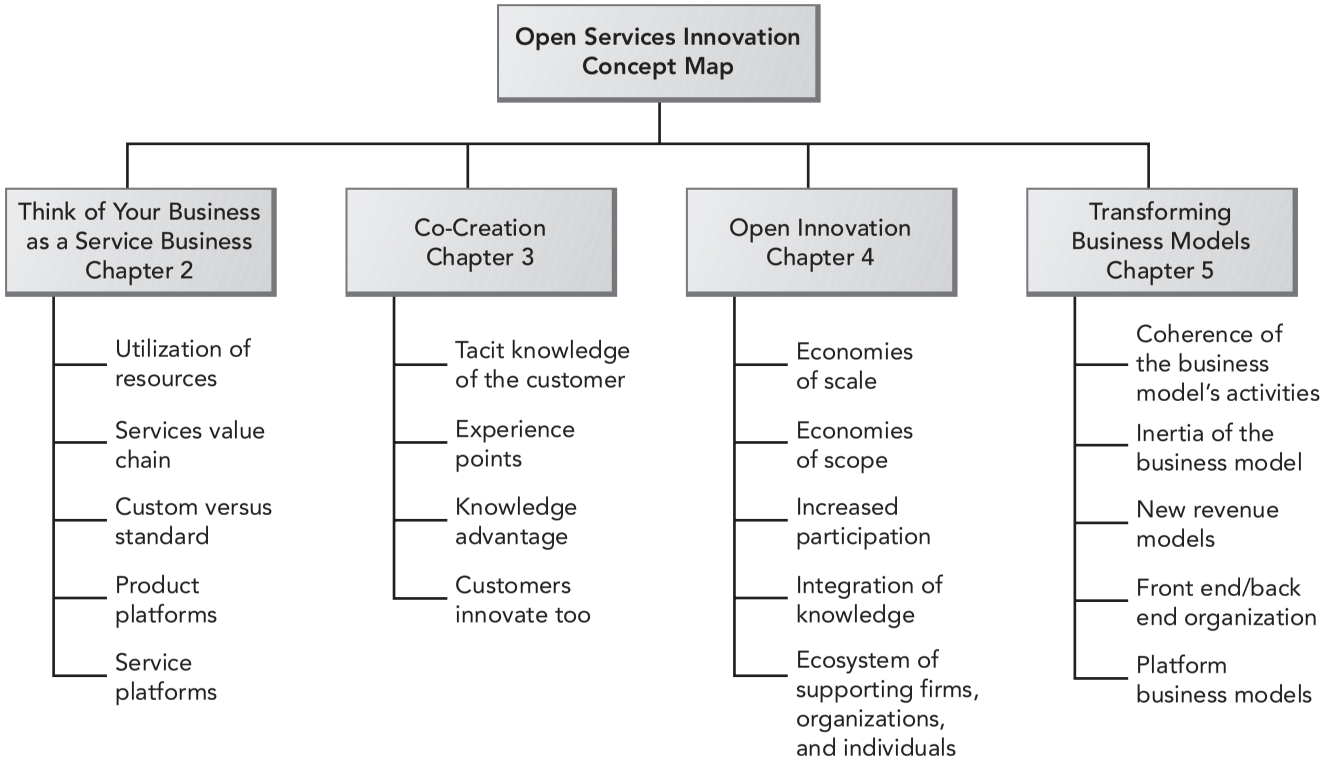
1. Think of your business (whether a product or a service) as an open services business in order to create and sustain differentiation in a commodity trap world.
2. Invite customers to co-create innovation with you in order to generate the experiences they will value and reward.
3. Use Open Innovation to accelerate and deepen services innovation, making innovation less costly, less risky, and faster. Use Open Innovation to help you turn your business into a platform for others to build on.
4. Transform your business model with Open Services Innovation, which will help you profit from your innovation activities. If you succeed in building a platform business model, you can also profit from others' innovation activities as well.

These concepts are displayed in Figure 1.1, which shows both the concepts themselves and the most important subsidiary ideas that lie beneath each one. We consider each of them briefly here. They will be developed at length in the coming chapters of the book.

Concept 1: Think of Your Business as a Services Business

Part of the commodity trap is caused by the fact that companies throughout the world have learned a great deal about how to innovate new products. This makes it harder to differentiate your product from that of someone

FIGURE 1.1 Open Services Innovation Concept Map



else. Therefore, in order to achieve and sustain differentiation, you will need to think about your business as a services business.

Product businesses have successfully adopted many best practices to advance their innovation capability. A few of the most important practices have now been widely adopted. Six Sigma process control methodologies help firms to manage and reduce variation in their processes. Total Quality Management instills the processes to build the product correctly the first time and to study defective products carefully to eliminate their root causes for the future. Supply chain management focuses companies on sharing information with key customers and suppliers in order to coordinate ordering and inventories throughout the supply chain. Customer relationship management helps companies reduce selling costs with their customers and develop a much better understanding of those customers at both a personal and organizational level.

Precisely because these techniques have been successfully developed and widely adopted in both advanced economies and, increasingly, the developing economies, they make it far more difficult to differentiate companies that practice these techniques from their competitors. This leads directly to commoditization, since those who invest the most in these practices and obtain the most volume will get to the lowest costs.

Customization Versus Standardization: A Tension in Services Innovation

Customers often have diverse needs. This is a critical insight, because it suggests that the future need not be ruled by whichever company gets to the absolute rock-bottom lowest costs. That customers want and will pay for variety and convenience that address their particular needs is an insight that begins to point the way out of the commoditization trap.

Think about your business, whether a product or a service, as creating a complete experience for your customers or an experience that is as complete as one you are able to envision offering. When Steve Jobs and his colleagues at Apple develop new products, they are quite clear that their vision for their new products is driven by the desire to deliver an outstanding customer experience.

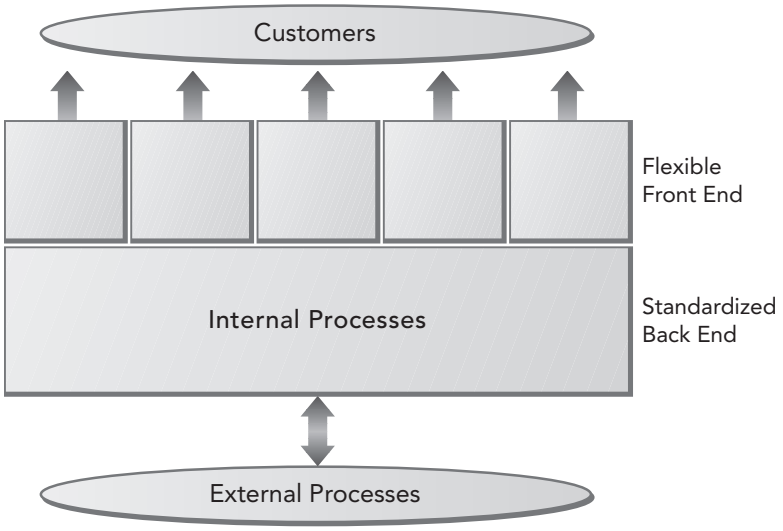
A company wishing to deliver a wonderful experience with a very low-cost process thus faces an obvious tension. The ability to customize the offering for the customer to deliver the most desired outcome to him or her requires treating each service transaction individually, so that the customer gets exactly what he or she wants. Yet in order to deliver services at very low cost, the business must aggregate individual transactions together to be processed in a single homogeneous way so that the process is as efficient as possible. This is not an easy trade-off to resolve, yet a business that wants to be effective in innovating services needs to manage both customization and standardization.[11]

Your Organizational Structure for Services Innovation

Changing the way you think about your business will also require you to change the way you organize it. Traditional product organizations have structures with operational units organized along product, brand, and geographical lines. Services are usually a side organization that lack much clout and take their marching orders from the product group, the brand manager, or the country manager. These groups supplied products efficiently, but did so usually at the cost of being fairly inflexible about providing services.

Some leading companies, however, are developing new organizational structures that better manage the tensions between customized services solutions for customers and achieving economic efficiency in delivering those services. To simplify, these companies split themselves into customer-facing front-end units that are linked to standardized back-end processes. The front-end customer-facing units develop, package, and deliver customized solutions for individual clients and therefore focus on satisfying these customers. In this way, they generate revenues and profits, with the organizational clout to match. The back-end function of these new organizations provides standardized services that can easily be reconfigured at little or no cost for individual customers. The idea is for the back-end units to provide reusable elements that can be mixed and matched in different combinations by the front-end units. These back-end units thus focus on minimizing costs.[12] Figure 1.2 shows this

FIGURE 1.2 Customized Front-End Organization with Standardized Back End



combination of a customizable front end of an organization coupled with a standardized back end.

While it is quite helpful to rethink and reorganize your business, you can and should go further by pursuing services innovation. To take services innovation to a higher level of performance and effectiveness requires inviting customers directly into the process.

Concept 2: Innovators Must Co-Create with Customers

Another aspect of advancing innovation in services is to change the role of customers in the innovation process. Instead of treating customers as passive consumers, many companies are now involving customers in the innovation process. In many cases, customers are actually co-creating new products and services.

In the world of products, companies create future products based on information received from their customers. The suppliers develop specifications to describe the product to potential customers. Once we

start to think about offering experiences, though, it becomes much harder to develop specifications because much of the knowledge involved in providing, or buying, experiences is tacit. Tacit knowledge is knowledge gained from experience, and it is both difficult and expensive to write down. Learning to ride a bicycle is a classic example of the difficulty of acquiring tacit knowledge. Cooking a recipe for the first time also highlights the difference between knowing what to do and how to do it versus following the written recipe. Customers vary in their prior experiences, and suppliers vary in their prior activities as well. Tacit knowledge interferes with the ability of suppliers and customers to communicate with one another.[13]

Managing co-creation effectively requires developing ways to manage, and perhaps overcome, tacit knowledge. We already looked at the role that the package tracking tool plays for FedEx in helping customers know where their packages are at all times. Another company that has dealt with tacit knowledge quite effectively is Threadless.com, which sells custom-designed T-shirts to customers via the Web. In contrast to most other clothing makers, the company does not design the shirts. Instead, it invites anyone who wishes to submit a design for a shirt. These designs are then displayed on the Web site, where visitors can vote for the designs they prefer. Threadless tallies up the votes and then produces the top ten designs for that period. Best of all, the company has effectively presold much of its production, since the voters on the site are likely to want to own the shirt.[14]

Another example of a company that is embracing the possibilities of bringing users directly into the innovation process is the personal financial software company Intuit. As Intuit's founder Scott Cook explained in a 2008 article in the *Harvard Business Review,* Intuit has dramatically altered its approach to working with its customers. Instead of keeping customers out of the innovation process until the very end, it now builds in ways for customers to participate and contribute to their own experience and answer questions of other customers. Cook explains, "Such a [user contribution] system creates value for a business as a consequence of the value it delivers to users—personalized purchase

recommendations, connections between buyers and sellers of hard-to-find items, new personal or business relationships, lower prices, membership in a community, entertainment, information of all kinds."[15]

The importance of tacit information explains why services innovators often must co-create with customers. Tacit information is hard to convey, so repeated interaction between customers and suppliers is helpful, and often necessary, to transmit it. Suppliers must work closely with customers throughout the innovation process. Customers who are involved early and deeply in the innovation process—that is, co-creation—can share tacit knowledge with their suppliers. The key is for suppliers to change their innovation processes in ways that enable customers to share this knowledge.[16]

Inviting customers into the innovation process not only helps to resolve the challenges of tacit knowledge. It also begins to open up the innovation process more generally. Open Innovation is a powerful tool to advance your innovation capabilities.

Concept 3: Open Innovation Accelerates and Deepens Services Innovation

Innovating in today's environment requires being open. Open innovation can reduce the cost of innovation, help to share the risks and rewards of innovation, and accelerate the time required to deliver innovations to the market. This is as true for services businesses as it is for product businesses. Being more open can also help turn a business into a platform for others to build on.

In an open innovation model, firms use internal and external sources of knowledge to turn new ideas into commercial products and services that can have internal and external routes to market. These routes to market depend on the firm's business model. Projects that fit a company's current business model flow through internal channels to get to market. Projects that do not fit that model need to go to market through external channels. The result is that companies get more value out of their internal R&D for both those projects that go to market internally and those that go to market externally. A company's business model also benefits from

having both internal and external sources of ideas and technology to take to market.

While my earlier books have been primarily concerned with manufacturing firms that use open innovation to develop and commercialize new products, this approach can be usefully applied to services as well.[17] For example, traditional broadcasting companies like the British Broadcasting Corporation (BBC) face the challenge of successfully responding to the proliferation of digital media technologies and markets. Acknowledging that it no longer has the "R&D" capacity in-house to maintain its leading position as a supplier of content on its own, the BBC set up an open innovation community to engage with numerous external individuals and firms through a process of experiments called BBC Backstage. External developers are encouraged to use its Web site (established in 2005), which offers live news feeds, weather, and TV listings, to create innovative programming, some of which will run on BBC.[18] This greatly expands the number of choices BBC can offer to its audiences, which are economies of scope for BBC.

A related benefit from open innovation comes from the participation of many more individuals and firms in the market. With the diffusion of more knowledge to more participants in the industry, more people can experiment in parallel with possible ways of using and combining knowledge. No single person or company can hope to compete with this external explosion of potential offerings by relying exclusively on their own internal knowledge. Although such internal knowledge and resources may be deep, they are necessarily limited in scope. Experiments are organized and performed one at a time within a single entity, while they can proceed in parallel among many if that entity opens itself to the market.[19] More parallel experiments result in more variety and more choices, which foster more rapid innovation.

The best way forward for open services innovators is to become integrators of both internal and external knowledge. This enables them to create areas of differentiation arising from their internal knowledge and surround them with the many fruits of labor from an abundant landscape of external knowledge. When the internal and external elements are

combined, they can provide a wealth of choices for customers while allowing the providers to specialize on their own distinctive competences. The result can be the creation of a business ecosystem in which many parties vie for the attention of the customers, who in turn benefit from more variety and more specific alternatives for them to consider.

Concept 4: Business Models Are Transformed by Services Innovation

Opening up your innovation process can greatly advance your innovation capability. But you can go still further if you open up your business model as well. Companies that are experiencing success in services innovations often have to change their business model in fundamental ways in order to sustain that success.

Business models are a way to create value for a business and then to capture at least some of that value for the organization. Once a business model becomes successful, however, it develops substantial inertia. This inertia can cause a company to miss out on new innovation opportunities should those new opportunities conflict with the logic of the business model. You can see the inertia of your current business model by looking at the metrics used to measure its success. Product-based business models focus on the financial metrics associated with products: inventory levels, gross margins, failure rates, and so on. Services business models differ in many ways from the metrics used for product business models. The key financial metrics tracked in running a services business are customer retention rates, the lifetime value of the customer, customer satisfaction levels, and so on.

Many successful services innovators have found that they need to overcome this inertia and adapt their business models in an effort to create new services offerings. UPS's business model now offers to take over the shipping department function for its customers. Under the terms of this offer, UPS becomes the shipping department for its customers and sends anything that needs to be sent to wherever it needs to be sent, and by whatever means makes the most sense. Usually that will be UPS, but sometimes UPS might send something using the U.S. Postal

Service or even FedEx—whatever is best for the company's needs for that particular shipment.

Companies that are moving to services have discovered that the shift sometimes forces them to change their business model. Johnson & Johnson, for example, now markets certain drugs, like the cancer drug Velcade, in Europe with the proviso that the country's national health service pays only if the drug proves efficacious for the patients who receive it.[20] Johnson & Johnson used to focus primarily on the prescribing physician as the key customer in its marketing. This new business model requires it to focus far more than before on the patient as the customer, tracking patient compliance and making sure that the right patients are receiving the medicine.

Organizations with services-based business models also look different from ones that are products based. In most product organizations, the services function is treated like an organizational backwater—something that must be provided, but not something that makes the difference between success in the market versus failure in the market. Moreover, the manager in charge of services rarely makes it to the senior levels of a product organization. To put it differently, product people are the leaders with the most power in product-based business models: they can be counted on to resist incursions from the services function, particularly if their own power and authority are diminished in the process.

Services-oriented business models operate completely differently. The services function, a critical element to competitive success in the market, is managed by highly capable people whose careers can readily extend to the most senior levels of the organization. Although these companies may also have powerful product people, the services executives are full partners in the organization and play an integral role in charting its future course.

If you want to assess your own organization's current business model, take a look at your senior management team and examine their backgrounds. If most of them came up through product organizations, it is a safe bet that your organization has more of a product business model mind-set than a services-oriented one. We examine services business models more closely in Chapter Five.

Combining the Four Concepts for Success

Combining these four key concepts provides the essential perspective necessary to move to open services innovation. These concepts, along with their major supporting points, are shown in the concept map in Figure 1.1, which will help you link these concepts and retain them after you have finished this book.

RUNNING YOUR OWN RACE: OVERCOMING THE COMMODITY TRAP

The treadmill of ever more similar products coming at an ever-faster pace is a race that very few can hope to win. And even the winners have to worry that someone else is readying an onslaught that could knock them off their perch in the next generation of products.

That's why it is far better to get off that treadmill and run your own race. Rethink your business as a purveyor of experiences to your customers. Invite those customers into your own innovation process, and don't stop there: open up your innovation process more generally to get the best ideas and technologies from others for your own business model, and let others use your innovations in their business models. If you follow the logic of your new approach, chances are that you will innovate your business model as well, redefining the way that you create and capture a portion of value for your business.

Your competitors will have a harder time copying your innovations. Because they are based in part on tacit knowledge, they are hard to copy. Because you have included your customers directly in your innovation, these customers will have invested their own time and self-generated content, making them less likely to abandon you at a moment's notice should another company try to lure them away. If you are able to open up your innovation process, you simultaneously increase your own sphere of possibilities and complicate any attempt for others to mimic what you're doing. And if you are creating and capturing value in new ways, competitors stuck in the product conception of their business model will

be slow to understand how you are winning in the market. They will have to fight their own battles against inertia to respond to your success.

This is the way out of the commoditization trap. It requires a new way of thinking about innovation, services, and business models. The winners in this new economic environment will be those firms that develop strong internal capabilities in a few areas and leverage those capabilities by enlisting the efforts of many others in support of their business. Since the world is moving to a services economy, it is time to move innovation into the services context as well. The world is ready for Open Services Innovation.