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Foreword
Most would agree that the concept of sustainable business has hit the mainstream. You’d be hard-pressed to find a company that hasn’t at least started a recycling initiative or engaged in some kind of community development project, even if the efforts are spare. Fortunately, many companies have gone far beyond that minimum—they have overhauled products and processes and have started to look outwards at system-wide trends and challenges that promise to radically reshape their businesses in the future.

SustainAbility has long recognized and advocated the need for fundamental shifts in business practice, including in business models, both to drive necessary progress toward, and to unlock business value from, sustainability. Such shifts are all the more urgent and relevant today, given slow progress on sustainable development broadly and accelerating innovation and disruption (both positive and negative) already playing out in many industries.

That is the basis for Model Behavior, exploring the role and practice of business model innovation in the context of sustainability. In it, we break down the innovative models we’re seeing, trying to better understand their origins, mechanics and implications. In doing so, we hope to induce more focused conversation about business model innovation, going beyond merely marveling at each new car-sharing company or crowdfunding site, and delving deeper into how such innovation comes about, and how we can catalyze more of it.

We acknowledge that business model innovation will not come easily, especially for many of the large, established companies we work with every day. But we proceed with the conviction that those who experiment and take the leap will be better able to traverse the shifting terrain ahead, and reap the benefits.

This report helps by offering inspiration and reflection, by raising issues and questions for further exploration, and by providing a framework for ongoing discussion. It grows out of SustainAbility’s past work on social entrepreneurship and innovation (supported by the Skoll Foundation and others) and on the evolving role of the private sector in sustainable development (via our 2012 Regeneration Roadmap project and its final report, Changing Tack), and responds to the growing emphasis on systems change and collaboration as key enablers of a sustainable future.

We welcome your comments, questions and insights. We are also seeking sponsors and partners to help shape and support further research on this topic. To share feedback, and/or to discuss partnership or sponsorship opportunities, please contact Lindsay Clinton (Clinton@sustainability.com).

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Context
The idea of business model innovation—that a company could launch a new business model never conceived of before, or transform an existing business model—has long captivated business leaders. Leading academics focused on the topic, like Clayton Christensen, Michael Porter and the late C.K. Prahalad, have discussed the merits of disruption, the value to be created and the fortune to be gained by shifting business models. And yet, executives are often held back by vested interests in their current approach: “If it ain’t broke, don’t fix it.”

Disrupt or Be Disrupted
It is a hard sell to convince a CEO to change a business model based on threats or opportunities that have not yet materialized. Innovation, therefore, often remains piecemeal or incremental, rather than transformational, fundamental and system-wide. But as global trends—environmental, social, political, technological—continue to shift the foundations of our current business models, incremental innovation will become less and less effective in enabling companies, industries and whole economies to adapt and succeed. There is an urgent need for fundamentally different approaches to value creation.

The utility industry, for example, is currently confronting a mounting crisis with its existing business model. Changing regulations, rising fossil fuel prices, falling prices of renewables, and the arrival of improved energy storage solutions and other decentralized energy options will completely alter the playing field for large coal and nuclear-powered utilities. For a long spell, these companies have enjoyed a stable business model dependent on a high degree of integration along the value chain: from power generation to transmission and distribution lines to customer relations. More recently, this large-scale, centralized system has been disrupted by the rise of smaller, decentralized energy systems, especially those focused on delivering solar and other forms of alternative energy. While they once captured just a tiny, elite niche of the energy marketplace, companies in this space are now growing rapidly and helping speed the decline of the traditional, vertically integrated utility model.
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While many utilities are struggling to handle this disruption, some are acting quickly to adapt. RWE, a German utility with over 24 million customers across Europe, plans to shift its traditional utility model and instead use its expertise to help manage and integrate renewables into the grid, switching from being a power seller to a renewable energy enabler—what we would call a product as a service model. Much as Xerox and Rolls Royce plc have shifted from being sellers of hardware to more service-based businesses, RWE is transforming from a “volume to value” business.

We are seeing the same sort of disruption burst like a geyser from businesses that are part of the sharing economy. Alone, a company like Zipcar demonstrates a more thoughtful and potentially sustainable business model. But, combined with other mobility-related sharing businesses like ParkatmyHouse, RelayRides, GetAround and FlightCar, it represents a much more fundamental disruption of the automotive industry.

2. Ibid.
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Where to Start?

In fact, the sudden proliferation of such innovation gets to the core of why we’ve written this report. For all its promise and necessity, advocates of sustainable business model innovation have struggled to get beyond citing a few beloved examples (e.g., Zipcar). Nowadays though, examples of sustainability-related business model innovation abound, with new ones arriving almost daily. So we set out to better understand which new business models are emerging, where innovation is happening, and how both new and established companies are experimenting to embed sustainability into the underlying structure of their businesses. The findings shed light on both what’s working and what’s possible.

From our research and review of 87 company examples, Model Behavior identifies 20 distinct business models falling into five categories, offering a closer look at what’s occurring in each of these models to produce more sustainable outcomes. In brief, these are as follows:

Environmental Impact

- **Closed-Loop Production**: The material used to create a product is continually recycled through the production system.
- **Physical to Virtual**: Replacing brick and mortar infrastructure with virtual services.
- **Produce on Demand**: Producing a product only when consumer demand has been quantified and confirmed.
- **Rematerialization**: Developing innovative ways to source materials from recovered waste, creating entirely new products.

Social Innovation

- **Buy One, Give One**: Selling a specific good/service and using a portion of the profits to donate a similar good/service to those in need.
- **Cooperative Ownership**: Companies owned and managed by members, often taking broader stakeholder concerns into account, including those of employees, customers, suppliers, the local community and in some cases, the environment.
- **Inclusive Sourcing**: Retooling the supply chain to make a company more inclusive, focusing on supporting the farmer or producer providing the product, not just the volume of the product sourced.
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Base of the Pyramid

- **Building a Marketplace**: Companies build new markets for their products in innovative and socially responsible ways, including delivering social programs, adapting to local markets, and bundling with other services like microfinance and technical assistance.

- **Differential Pricing**: Realizing customers may benefit from the same product but have different payment thresholds, companies charge more to those who can afford it in order to subsidize those who cannot.

- **Microfinance**: Providing small loans—and in some cases access to financial services—to low-income borrowers who do not have access to a traditional bank account.

- **Micro-Franchise**: Leveraging the basic concepts of traditional franchising, but specifically focusing on creating opportunities for the poor to own and manage their own businesses.

Diverse Impact

- **Alternative Marketplace**: When a firm circumvents a traditional method of transaction or invents a new type of transaction to unleash untapped value.

- **Behavior Change**: Using a business model to stimulate behavior change to reduce consumption, change purchasing patterns or modify daily habits.

- **Product as a Service**: Consumers pay for the service a product provides without the responsibility of repairing, replacing or disposing of it.

- **Shared Resource**: Enabling customers to access a product, rather than own it, and use it only as needed; often dependent on the participation and generosity of community members to share their goods with others.

Financing Innovation

- **Crowdfunding**: Enabling an entrepreneur to tap the resources of his/her network to raise money in increments from a group of people.

- **Freemium**: Offering a proprietary product or service free of charge, but charging a premium for advanced features, functionality or virtual goods.

- **Innovative Product Financing**: Consumers lease or rent an item that they can’t afford or don’t want to buy outright.

- **Pay for Success**: Employing performance-based contracting, typically between providers of some form of social service and the government.

- **Subscription Model**: Customers pay a recurring fee, usually monthly or annually, to gain ongoing access to a product or service; model has been used to lower barriers to entry to the purchase of green innovations.
Findings and Implications

In reviewing these models, Model Behavior reveals a number of themes relevant to the practice of business model innovation for sustainability.

1. Every exchange in a value chain provides opportunities for innovation and impact.

We argue that business model innovation for sustainability boils down to creating a novel form of exchange at some point along a company’s value chain. In the models listed above, the traditional form of exchange—between a company’s customers, employees, owners or community—has changed in some way that usually distributes value more equitably for more stakeholders. Each exchange that a company engages in, therefore, presents an opportunity for a potential shift in model, and potentially also in social or environmental outcomes. By identifying and analyzing these points of exchange, an established business can find areas of promise for business model innovation.

2. Companies that have demonstrated a business model innovation have often done so by shifting incentives in the value chain.

When a business understands what each stakeholder wants or needs and responds creatively, or perhaps even radically, business model innovation begins to take shape. For example, late in 2013, GlaxoSmithKline announced that it will stop paying doctors to promote its drugs and that it will no longer link the compensation of sales representatives to the number of prescriptions that doctors write—practices that have long been deemed conflicts of interest in the pharmaceutical industry. Glaxo says that it will now pay sales people based on their technical knowledge and the quality of service they provide, completely changing the incentives for its sales force, and also changing the incentives for doctors, likely reducing the quantity of unnecessary medications prescribed, and perhaps unlocking other opportunities for innovation and value creation that better serve customer needs.

Many of the models we identified are also trying to tweak incentives. The buy one, give one model incentivizes customers to purchase their products by building in social good. The shared resource model incentivizes property owners to make money off of idle goods. The behavior change model incentivizes consumers to lower their energy use to beat their neighbors. Shifting the incentives at play can often shift the entire model.
3. The largest companies tend not to be the source of new models, but they can help evolve and scale them.

Most business model innovation emerges from companies that design more sustainable models from the start. That said, bigger companies can help to bring these models to maturity. This may occur through acquisition or mutually-beneficial partnerships, or the adoption of new ideas into a given industry.

In addition, large companies are finding creative ways to innovate and experiment with new business models. They are partnering with social entrepreneurs and using a range of tools—impact investing, innovation platforms, in-house venture funds, and dedicated R&D centers—to search for and exploit effective new models.

Although smaller companies often lead the way in business model innovation, we believe bigger companies have a critical role to play in helping to enhance the impact of the most important innovations.

4. Business model innovation doesn’t happen in a vacuum.

However urgent our quest for sustainability, new business models can’t just be willed into existence. Instead, we must recognize how any model—sustainable or not—is dependent on surrounding conditions, and that new models are often enabled by, or arise organically from, changes in those conditions. Looking across the models identified in the report, we see numerous examples where changes in circumstances—an infusion of technology, entry into a new country, a shift in customer demographics and/or preferences, areas where old systems have crumbled—along with the keen insight of the innovators themselves, have been the key to radical shifts in models.

But the implication is not that business leaders and companies should simply stand by and wait for things to happen organically. Disruption frequently catches us off guard and is almost never orderly in its impact, and in a world that is more and more defined by the increasing scope and pace of change, it is more or less inevitable. The key is to increase our individual and collective ability to recognize and respond to—and where necessary, to directly engineer—circumstances that will support new, more sustainable ways of doing business.
The Challenge of Change

If it were easy to be a sustainable business—to create, deliver and capture value in a way that meets human needs within planetary limits—everyone would be doing it. But typically companies devote the majority of their resources to optimizing current business models especially by applying and improving incrementally on existing capabilities. This is because business models are ultimately based on a common understanding among individuals—company managers, employees and investors—of what business they are in and how they create value. Shifting these mental models to evolve business models remains a powerful barrier to innovation.

But, just because business model innovation requires a mental leap and requires potentially painful shifts within a company doesn’t mean it isn’t possible or necessary. In fact, when it comes to survival, some established companies will shift their models, and will do so quickly.

In 2012, the world’s largest electronics retailer, Best Buy, announced that it would begin a transition to a new model, initially requiring the elimination of 50 stores, the creation of 100 new smaller stores, and a focus on mobile device sales. The business model shift, from big-box retail to “Connected Stores,” was precipitated by swiftly declining sales and competition from online retailers. The experiment with smaller, more mobile-focused stores began immediately and was brought online in a span of only 18 months. Whether Best Buy’s experiment is a commercial success or not, its effort is evidence of how quickly a company can shift market position and approach when conditions require it.

Where We Go from Here

When we started this report, we intended it to be a short primer covering a handful of models that seemed to hold promise for future sustainability. It has become much more than that. And yet, we feel this is only the beginning of a more in-depth exploration of this topic.

If business model innovation is indeed a key ingredient to transforming our economic landscape and improving social and environmental outcomes, it is worth understanding what drives it, what the most promising business models are, what might compel an established company to transform its model before such change is urgent or unavoidable, and what broader systemic shifts—in policy, markets, consumer mindsets, etc.—may most hasten the rise of beneficial new models.

We look forward to exploring this topic with you.
**SustainAbility** is a think tank and strategic advisory firm that for over 25 years has catalyzed and supported business leadership on sustainability. Through our agenda-setting research and advocacy, we chart new territory and help business leaders and their stakeholders understand what’s next. Through our advisory services, we help clients anticipate key trends, develop effective strategies and initiatives, and unlock new possibilities via authentic stakeholder engagement and collaboration.

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