BUSINESS MODELS

How to Monetize a Business Ecosystem

by Peter Williamson and Arnoud De Meyer

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More companies are starting to recognize that developing a vibrant ecosystem of partners across industries is essential for accelerating innovation and withstanding disruption. Partners can share new technologies and knowledge, open up new routes to market, and help create new business models.

But it isn't enough to get an ecosystem up and running; you also need a way to sustainably monetize it.

IBM learned this back in the 1980s with its personal computer business. Its IBM PC-compatible architecture became the framework used by other companies specializing in hardware and software for delivering powerful, low-cost computing to users. But despite leading the emergence of this ecosystem, IBM failed to extract a sustainable stream of profits for itself, and sold the business to Chinese computer maker Lenovo in 2005.

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In our work analyzing company ecosystems, we've found that a firm needs to do three things if it wants a sustainable profit stream from the ecosystems it has created.

First, it must identify a keystone contribution, some element or activity it can uniquely own and control that is essential for the ecosystem to create value for customers. For example, the chip designer ARM Holdings, which I've worked with for over a decade, had a keystone contribution with its chip designs. It partners with major phone makers including Apple, Samsung, and Huawei, as well as many of the leading semiconductor fabricators such as Intel and Taiwan Semiconductor. Its chips go into 90% of smartphones. Phone makers can't switch to designs from an alternative supplier without making heavy investments in additional tools, processes, and training. Having invested years in building close, trusted relationships with its partners, ARM is uniquely able to access their product road maps, making it hard for any competitor to imitate its chip design.

Second, an ecosystem leader needs to establish an efficient "tollgate" to collect revenues when partners use its keystone contribution. The tolls may take the form of: license fees, royalties, or commissions on transactions within the ecosystem; a share in the revenues of the products and services that partners supply; or the profits on value-added products or services created using the data and knowledge from the ecosystem.

The size of the toll needs to balance the lure of increased profitability for the ecosystem leader against the risk of extracting so much that it milks the ecosystem dry, leaving too little upside for partners to keep them engaged.

Of course, the toll for any single type of transaction, activity, or partnership can be only so high. Leaders must also diversify their revenue sources. That means designing multiple tollgates at different points in the ecosystem. Many of the ecosystems we've analyzed, such as those of Alibaba, Amazon, ARM, and Thomson Reuters, have generated profits without inflicting too much pain on partners or customers, using multiple tollgates that each collect a small fee. ARM, for example, charges one-off license fees to anyone who wants the right to its proprietary IP. But it also charges a royalty on the sale of every unit of the devices that embody its designs. It derives a double benefit as the ecosystem expands: Its revenues and profits grow when new participants join the ecosystem as well as when as existing partners grow their sales. Designing your monetization so that revenues and profits grow as the ecosystem expands avoids burdening it with large fixed costs and stifling its growth when it is small and underdeveloped.

Another useful strategy we've observed is to vary the charges between participants, subsidizing some and demanding a higher share of the value created from others. You want to collect lower tolls from those who contribute enormously or those who derive less value but nonetheless play a useful role in the ecosystem. Alibaba, for example, invites small sellers on its business to consumer site, Taobao, to join for free, with the option to buy value-added services, while large retailers on its high-end Tmall platform pay a substantial up-front listing fee as well as commissions.

Third, leaders need to find a way to leverage the ecosystem to innovate and find ways to renew the keystone contributions. This means establishing reliable and ethical channels to accumulate data on the activities of partners and customers, and processes for innovating on insights gleaned. Thomson Reuters, for example, created a simple mobile app that enabled farmers to upload data about the acreage they planted and provide updates on the condition of their crops. In exchange, farmers received aggregate information and analysis of trends, along with weather reports. Thomson Reuters used the data in its models to develop more accurate forecasts for crop volumes and prices, which it then sold to financial traders as part of a new suite of services, opening up an additional revenue stream.

While some learning needs to remain proprietary, some can be shared with partners to help make the ecosystem more productive. Alibaba aggregates and analyzes user data from the millions of websites that are part of its ecosystem, to distill unique insights about its buyers' shopping preferences and habits. It then shares these insights to help its partners make better product marketing decisions.

Beyond customer data, ecosystems can also provide a wealth of other insights that can be monetized. By working closely with diverse partners across its industry, for example, ARM gains unique insights about future technology and product trends. This knowledge has helped it enter new application markets for its chip designs in cars, health care, infrastructure, and wearable devices, each opening up new revenue opportunities.

By focusing on these three priorities, companies can establish sustainable profit streams, ensuring their ecosystems work for them.

Peter Williamson is Professor of International Management at the Cambridge Judge Business School and co-author with Arnoud De Meyer of the forthcoming book, *Ecosystem Edge: Sustaining Competitiveness in the Face of Disruption*.

Arnoud De Meyer is University Professor at Singapore Management University and Chairman of the Stewardship Asia Centre.

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