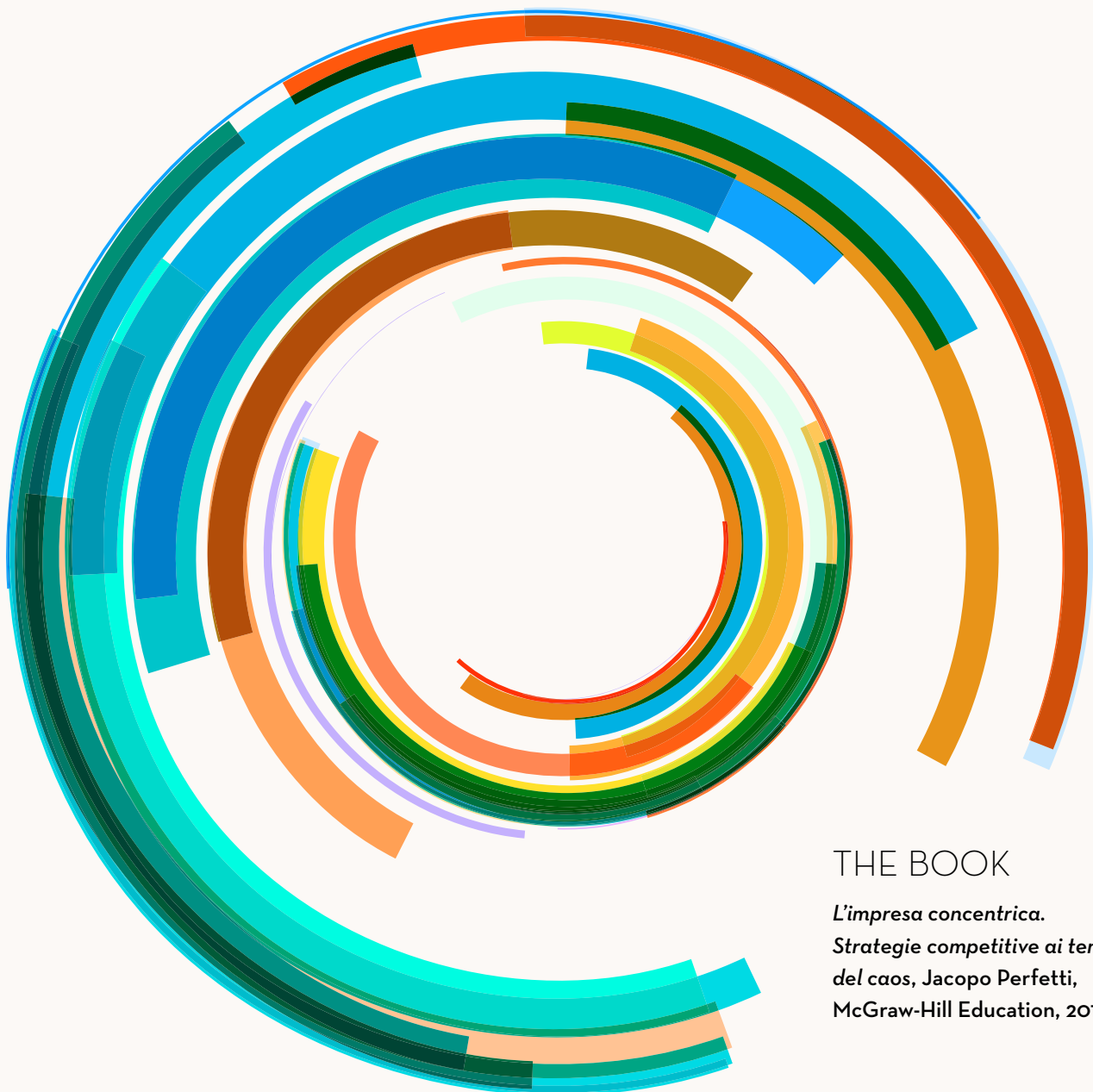


CONCENTRIC ENTERPRISE HOW TO REDUCE COSTS, INCREASE PROFITS AND CREATE VALUE FOR OUR CUSTOMERS IN THE TIMES OF CHAOS.

a book by Jacopo Perfetti



THE BOOK

*L'impresa concentrica.
Strategie competitive ai tempi
del caos, Jacopo Perfetti,
McGraw-Hill Education, 2016.*

CONCENTRIC ENTERPRISE

Today's competitive environment is generating new business models that actually thrive on market uncertainty and complexity. These are lean and flexible organisations premised on a stakeholder network, the product of unique and distinctive activities, that devolve their costs to the periphery while retaining profits and control at the centre: welcome to the era of concentric enterprises.

There was a time when an enterprise meant the classic, pyramidal, vertically integrated enterprise. Revenues and costs were for the entrepreneur and thus his profits (p) are the product of revenues (r) less costs (c), i.e. $p = r - c$. Then the cooperative network enterprise developed, where all revenues and costs are distributed over a network of enterprise contributors (n). Profits are the sum of revenues minus costs, divided by the network, i.e. $p = r - c/n$.

Today, in addition to the pyramidal or horizontal/network model, a new entrepreneurial model has appeared: a *concentric*, vertically integrated model with a participatory nature where the most profitable part of the revenues remains in the hands of the entrepreneur, leaving the heftier part of costs spread over the entire network of the enterprise's contributors; i.e. $p = r - (c/n)$.

In his popular article in Techcrunch, Tom Goodwin analysed today's competitive environment: "Uber, the world's largest taxi company owns no vehicles. Facebook, the world's largest media owner doesn't create content. Alibaba, the world's largest retailer has no inventory. And Airbnb, the largest accommodation provider in the world owns no real estate".

But the list continues. YouTube, the world's largest producer of video content does not make videos. Amazon KDP, the world's largest self-publishing platform does not publish books. Li&Fung, one of the most important suppliers of American and European branded garments does not own textile factories. Blablacar, one of the leaders in European long distance private car transport does not own a single car. And so forth.

Many of these companies while retaining parts of the pyramidal

entrepreneurial approach, level them out with advantages associated with participatory networks, and, in so doing, have developed a new model of enterprise, which I call *concentric*. The Latin prefix *com-* (together) refers to the production sphere, based upon cooperation with the network of stakeholders. The *-centrum*, or centre, refers to where profits are totally or mainly concentrated. Therefore, the direction of profit is inversely proportional to the direction taken by costs: the larger the network of enterprise's contributors, the lower the costs accruing to the entrepreneur until a potential zero marginal cost is reached that enables the enterprise to increase its long-term profits margins and reduce operating risk.

This kind of structure is especially profitable in such traditionally high capex sectors as hospitality, car

transport or media, with their high fixed and variable costs. To better understand the concept, we can offer an example. Traditionally, if we wanted to introduce a new hotel chain in the hospitality industry we would first and foremost need a hotel, a major investment, but this, in its turn, operates as a barrier to new entrants. Instead, with the concentric approach we can put the enormous stock of rooms and houses around the world to use by creating a platform where demand and supply have a better chance of meeting up thanks to enormously reduced start-up and maintenance costs. But how can we create enterprises of this type? First of all, it should be pointed out that this type of enterprise is not applicable to any context but within the right socio-economic context, which I define as *Times of Chaos*, it can realise its maximum competitive advantage.

01. Times of chaos (the context).

Fyodor Dostoevsky in *Notes from the Underground*, imagined a future where reason and science predominated and all human actions reflected mathematical calculations. This idea of the future, shared by many late nineteenth century writers, was based on the assumption that the more technological the future the more predictable it would be. Today's technology is far more advanced than the last century's, but the direction taken by the markets, instead of foreshadowing Dostoevsky's long-term predictability only forecasts uncertainty, complexity and volatility.

A milieu rife with threats that could be transformed into strengths but also one whose opportunities, for whatever company in whatever sector, could morph into weaknesses. In such a dynamic and fluid global scenario, concentric enterprises thrive in today's market conditions and, in particular, benefit from the five socio-economic phenomena that I have summarised with the acronym *c.h.a.o.s.*, and hence the *Times of Chaos*:

- C** Change, not Crisis;
- H** Half Entrepreneurs;
- A** Abundance Unexploited;
- O** Open Innovation;
- S** Sharing & Access.

Change, not Crisis

Although, over time, the word *crisis* has acquired a negative connotation, its original meaning was associated with concepts such as *change*, *lack of regularity* and *periods of transition*, which gave us words like *chrysalis*, understood as an intermediate stage of a metamorphosis that can lead to something better.

If we bear this in mind, we can appreciate that one of great limitations of our times is to persist in seeing crisis, which for the past eight years has become a permanent feature of our markets, as



A) Classic, pyramidal, vertically integrated enterprise:

$$p = r - c$$

Revenues and costs are for the entrepreneur .



B) Cooperative network enterprise:

$$p = (r - c) / n$$

Profits are the sum of revenues minus costs, divided by the network.



C) Concentric enterprise, vertically integrated model with a participatory nature:

$$p = r - (c/n)$$

The most profitable part of the revenues remains in the hands of the entrepreneur leaving the heftier part of costs spread over the entire network of the enterprise's contributors.

something fleeting and negative, pending the return to “normality”; something that, by now, no longer exists.

Crisis should, on the contrary, be seen as the sign of a much vaster change that can be transformed into a major opportunity with which to create new markets and stimulate demand. Modern economic history is a succession of crises, each marking the overturning of a prevailing economic climate and the transition from a period of expansion or growth to one of depression or decline, followed by a period of recovery.

The nineteenth century was a period of crises, from the panic of 1837 to the Baring crisis in the 1890s. Similarly, there were crises in the following century, from the dramatic Great Depression to the dot.com bubble. And other crises will befall us in this century. As Einstein remarked *problems cannot be solved with the same thinking that created them* and the great challenge of our times is not to do better than before but rather to do it differently. From a strategic point of view, this denotes the need to innovate, and introduce new business models and new managerial paradigms.

Half Entrepreneurs

In today's labour market ever more persons, either for choice or necessity, are reinventing themselves as entrepreneurs. However, the term entrepreneur does not only mean the founder of a company with a billion-dollar capitalisation, as it refers equally to an *industrial army* of freelancers, VAT professionals

Often enterprises spend money they don't have (i.e. they take out loans) to buy assets that serve no purpose, to create products that customers don't need.



and contract workers that has increased exponentially over the last ten years in the wake of the financial crisis, overproduction, deregulation, technology or any other of the factors impacting upon the labour market.

This is the way in which new economies come into being, such as the *gig-economy* or the *on-demand economy*, based on very-short term temporary work, and whose importance, thanks to the entrepreneurial approach typical of Anglo-Saxon cultures, where the jobless young tend to invent work for themselves, is constantly growing. In this scenario, the idea of the entrepreneur acquires connotations that are hard to define.

Can the person driving his car for Uber or renting a room over Airbnb be deemed an entrepreneur? Yes, insofar as he or she is the owner of a micro-business. No, as he or she depends upon a structure that dictates the business's prices, rules and brands, the accolade is not applicable, at least not in full. He or she is a *half-entrepreneur*. And this, in strategic terms, engenders threats, by encouraging potentially new entrants with the consequent reduction in market barriers, as much as it

does opportunities, in the shape of higher numbers of gainful workers and reduced labour costs.

Abundance Unexploited

Much of the abundance we enjoy today frequently remains under-used or not used at all. Uninhabited houses, uneaten food, empty trucks in transit, non-rented hotel rooms, unused working spaces, books earmarked for pulping and so forth.

Think, by way of example, of how we make use of our cars. Various studies show that our cars remain unused 90% of their lives while only 10% of their potential is utilised against a sustained cost of 100%. And if we consider that many cars are used by only one or at most two persons when, on average, they can seat five, their underuse increases fourfold. This fact explains the success of companies such as Blablacar, a ride-sharing platform where car places can be shared, or better, rented.

As the economist Tim Jackson put it: «[we] are being persuaded to spend money we don't have, on things we don't need, to create impressions that won't last, on people we don't care about». If we look at this concept from a business point of view, we shall find that often enterprises spend money they don't have (i.e. they take out loans) to buy assets that serve no purpose, to create products that customers don't need, thereby generating an ever greater number of unused goods.

In strategic terms this *unexploited abundance* highlights the fact that today what is at issue is

Idea in brief

THE CONTEXT

Today's competitive environment is generating new business models that actually thrive on market uncertainty, volatility, complexity and, in particular, on five socio-economic phenomena, summarised with the acronym *c.h.a.o.s.*:

Crisis and the change of many paradigms; new economies such as the *gig economy*; availability of many resources under-used or not used at all; open innovation as a way to outsource R&D, *Sharing Economy*.

THE MODEL

The Concentric Enterprise reduces costs devolving them on a network of contributors through the creation of unique and distinctive activities, while retaining profits and control at the centre.

not so much *making* or *buying* the resources we need as *connecting* existing ones by creating innovative activities in order to reduce our idle capacity and increase our margins.

Open Innovation

Inventing and innovating are very different concepts. The first refers to *what* we do. The second to *how* we do it. An inventor invents something new, something that previously did not exist. An innovator, on the other hand, innovates something that already exists, and which was previously made or used in a different way.

The twentieth century gave us many inventions but today's tendency seems to be going in the direction of innovating what has already been invented. The cinema offers ever more remakes, sequels or prequels of old films, industries propose more advanced versions of last century's models, the fashion industry copies the styles from the past and so forth.

Although many forms of innovation exist, ranging from process innovation to marketing, from the concentric enterprise's point of view, one of the most interesting forms of innovation is open innovation, a term coined by the American economist Henry Chesbrough, who applied it to innovation

processes where ideas and players are outsourced in order to further enterprises' technological skills and spread their risks and resources.

According to this vision, it is not necessary to develop research in-house because it is cheaper to capitalise upon the best innovations offered by the outside market and transfer them into our business model. Therefore, in strategic terms, the R&D phase, hitherto always centralised, can be externalised to reduce overheads and increase our enterprise's flexibility.

Sharing & Access

As soon as I began to study the phenomenon of the Sharing Economy I heard it described in many ways: the *Access-Driven Economy*, the *Collaborative Economy*, the *Peer-To-Peer Economy*, the *Platform Capitalism* and so forth. However, regardless of the definition, is the Sharing Economy really based on sharing? In one sense it is. Private persons and companies do share their assets. But so long as the exchange is a commercial transaction (I pay for a service), I believe it is more correct to speak of access rather than sharing.

Yet it is undoubtedly correct that the Sharing Economy is an expression of a Sharing Society, where persons prefer access to possession and where sharing is

experienced as a primary need. Thanks to the Internet we are living in an era of connected individuality. Single individuals rotate around centralised nuclei such as social networks or platforms where any kind of property, experience or capacity can be shared with the collectivity.

There was a time when only limited amounts of goods were put on the market but today any of our objects or skills can become the object of some kind of commercial transaction. This is a kind of *All You Can Rent Economy* (to add yet another definition) in which anybody can profit from things owned or known. From a strategic point of view, this means being able to satisfy a market need but, at the same time, it also allows new entrants to undercut our own product or service prices.

Inventing and innovating are very different concepts. The first refers to *what* we do. The second to *how* we do it. The twentieth century gave us many inventions but today's tendency seems to innovate.



02. The concentric enterprise (the model)

Commencing from the study of various companies in different sectors, my book *L'impresa concentrica - Strategie competitive ai tempi del caos* (publisher McGraw-Hill Education, 2016), proposes a reference model for building a concentric enterprise or for re-thinking an enterprise in concentric terms, based upon four phases that we can briefly outline as follows.

Phase 01

Constructing an innovative **Value Proposition** through five key questions: *Why*, what is the real and profitable market need we set out to meet, which can be grasped by living within the reference market or through market analysis; *Who* is our reference target in terms of customer profiling and size; *Why us*, or what competitive advantage do we have over our competitors, which means focusing as much upon our distinctive features as the needs of our reference target; *What* does our product offering consist of and at what price is it to be marketed; *Where*, in other words what is our reference industry or industries.

Phase 02

Constructing a **Concentric Value System** tailored on our value proposition, where the key question of *How* to reduce the need for resources, and thus investments, is a two-step process. The first step concerns the resources we really need and entails: A) breaking them down so as to identify the real attribute our customers are willing to spend their money upon; B) identifying *substitute resources* already on the market; C) moving the costlier resources to the periphery. The second step, instead, addresses the unique and distinctive activities to engage upon for purposes of distributing resources within our concentric model. These may be *connection, making, buying or transformation* activities.

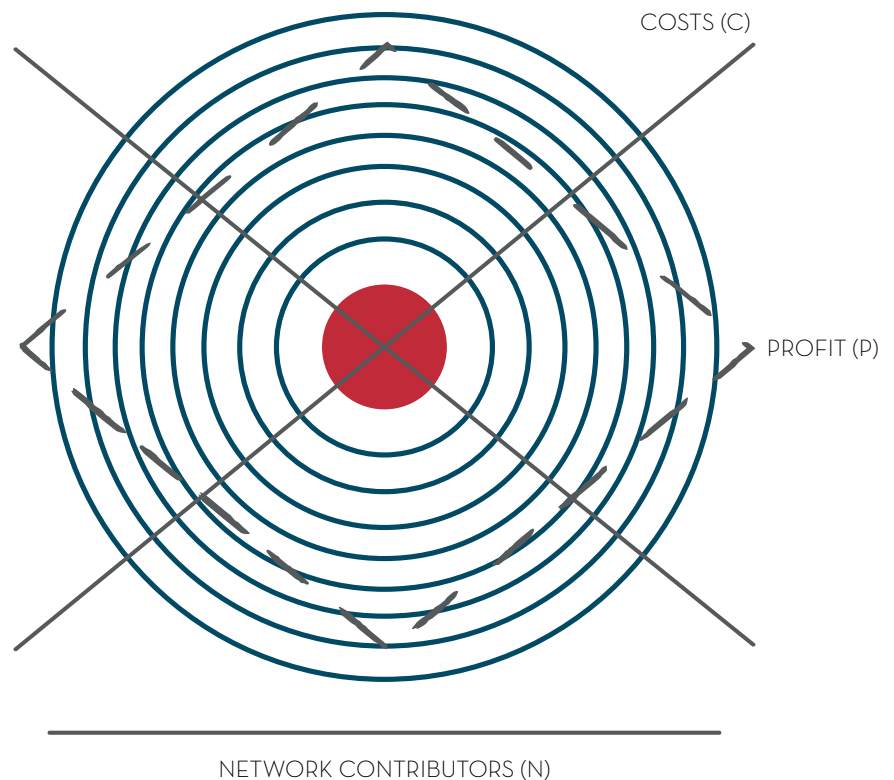
Phase 03

Constructing the **Market-Driven Stakeholders Community**, which is the question of *With*. Although the concept of community has traditionally been slanted towards customers, a concentric enterprise can - and must - apply the same marketing approach to create an equally strong and highly motivated community of suppliers, understood as persons able to contribute more or

STRUCTURE OF THE CONCENTRIC ENTERPRISE

Profit flow (p) is inversely proportional to cost flow (c). The larger the network (n) of enterprise contributors, the lower the costs (c) accruing to the entrepreneur up until a possible zero marginal cost is reached that will enable the enterprise to increase its long-term EBIT, reduce invested capital - thanks to the use of substitute resources - and thus generate a ROI potentially superior to the industry average, thus signalling the achievement of a competitive advantage with, inter alia, limited operating risks.

$$\frac{\uparrow \text{EBIT}}{\downarrow \text{INVESTMENT}} = \text{ROI} \uparrow \text{ WITH RISK } \downarrow$$



less gratuitously to our enterprise's value. The essential features of this Janus-faced community are: A) constructing a strong and shared brand of one's own; B) simplifying the processes for demand and supply to meet; C) creating community rating systems that assign evaluation functions to the market; D) identifying the best ways to communicate with and motivate suppliers and customers to secure their active involvement.

Phase 04

Defining an *economic and financial plan* to achieve the following 4 operating results: A) a sufficiently large market share such as to position the enterprise as an industry leader and optimise network advantages in the shortest period of time possible; B) a marginal cost - the cost for every additional product produced – at or close to zero to guarantee our enterprise ever greater long-term margins and an above-average ROI for the industry; C) lower operating leverage and hence fewer operating risks through a system of average-to-low overheads and increasingly lower variable costs so that the enterprise will be less exposed to market volatility and can more quickly adapt to external threats and opportunities; D) a scalable model so our enterprise can expand in different industries by exporting its own distinctive operations while maintaining the specific resources of the reference industry in the periphery. And, therefore, our main question here is *How far*: how should our enterprise be sustainable and scalable.

Epilogue

Today, companies such as Airbnb or Uber are in the centre of investment euphoria on the part of venture capital funds as the dot.coms were at the start of the century. Uber has a 68-billion-dollar valuation, above that of enterprises that have worked in the transport industry for over a century, such as General Motors. Therefore, the question that naturally arises is what would happen to these enterprises if the speculative bubble burst, or the level of investment by external funds shrank; or how would Uber fare if and when self-driving cars came onto the market, and how will governments want to regulate the growing wave of ride and house sharing.


HOW TO CREATE A CONCENTRIC ENTERPRISE IN FOUR PHASES:

PHASE 01: VALUE PROPOSITION


Why? What is the real and profitable market need we set out to meet?

 Richard Branson has always had a direct experience of the market, understanding and anticipating its needs from the inside.


Who? Who comprises our reference target in terms of customer profiling and size?

 Michele Ferrero named his reference market "Valeria", and on the basis of her decided what products to put on the market.


Why us? What is our competitive advantage in terms of our distinctive characteristics? And what value do customers attach to them?

 Frédéric Mazzella built up Blablacar by unifying his own distinctive characteristics to a real and profitable market need.

What? What is our product offering and at what price will provide value for customers and profitability for our company?


 Henry Ford created the Model T by giving his customers a disruptive product in line with their real economic possibilities.

Where? What is our reference industry and how can we modify it to exploit our competitive advantage?


 Guy Laliberté extended the demand for circus entertainment thanks to a new circus concept, the Cirque du Soleil.

PHASE 02: CONCENTRIC VALUE SYSTEM

How (Resources)? What resources do we really need and what *substitute resources* can we use to reduce costs and grow margins?


 Airbnb broke down its need for resources so as to understand customers' real needs, identify alternative resources - private homes - and shift principal overheads to the periphery.

How (Activities)? What activities must we create in order to distribute resources within our concentric model?


 Self-delivery and self-assembly activities enable Ikea to move important costs linked to logistics to the periphery and increase its own margins.

PHASE 03: MARKET-DRIVEN STAKEHOLDERS COMMUNITY

With (Suppliers)? What are the best drivers and tools for building up a community of suppliers, who, with their work, can contribute towards the creation of value for our enterprise?


 Threadless shifted R&D activities to a community of suppliers that collectively contribute towards the American enterprise.

With (Customers)? What are the best drivers and tools for building up a community of customers that can create value for our enterprise?

 The start-up CREW made use of content marketing and PR media tools to actively involve its customers and generate new business.

PHASE 04: THE ECONOMIC AND FINANCIAL PLAN

How Far? How to make our enterprise sustainable and scalable in order to achieve our 4 operative results?

 In a just a few years Uber has become the world leader in private car transport. It is organised in such a manner that when a new driver becomes part of the community the additional costs are minimal, while revenues are exponential. With respect to a high capex industrial company it has a much lower operating risk and with UberEats it has succeeded in entering the food delivery sector with few added costs while capitalising upon its existing community of suppliers.

We might also ask what would happen when the five reference socio-economic phenomena change or evolve, or, in conclusion, how could the scenarios change if consolidated players such as Opel or Hilton were to re-think their own business models in concentric terms.

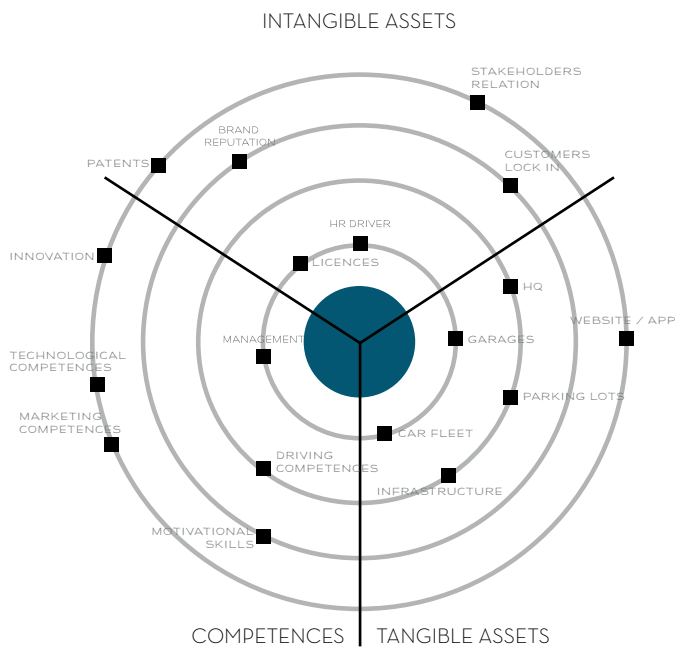
None of these questions can be answered with any certainty. However, what is taking place in the entrepreneurial world and, more generally, in the socio-economic scenario we are living in today, shows that it is possible to challenge major players from scratch thanks to a new way of conceiving one's business and the capacity to extract value from resources previously regarded merely as costs.

From this standpoint, the concentric model can transform not only market opportunities but also market threats into a means for innovating traditional processes and procedures with which to do things better, because the concentric enterprise is an expression of the times of chaos, and

Under the stress of current market shocks it will neither break up nor remain unchanged but instead transform itself and learn to capitalise upon change and external volatility.



as such, seizes on concepts such as uncertainty, ambiguity and dynamism in order to extract value from them. In the words of the Lebanese author Nicholas Nassim Taleb, a concentric enterprise is neither fragile nor robust but rather *anti-fragile*; under the stress of current market shocks it will neither break up nor remain unchanged but instead transform itself and learn to capitalise upon change and external volatility.



Availability of resources within an enterprise in the private car transport sector with a traditional approach and high capex, where most of the tangible assets such as the car fleet or the garages are concentrated.



Availability of resources within an enterprise in the private car transport sector with a concentric approach, where most tangible assets are moved to the periphery, while intangible assets, such as the brand, remain at the centre.

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