

What business ecosystem means and why it matters



Companies that utilize business ecosystems will be better positioned to drive innovation and capital efficiency to

By **Greg Sarafin**

EY Global Alliance and
Ecosystem Leader

6 minute read
23 Apr 2021

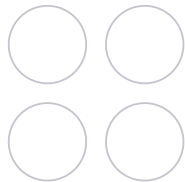
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create customer value.

In brief

- A good understanding of business ecosystems is growing increasingly critical to keeping up with – and staying ahead of – the pace of change.
 - Participants in business ecosystems create more value collectively than they could create individually.
 - Companies who do not embrace business ecosystems risk falling behind.
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Ecosystem defined

Ecosystem is one of those terms that if you ask one hundred people what it means, you will probably get one hundred different answers, most of them in a similar zone, but the variation would be significant. The first time I ever heard the word ecosystem was probably in a grade school science class where we studied the “ecosystem of the ocean”.

Ecosystem is a concept that recognizes, in any closed system, the members of that system must work with and around each other to keep the system stable, ideally optimizing the collective benefit. We see plenty of evidence in the natural

world of how a balanced ecosystem benefits all participants - and how destructive imbalance in an ecosystem can be.

Since we work in the business world, I felt it would be useful to make a more precise definition of ecosystem relative to the goal of business value creation across multiple parties. Thus, we define a “business ecosystem” as follows:

"A business ecosystem is a purposeful business arrangement between two or more entities (the members) to create and share in collective value for a common set of customers. Every business ecosystem has participants, and at least one member acts as the orchestrator of the participants. All members in a business ecosystem, whether orchestrators or participants, have their brands present in the value propositions."

There is a fair amount to unpack in this definition. The requirement that the business ecosystem members are seeking to create value for a common set of customers recognizes that without common customers, the members are simply targeting value at each other. The point of our definition is that business ecosystems exist to create a higher level of value collectively than the members can create individually considering time, capital, brand permission, market access and other real-world constraints. The members of a business ecosystem sell with each other to common customers. They may also sell to each other in other contexts, but that activity is not part of the business ecosystem.

The concept that a business ecosystem requires one or more members to act as the orchestrator recognizes that there must be a party responsible for the structure and performance of the business ecosystem, including governance,

commercial arrangements, go-to-market coordination, value creation mechanisms, value sharing mechanisms, and risk management. Going back to my grade school example of the ecosystem of the ocean, there is no orchestrator of the ocean's ecosystem. That ecosystem occurs naturally, rebalances as change is introduced, and does not exist to serve a common purpose for its participants other than to seek stability amongst them. Business ecosystems have an overarching purpose to create collective value for common customers, and thus require orchestration.

Finally, the requirement that all brands be present is how we draw the line between ecosystem business models and strategic supply networks. Let's illustrate this with a simple real-life example. If you drive a car, you know your car has brakes, but you probably don't know where your car manufacturer sourced those brakes. Those brakes were sourced to your car's manufacturer through its strategic supply network. However, you might drive a car with "Brembo" brakes, and the fact that it has branded brakes may have added to your perception of the value of the vehicle leading up to your purchase. That is where Brembo crossed the line into a business ecosystem relationship with the car manufacturer. Our view has been that a key enabler of a business ecosystem is the collective value of the brands of the members, particularly that of the orchestrator, though the participants' brands are important as well. Hence the stipulation that all brands are present in the value proposition.

As noted above, to get value from an ecosystem business model, it is important to have an ecosystem function that enables both participation-in and orchestration-of business ecosystems. There is a certain amount of general

overhead to enabling business ecosystems, and each business ecosystem will have specific costs relative to the facts and circumstances of the commercial arrangement. As companies become mature at this function, they will be able to calculate these marginal costs which can be significant. It is important to maintain strict cost discipline as it is entirely possible that the incremental value creation that is realizable in a business ecosystem may not justify the marginal cost.

Why ecosystem matters

Ecosystem is one of those terms, like digital, that is rapidly becoming ubiquitous across the business landscape. We see the university and analyst communities increasingly writing about ecosystem. We see the highest valued companies in the world are increasingly digital natives who employ ecosystem business models to efficiently and quickly generate customer value. In my job, I am increasingly asked by clients how they can do more to create value from ecosystem in their companies.

I think the evidence is now clear that we are entering an era of ecosystem where most companies will heavily utilize ecosystem business models to drive innovation and the pace and capital efficiency with which they create customer value. Said differently, companies will increasingly favor the “partner” option in the “build, buy, partner” decision framework. The pace of change, demand for innovation and the democratization of capital through private markets make it increasingly difficult to keep up. Building can take too much time and buying can take too much capital. Meanwhile, the traditional technical and operational

hurdles that made partnering models difficult in prior times have been dramatically lowered by the cloud economy.

I don't mean to suggest that cloud is some sort of magic bullet that allows any company to jump into the ecosystem pool. Even with cloud, it is not easy to create value at pace and scale through partnering models. Most companies are not structured to partner efficiently, nor are they culturally aligned. Companies that are proficient at "building" typically have very mature R&D and innovation functions that seamlessly scale into full production of new products and offerings. Similarly, companies proficient at "buying" typically have very mature corporate development and M&I functions to identify and integrate new entities. But outside of certain industries, like the software industry which has been utilizing ecosystems for decades, there are very few companies that have a mature ecosystem function, let alone a broader operating model structure that is optimized for ecosystem value creation.

The good news for companies who wish to utilize ecosystem business models, but otherwise lack the structures and maturity, is that there is a growing body of leading practices and an increasingly large workforce that understands the practical elements of building and operating an effective ecosystem function. Companies that incorporate ecosystem business models into their corporate strategies can now feel more confident that they can successfully develop the capability to execute those strategies. That wasn't the case almost four years ago when I took my Ecosystem Leader role at EY. It was a lot harder back then.

Summary

We've learned a lot of lessons in the last four years that have me optimistic that coming out of COVID, we are going to see an explosion in value creation around the world. I firmly believe that the future belongs to those companies who build ecosystem business models into the structure of their value creation strategy. In my next article, I'll be sharing some of my thinking on how we all can benefit from a world that increasingly views ecosystem as a path to economic advantage, and more specifically, how we can structure ourselves to take advantage of it. Stay tuned for more.

About this article



Greg Sarafin

EY Global Alliance and Ecosystem Leader

Passionate about improving the pace and scale of value creation. Fearless business strategist. Former entrepreneur and dot-commer. Unabashed binge watcher. Traveler, foodie and father of three.

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