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PERSPECTIVE ON BUSINESS

It's Death of a Salesman as Shared-Savings Catches On



You don't need that air conditioner. You need cooling services. That difference is changing companies.

By JEREMY RIFKIN

I have long been a skeptic when it comes to the prospect of persuading companies to take responsibility for protecting the environment and public health. Yet now a revolutionary new way of doing business called "shared savings" is changing the basic rules of commerce and, in the process, making environmental protection and public health synonymous with the bottom line. The implications are profound.

Many companies are making a shift away from profit-driven transactions—the hallmark of traditional capitalism—to shared savings. In the new scheme of things, minimizing rather than maximizing the materials and energy needed for production is increasingly the measure of commercial success. It's all part of the great transformation taking place from a market to a "network" economy. In the latter, servers provide clients access to services and experiences over a defined period of time.

Here's some examples of how the new commerce works:

- Carrier, the largest manufacturer of air-conditioning equipment, now offers cooling services rather than just selling air conditioners. Carrier installs its equipment on a client's premises and charges a service fee for maintaining an agreed-upon level of comfort.

This is very different than traditional product-based sales, in which a company attempts to sell the largest capacity piece of equipment it can, i.e. one that uses more energy than necessary. In a service relationship, the idea is to minimize the use of energy in order to save on the cost of the service. That's why Carrier provides free energy savings services, including lighting retrofits and special windows, so that its clients will use less energy.

- Companies in the chemical supply industry have taken an even more innovative approach to doing business called "gain sharing." For example, chemical supply companies traditionally have sold chemicals on a per-drum basis to automobile manufacturers for various production processes. Because the chemical supplier is not responsible for

the environmental costs associated with the final use and disposal of its products, it has little or no incentive to invest in costly research to develop less toxic chemical compounds. Its primary incentive is to sell as much of its chemicals as possible while minimizing its up-front costs of production, handling and transport.

In a gain-sharing arrangement, however, the chemicals remain the property of the chemical supplier, which enters into a performance contract in which it is responsible for both the management and the application of the chemicals at the site where automobiles are manufactured. In other words, the seller-buyer relationship is transformed into a server-client one. This entirely transforms the incentives of each party.

If, for example, the supplier can introduce innovations that reduce hazardous waste generation, the automobile company, which is responsible for controlling and cleaning up these wastes, agrees to share the cost savings with the supplier. In one such situation, PPG/Chemfil and Ford Motor Co.'s gain-sharing arrangement at Ford's Taurus assembly plant in Chicago has resulted in significant environmental remediation and cost-savings, which was shared by the auto company with its paint supplier.

This new approach to doing business, based on access to services rather than the sale of products, has the potential to make environmental savings an intimate part of the commercial mix in many industries.

Gain-sharing is becoming popular in a wide number of fields for the simple reason that in some industries there is little or no money to be made any longer in pure sales. The problem is compounded by there being too many suppliers in a given industry competing for a limited number of customers, further depressing prices and profit margins.

How, then, does a company win market share? The answer, say a growing number of companies, is to let go of the idea of selling goods or services, as radical as that might seem and, instead, to lend their know-how and expertise to help run the customer's business.

One good example of this phenomenon is the health care industry, in which several drug companies have entered into "disease management" arrangements with HMOs. The drug companies agree to take responsibility for the total treatment

of a patient, including disease prevention, patient care and the administration of drugs. Eli Lilly, for instance, has singled out five major diseases—diabetes, heart disease, central nervous system disorders, cancer and infectious diseases—for disease management. The new mission is to get the patients well and keep them well.

By shifting focus from "only selling drugs to also servicing patients, companies like Eli Lilly help reduce HMO and hospital costs and share in the savings.

This has the potential of revolutionizing the health care field by focusing increasingly on managing prevention rather than administering cures.

In these kinds of shared-savings or gain-sharing networks, then, the logic of the marketplace is turned on its head. The more successful the pharmaceutical companies are at reducing the cost of health care, the more savings available to be shared by the HMOs. Some health industry analysts are considering taking the process a step further by also including productivity gains resulting from less absenteeism and improved worker health as part of the gain-sharing agreements with pharmaceutical companies, insurance companies and HMOs.

The transformation from profit-based transactions between sellers and buyers to shared-savings and gain-sharing agreements between servers and clients is quickly spreading to other industries, changing many of the fundamental assumptions upon which business is conducted.

We could be witnessing the early stages of a fundamentally new kind of capitalism. In an age increasingly dominated by memberships, subscriptions, retainer agreements, service contracts, leases and other forms of commodified relationships between servers and clients operating inside vast commercial networks, shared-savings and gain-sharing agreements could become as important as profits derived from product sales were in the market economy.

If that were to happen, our world would change forever.

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