

# **Business Model Design**

HOW TO DISRUPT A 100 YEAR-OLD BUSINESS—
CHALLENGING THE SHAVING INDUSTRY BUSINESS MODEL

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MANAGEMENT ACCOUNTING GUIDELINE

**CASE STUDY** 

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## Introduction

Many well-established business models of stable industries are being challenged by up-and-coming companies (i.e., disruptors) that leverage new technologies, sales channels, social channels, and mobile trends to rewrite the industry's long-held beliefs. In this case study we will examine one such industry: the razor and blades component of shaving products. We will look at how two companies have upended the solid business model of retail sales and advertising paired with low cost products with lock-in for high priced consumables. We will also consider how these companies have achieved this success with two very different infrastructure approaches. Lastly, we will demonstrate how the RAISE drivers (namely, Resilient + Adaptive + Innovative) ensure an enterprises sustainable edge.

## **Razor Industry Background**

The concept of a razor with replaceable blades was the inspiration of King Gillette, and was launched in 1904. Gillette protected its products with patents, selling razor handles at a high price and replaceable blades at a low price. This strategy was very successful until 1921 when the original patents ran out and competition in the marketplace increased.

Gillette dropped the price of its standard handle to compete with others at the entry level and introduced a higher quality handle and blades to attract dedicated and "locked-in" consumers. The blades continued to sell at a low price, but the number of blades per package was reduced to increase profits.

In the 1960s, the development of the cartridge razor was a milestone change in the industry. It opened the door to patents on the cartridge connection method and allowed razor companies to lock people into one product for replacement blades. To attract users to purchase the high-margin patented blade cartridges, the shaving companies began to sell handles at a low cost (or give them away for free). Once a customer had committed to a particular handle, they were locked in to buying that company's blades.

In the late 1990s, Gillette ramped up the shaver razor-blade technology battle with the release of the Mach3 shaver. More than 50 patents protected its triple blade, single point docking, lubricating strip, and new blade formats. Seven years later Gillette introduced the Fusion razor, a system with more than 70 patents. Gillette's competitors soon followed with their own razor technology.

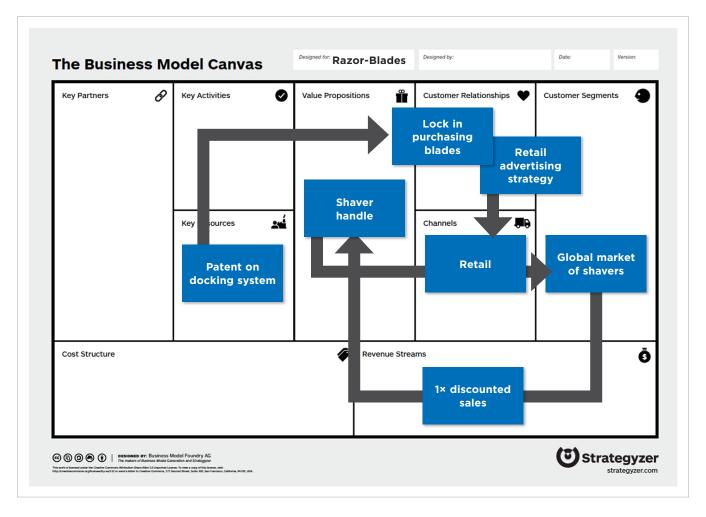
From 2009-2012, as Gillette and its competitors raced to create newer and more "technologically advanced" blades, the price of the blades more than doubled and created an over-served market, ripe for disruption.

## The Razor and Blades Business Model Pattern

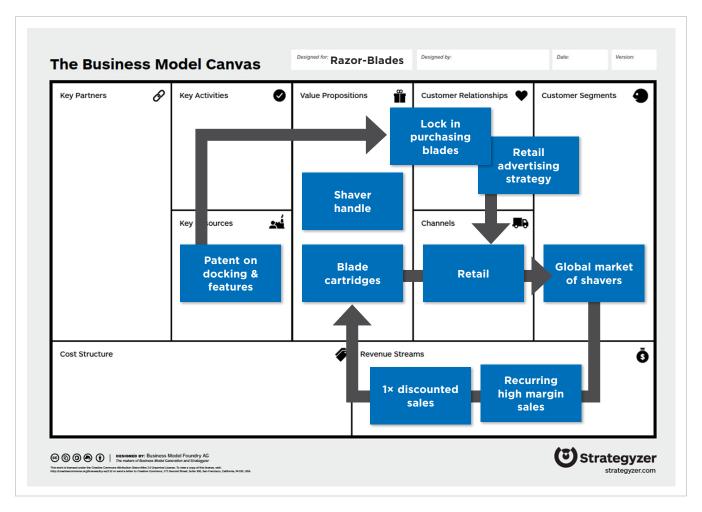
Historically a very successful business model pattern, "razor and blades" is a type of a broader pattern known as "bait and hook." The logic of the strategy involves offering an initial product, usually a one-time purchase (either at a deep discount or offered for free) that traps the consumer and "locks them in" to purchasing an associated, higher margin, recurring product.

In the shaving industry, the "bait" is the shaver handle and the "hook" is the consumable blade cartridges, which are proprietary and protected by a vast array of patents. Once the consumer accepts or buys the razor and trial blades, they are locked-in to purchasing the only blades that fit that razor. The blade cartridges are sold at a high margin.

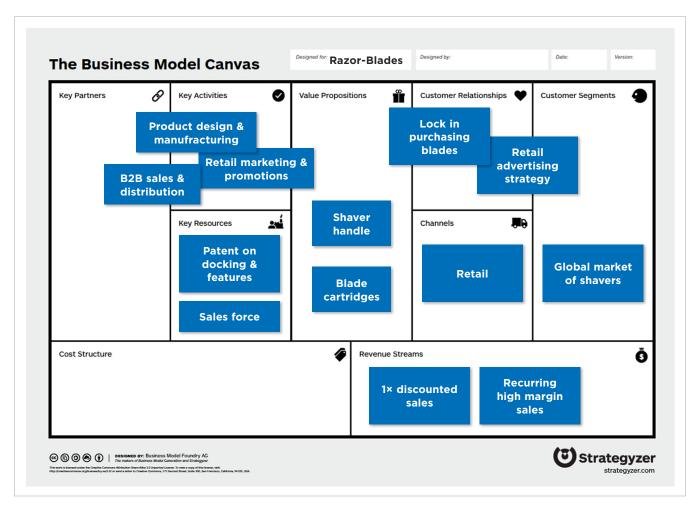
The business model starts with the offer of a desirable handle that is a one-time sale at a discounted or free price through retail channels to attract the user. Customer acquisition relies heavily on traditional advertising and retail strategies such as promotional displays and product placement. The handle is protected by patents for its cartridge docking system creates the "lock-in" retention strategy for the purchase of the blades.



The second component of the offer, the blades, is strongly protected by a series of patents to create barriers for competitors from creating compatible cartridges (docking system) and to create a feature set to differentiate from competitors' blades (e.g., type and number of blades, lubricating strips). The blades are sold through retail channels and are a recurring sale that is high margin.



The core infrastructure elements of this model involve product design and manufacturing, B2B sales and distribution, retail marketing, and sales force and patents.



# Disrupting the Traditional Razor and Blades Model

**Note:** For the purposes of this case study, we will stay focussed on handle and blade sales and not address the questions of accessories and grooming products.

There are a number of vectors in which two companies, Dollar Shave Club (DSC) and Harry's, attacked the traditional razor and blades model.

Core to their success was to move away from a transaction-based retail model and expand the value drivers of the buying experience: emphasizing the feeling of being special with membership in a "club" and extending the experience to the buying process and the after sales connection (e.g., club newsletters).

The first vector of change was to shift from B2B and its reliance on retail structures such as product placement and store marketing, to a B2C model thus dis-intermediating the value chain for the consumer. Much like Nespresso's success in the coffee industry with pod distribution, direct fulfillment avoids sharing the lucrative sales with wholesale and retail delivery structures.

Along with the shift to B2C for the second vector, DSC and Harry's needed to change the acquisition strategy. DSC's rise to fame was largely driven by viral videos done with a great deal of humour. Harry's has followed suit and in both these cases content-based marketing through social media continues to be the key strategy in customer acquisition.

The third vector of change was the revenue structure. Rather than relying solely on transactional sales, both start-ups introduced membership-based pricing. All three drivers were instrumental in leveraging the components of resiliency, adaptability and innovation in the face of meeting the evolving market and consumer-based needs and demands.

Does this mean these two companies are mirrors of each other? Absolutely not. You will see in the following sections that although DSC and Harry's built their business with similar building blocks they did so with two very distinctive approaches to their business models.

## **Dollar Shave Club (DSC)**

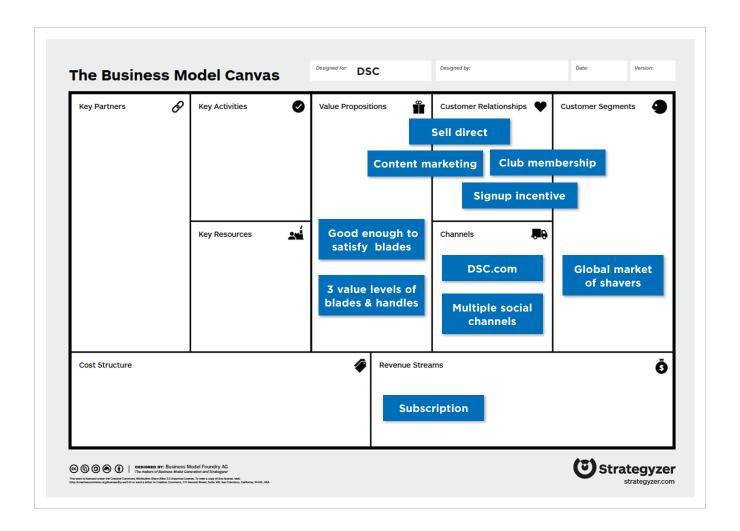
Dollar Shave Club, the first company to market with the disruption (the resilient driver in RAISE), built its business model on three key elements:

- Good enough blades in three increasing value levels, with a unique handle for each product level.
- A membership-based structure with a front-end discount (\$1 for a customer's first purchase).
- A focus on making purchasing shaving supplies fun by being a member of a club and using humour in online videos and club magazines. This created an engaging retention strategy.

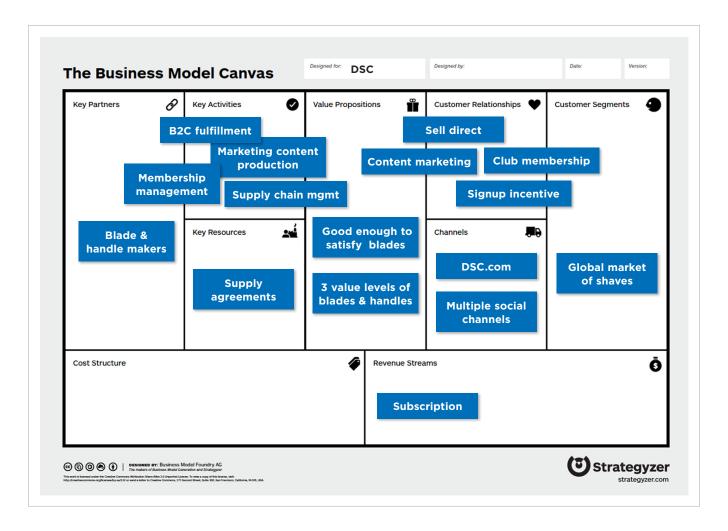
DSC's most effective customer relationship strategy was its promotional videos. As of May 2017 the first video, released in 2012, has more than 16 million views on YouTube. Within the first 48 hours of the video's release, 12,000 people had signed up for a membership in the club. By the summer of 2013, DSC boasted a membership of 330,000. That success clearly established the effectiveness of content-based marketing through social media (the adaptive driver in RAISE). DSC currently has a strong presence on Facebook, Twitter, Instagram, and Vine. DSC uses these channels differently, offering differing incentives through each.

#### **Shave Club**

- Dollar Shave Club is a direct-to-consumer (B2C) retailer selling via internet and mail order.
- Founded by entrepreneurs Mark Levine and Michael Dubin, the company was originally based in Gardena, California. DSC now operates its warehouse and fulfilment centre in Kentucky.
- DSC raised \$1 million in funding from venture capitalists and launched operations in 2011, the company launched operations in Canada and Australia in 2012.
- DSC raised almost \$100 million in venture investment. In 2016, DSC was acquired by Unilever for \$1 bllion.
- Revenues are based on a three-level membership plan and additional product sales.
- The core product line is based on three levels of quality for razors and blades.
   DSC purchases its razors and blades from third-party manufacturers. In 2014, DSC expanded its offer to include grooming and hair products.
- The company's focus on social media content marketing has produced several humorous viral videos about being part of the club: the experience of choosing, buying, using and renewing its products.



In terms of infrastructure, DSC does not manufacture razor handles or blades. It sources products from established manufacturers. DSC's infrastructure is focussed on managing its membership, producing content for marketing, and fulfilling customer orders.



DSC's key resource is its agreements with supply partners. Notably, DSC, since it purchases handles and blades from other manufacturers, has no need to manage product patents or worry about infringement by competitors. This is an interesting tradeoff. Purchasing products from manufacturers allows DSC to operate without research and development, patenting, and protection costs. DSC also has the flexibility to change its products should the competitive advantage disappear. The downside is dependency on suppliers and the risk of fluctating cost and supply.

DSC's business model has been so successful Unilever bought the company for approximately \$1 billion USD in July 2016.

#### Harry's

Given that both DSC and Harry's based their industry disruption on a shift to B2C, dis-intermediating sales channels and membership-based revenues, how are Harry's and DSC different?

The first area of differentiation is the products each company offers (i.e., their value propositions). Harry's offer is built on high quality blades that only come in one format. Its handles are lower quality than DSC's but come in multiple styles and are customizable.

With its acquisition and retention strategy (i.e., its customer relationships), Harry's attempted to replicate DSC's social media marketing approach but with a focus on higher quality blades and an underlying theme of sophistication.

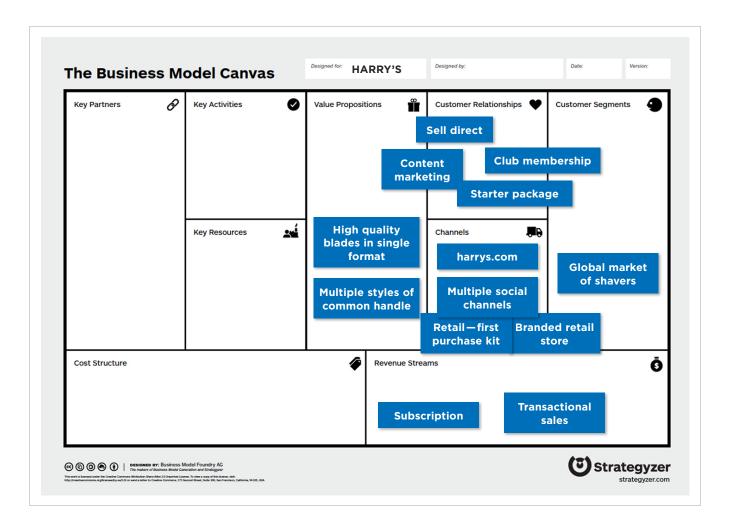
Harry's activation strategy (customer relationships—getting people to try the product for the first time) is based on a standardized "starter" package the company offers, charging customers only the cost of shipping.

Harry's relies less on the subscription model by including transactional sales (i.e., revenue streams) for anyone who doesn't want the recurring supply of product.

Recently, Harry's has differentiated itself from DSC significantly with its channel strategies. Like DSC, Harry's relies heavily on the website and social media channels, but Harry's has recently opened a branded store to experiment with owned distribution channels. Another significant difference is the agreement Harry's has with Target to sell its starter kits, subsequently referring customers to its website for further purchases (subscription or transactional).

#### Harry's

- Harry's is a direct-to-consumer (B2C) retailer selling via internet, mail order, resellers, and branded stores.
- Founded in 2013 in New York State by Andy Katz-Mayfield and Jeff Raider.
- In 2014, Harry's acquired the Feintechnik razor factory in Germany.
- In 2015, Harry's received \$75.6 million in financing.
- In 2017, it launched a reseller channel through Target in the US.
- Revenues are based on two options to purchase: (1) transactional sales, (2) membership with options to set up cycle of purchasing.
- Harry's has one format for blades and handle. The high quality blades are sold at low margins. The handles are customizable and may be personalized. The company offers a wide range of accessories and personal grooming products.
- The company's marketing is largely focussed on content marketing emphasizing high quality, reliability, and efficient delivery.

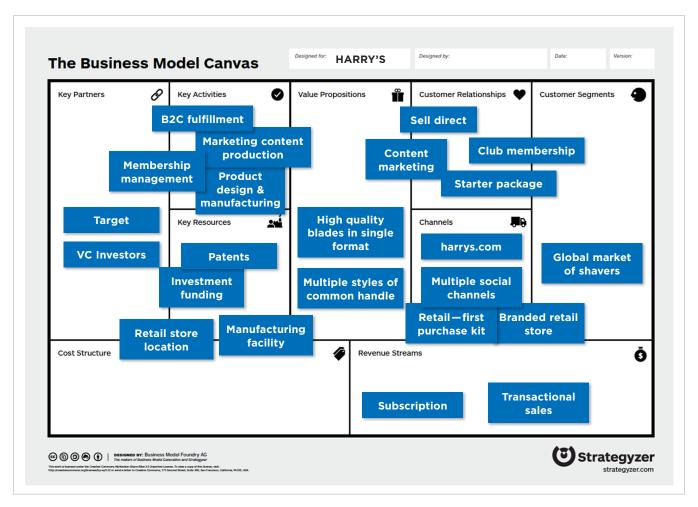


The most significant differences between the two business models occur in the area of infrastructure.

Harry's infrastructure is much more capital-intensive than DSC's. Harry's purchased a blade manufacturing facility in Germany to ensure it owned its own manufacturing process. With a single supply source, Harry's focusses on one type of blade cartridge and provided multiple handles to appeal to consumers' tastes. Harry's owns the patents on its blade and razor handles. The company's infrastructure, therefore, has activities for design and manufacturing along with the key resources of patents and manufacturing facilities. Harry's is also experimenting with "owned" channels so it has the added resource of retail locations.

In 2015, Harry's announced a \$75.6 million USD series C funding round to finance its capital-intensive infrastructure.

As part of the shift in channel strategies, Harry's has added a partnership with Target. It will be interesting to see if Harry's further develops partnerships with other retail chains or Amazon.



# **How to Disrupt an Industry: Two Approaches**

From the preceding analysis we can see how two start-ups attacked a highly successful business model pattern by redefining product performance-cost balance, shifting to selling directly to the customer, and dis-intermediating the distribution by selling over the Internet. Both DSC and Harry's rely on content marketing and incentives to spark sales.

They have also attacked the "control" of the traditional business model by building on a foundation of customer experience in the buying process using humour and sophistication. Moving away from traditional retail sales allowed the companies to restructure the revenue base to a subscription model (or in Harry's case, an integrated model of subscription and sales).

Beyond their common attack on the traditional model, DSC and Harry's have chosen differing approaches to their products and infrastructure, with DSC foregoing manufacturing, relying on a partnership model based on supply agreements, and Harry's opting for the capital-intensive owned manufacturing process built on patented products.

Interestingly, Harry's has incorporated elements of the traditional model into its own, using a partner retail channel and experimenting with branded stores.

Which of these two approaches will be the most successful is yet to be determined. There is no approved solution for innovation. Success is an unpredictable combination of creative disruption, market opportunity, and effective execution. Taken together, the drivers of resiliency and adaptability have effectively been leveraged and combined to ensure a customer-centric approach for ongoing organizational value with the implementation of a new business model.

As a final note on the confluence of approaches, in 2014 Gillette announced the launch of the Gillette Shave Club. In doing so Gillette contradicted its own 2012 marketing message that men replace blades based on feel, not a calendar. Gillette also downgraded the life cycle of its blades from "months" (advertising in 2012) to "about a month."



This publication is one in a series on Business Model Design. The entire series of overview, guideline, case study 1 and case study 2 are available on our website. For additional information or for general inquiries, please contact us at mags@cpacanada.ca.

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