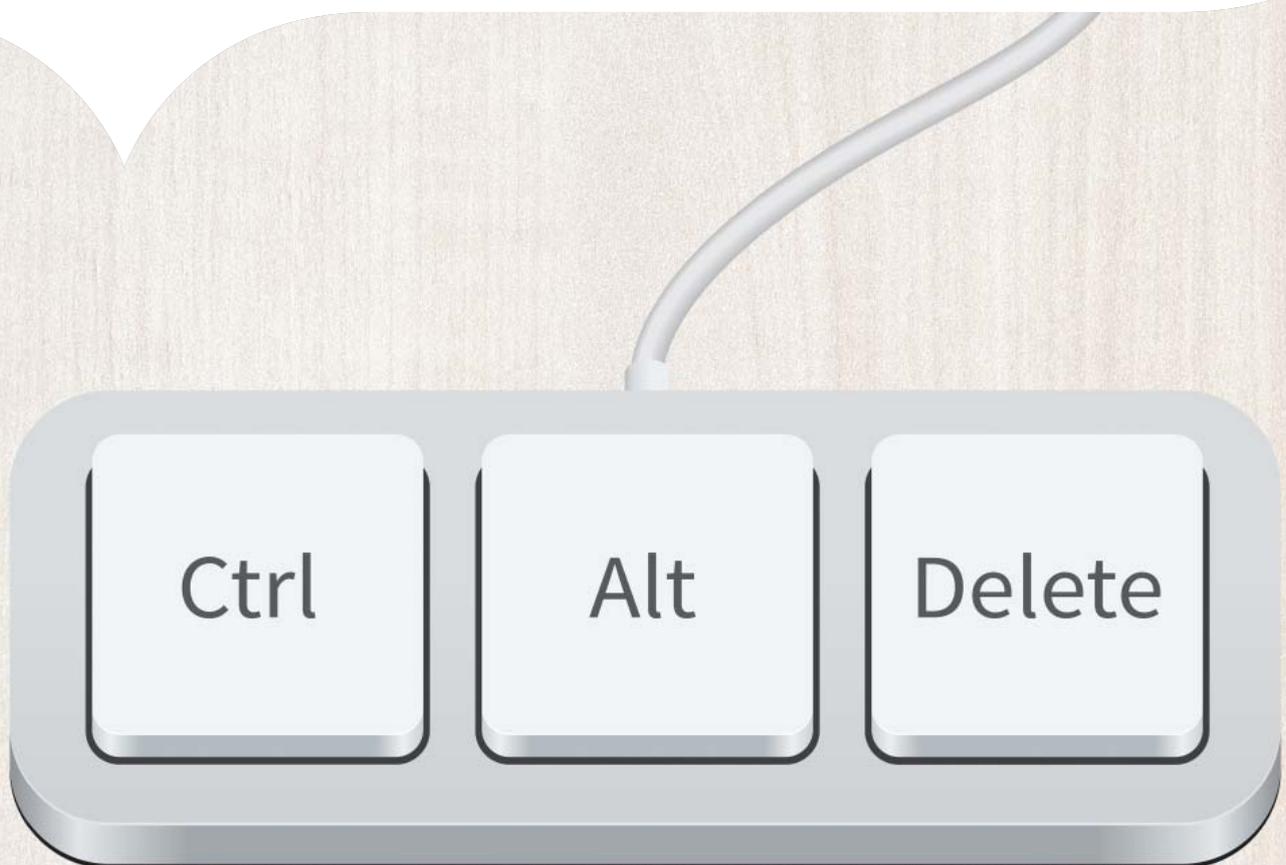


Ctrl-alt-del: Rebooting the Business Model for the Digital Age



Business Model Reinvention is a Necessity, Not a Choice

The collateral damage of the digital age is felt most profoundly at the business model level. Companies, across sectors, are today being forced to rethink every aspect of their business model as a result of new disruptors. What happened in the media industry could be the herald of the future evolution of many other sectors. The pace of change took many media players by surprise. In less than ten years, US newspaper and magazine combined ad revenues declined by nearly half while Google's ad revenues increased by nearly 1,200%. Google's advertising revenue now exceeds both magazines and newspapers in the US (see Figure 1).

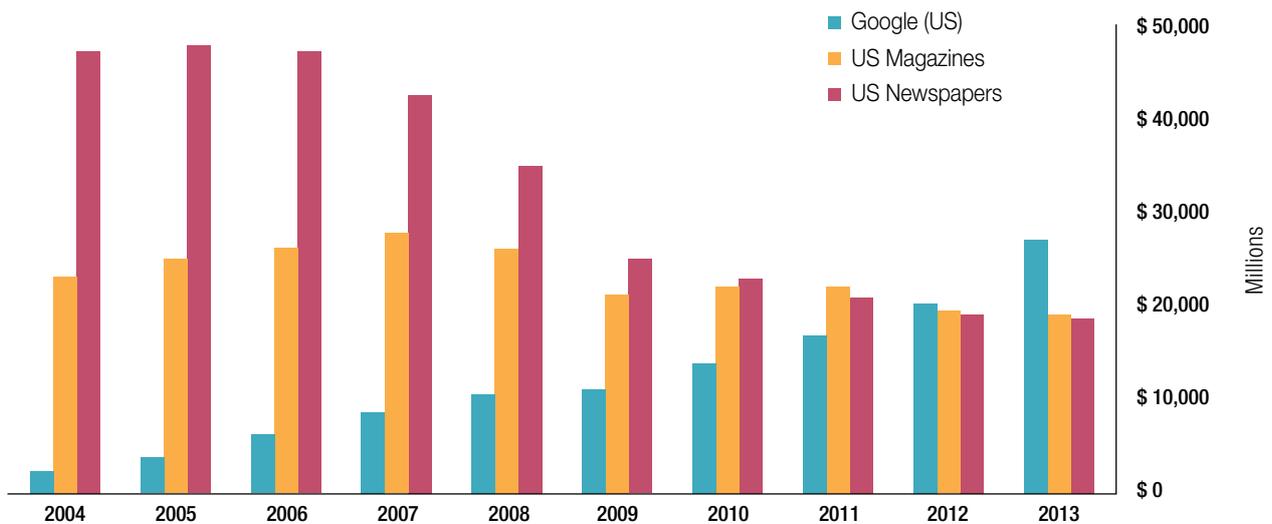
“
Google's advertising revenue now exceeds both magazines and newspapers in the US.
 ”

That is not to say incumbents are powerless. The Financial Times (FT), for instance, took its competitors head-on. Unlike its peers, who chose to depend on online advertising growth to compensate for falling print revenues, the FT decided early on to look for new ways to support its operations. It was among the first to charge users for access to its online publications, introducing a subscription model in 2001. In 2007, the FT introduced its “metered” charging model, offering registered users access to a certain number of free articles of their choice, before inviting them to purchase a subscription. The metered model has since been adopted by other newspapers and has contributed significantly to the FT's success. Since 2007, the FT's digital subscriber base has tripled¹. In 2014, its circulation reached an all-time high with 700,000 subscriptions and sales across print and online. The FT has also been able to more than double print prices in the last ten years to make print profitable in its own right².

“
Technology helped us establish a direct relationship with customers.
 ”

- Caspar de Bono,
 Financial Times

Figure 1: Google Vs Magazine Vs Newspaper Ad Revenue in the US, USD, 2004-2013



Source: Business Insider, Digital 2014

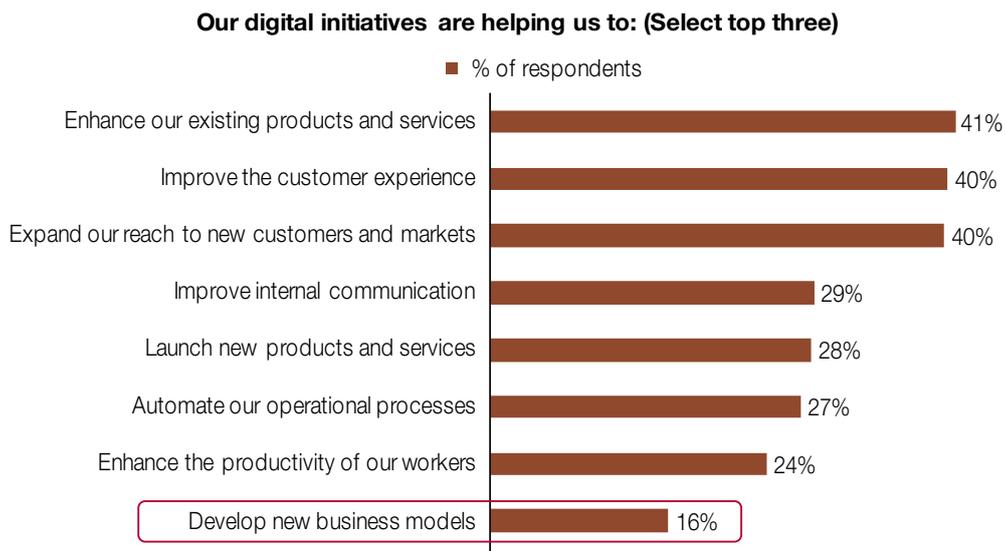
How did the FT do it? By constantly questioning and reinventing its business model. As Caspar de Bono, FT's Managing Director – B2B says, "Technology helped us establish a direct relationship with customers. This was very disruptive and the FT has significantly benefited from this disruption³."

**“
Only 16% of executives believe that their organizations are leveraging digital technologies to develop new business models.
”**

The FT, however, is a notable exception. Our research with the MIT Sloan Management Review reveals that only 16% of executives believe that their organizations are leveraging digital technologies to develop new business models (see Figure 2)⁴. Most organizations follow traditional approaches to innovation that focus on new products and services, rather than on business models. However, research suggests that the returns from traditional approaches have been diminishing with time⁵. As Serguei Netessine, Professor at INSEAD Singapore says, "Pharmaceutical companies spend as much as 30% of their revenues on R&D, trying to develop new products or technologies. But the return from this enormous expenditure has been very elusive and it is a common problem across industries⁶." Business model reinvention can be as good a route as technology, product or service innovations⁷.

**“
Business model reinvention can be as good a route as technology, product or service innovations.
”**

Figure 2: The Potential to Use Digital Technologies to Develop New Business Models Lies Unexplored



Source: Capgemini Consulting and MIT Sloan Management Review, "Embracing Digital Technology: A New Strategic Imperative," October 2013

How Can Organizations Reinvent Their Business Models Using Digital Technologies?

Reinventing an industry through business model innovation requires rethinking almost every component of the business model. This includes, among other facets, resources, processes, cost, revenue structures and customer value proposition. However, this is only one route to business model innovation. In this section, we highlight five different approaches that organizations can adopt.

Leverage Digital Technologies to Change the Dynamics of an Entire Industry

Tesla Motors, an American automaker, has gained widespread attention as it seeks to reinvent the auto industry. Tesla makes luxury electric cars and interacts with its customers and partners in a completely different way to the traditional automotive industry.

“
Tesla is taking unconventional steps to transform the automotive value chain and reinvent an entire industry.”

It adopts a direct-to-consumer model for taking sales orders online and engages customers through a small number of company-owned stores, completely bypassing car dealers. Tesla's Model S sedan allows you to exchange a depleted battery for a fully charged one in 90 seconds, using an automated robotic platform⁸. The company also has plans to launch swapping-stations capable of delivering the battery swap as part of its supercharger network⁹.

In 2014, Tesla opened up all of its patents related to electric vehicles. Tesla believes this move will stimulate innovation in the electric car industry and would allow the world to benefit from a rapidly evolving technology platform¹⁰. Tesla is clearly unafraid of taking unconventional steps to transform the automotive value chain and reinvent an entire industry.

It is not just new entrants who are going down this route. Incumbents, with existing businesses, are also using digital technologies to rewrite key elements of their business model. Take the case of GE, which is using technology to rewrite the economic model behind their products.

Today, GE is outfitting its core industrial products with sensors that monitor various parts of the machinery. Using advanced analytics, GE can provide real-time information to improve efficiency, increase productivity, and schedule more effective preventive maintenance. With this new data, GE can adapt its economic models and pricing formulas to capture some of the new value it creates for its customers. It can increase the profitability of its service contracts or change the nature of its products, such as selling hours of aircraft availability rather than jet engines and service contracts.

The value for GE of these models is tied to the number of hours its customers are able to use the product. Rather than selling an engine as a one-time event, GE is moving to an outcome-based economic model, bringing the company closer to its customers' operations¹¹.

“
GE is using technology to rewrite the economic model behind their products.”

Substitute Products and Services with Digital Alternatives

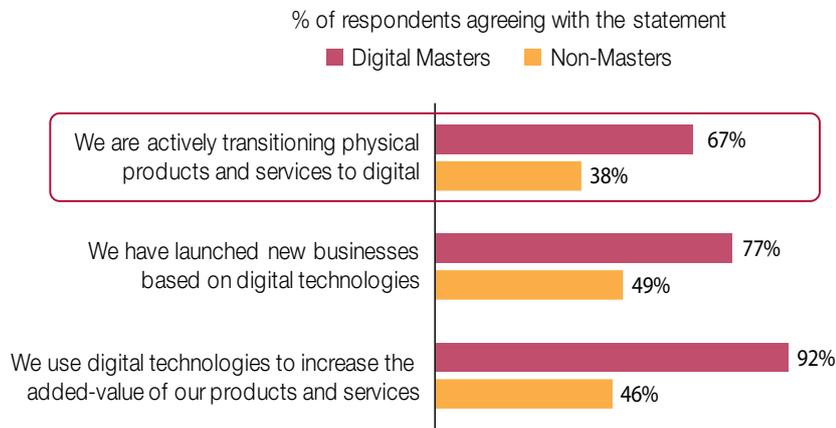
In some instances, rapidly evolving customer preferences force firms to introduce digital versions of physical products and services. Our research with the MIT Center for Digital Business highlights that 67% of digital masters are actively transitioning physical products and services to digital, in contrast to only 38% of non-masters (see Figure 3).

“
67% of digital masters are actively transitioning physical products and services to digital.”

Deutsche Post DHL, one of the world's largest mail and courier companies, faced a large-scale customer transition to digital and a drastic decline in its postal letter business. It launched an online communication platform, known as “E-Postbrief”, to provide a secure and reliable email service for a nominal fee¹². In 2011, SAP integrated E-Postbrief into its business platform, allowing corporate customers to seamlessly exchange data with their partners¹³. E-Postbrief saw a positive uptake, with the service registering one million users within months of its rollout¹⁴.

Deutsche Post DHL also launched “MyWays”. Using a mobile app, anyone can register to deliver packages with products ordered online directly to other end consumers¹⁵. It has also developed “SIMSme” (a secure messaging app), an online advertising service and “Dieredaktion.de” (a platform for journalistic content)¹⁶. Deutsche Post DHL has also ventured into newer tech-driven ways of delivery by using drones to deliver medicines¹⁷.

Figure 3: Role of Digital Technologies in Business Model Innovation



Note: Digital Masters are companies that leverage digital technologies to transform themselves completely

Source: Capgemini Consulting and MIT Center for Digital Business, "The Digital Advantage: How Digital Leaders Outperform their Peers in Every Industry", November 2012

Netflix is another example of a transition from physical to digital. By recognizing what benefits, or value, customers really derive from its products - and making that the basis of tailored offerings - Netflix has re-invented its business model several times since its inception in 1997. In its infancy, it started a pay-per-rental service that was not particularly successful¹⁸. Then, Netflix calibrated its value proposition to launch an online subscription model (called "DVD-by-Mail") allowing customers to rent unlimited DVDs that would be mailed to them for a fixed monthly fee. This strategy proved to be a game-changer. Customers preferred Netflix over its bigger competitors, such as Blockbuster, that relied heavily on physical assets.

Over the next few years, Netflix adjusted its business model by ascertaining the right price points based on customer convenience and willingness to pay¹⁹. As consumer preferences evolved and viewers started preferring laptops and smartphones over DVD players, Netflix created a new value proposition by launching its "Watch Instantly" service to allow customers to stream movies

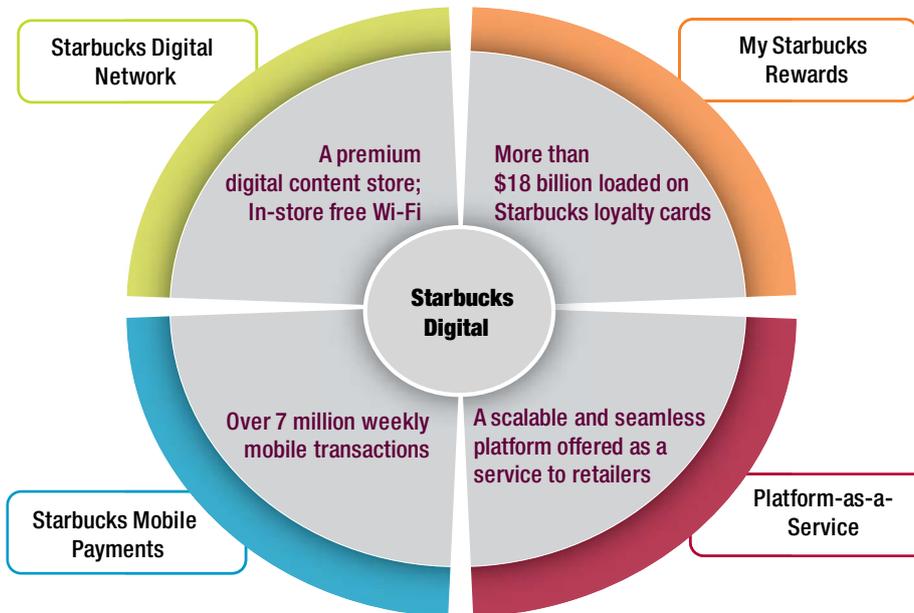
online. Netflix continued its hunt for new value propositions from its media content. It started airing an original TV series in 2013, using a unique model of releasing all episodes of a season at one go, giving viewers the flexibility to watch them anytime, anywhere, and on any device²⁰. With over 50 million members in 50 countries, Netflix continues to reinvent its business model²¹. It recently announced plans to launch its first original movie on the streaming service and IMAX theatres in August 2015²².

**“
Starbucks started
Digital Ventures as a
cross-functional unit
to bring new services
to Starbucks customers
through smartphones,
tablets, and laptops.
”**

Create New Digital Businesses

Digital masters also create new businesses by harnessing digital technologies. Starbucks, a brick-and-mortar coffee chain, started a dedicated digital unit in 2008 – "Digital Ventures". At the time, its coffee business was not doing well. Same-store sales were declining and stock price had lost half its value in less than two years. However, the shift to digital was not an obvious choice for a company whose core business had little to do with digital. Starbucks Digital Ventures started as a cross-functional unit to bring new services to Starbucks customers through smartphones, tablets, and laptops²³.

Figure 4: Digital Initiatives from Starbucks



Source: Capgemini Consulting analysis

Since then, the digital unit has successfully shored up a number of digital initiatives – free Wi-Fi in stores, “Starbucks Digital Network” (premium digital content store) as well as “My Starbucks Rewards” – a mobile payments system linked to the company’s loyalty program²⁴. These digital offerings have now become integral to Starbucks’ brand as a digital enterprise. As of March 2014, \$18 billion had been loaded onto Starbucks loyalty cards²⁵. Starbucks sees over 7 million weekly mobile transactions, accounting for 16% of all its transactions²⁶. The company has indicated it has plans to offer its mobile payments platform to other retailers as well²⁷. The platform can potentially become a significant revenue opportunity for Starbucks as it is scalable and seamlessly integrates with a loyalty program, making it attractive for merchants (see Figure 4). The company has also been active on social media. It has over 38 million likes on Facebook and over 7 million followers on Twitter²⁸.

Rethink the Value Proposition

Digital masters excel at enhancing value from existing products and services using digital technologies.

Entravision Communications is a Spanish-language media company with significant reach in the US Latino audience, a market that collectively has over a trillion dollars in purchasing power. The company, started in 1996, operates more than a hundred radio and television stations and digital platforms. The company was unique in its ability to offer highly localized marketing in different geographies.

“Digital masters excel at enhancing value from existing products and services using digital technologies.”

“Netflix has successfully reinvented its business model several times since its inception.”

As Entravision processed a growing amount of both internal data and data from licensing agreements with partners, executives began to see the potential value of mastering this new currency. Using advanced analytics, the company started to obtain fine-grained behavioral insights, which were highly sought after by companies selling products and services to the Latino population. The demand for deep insights into Latino markets began to grow beyond traditional media buyers, moving Entravision’s client conversations into analytics and predictive modeling. Thus, in 2012, “Luminar” was born.

“
Volvo used digital technologies to evolve to a B2B2C model.
”

Luminar is a dedicated business unit that shifted from delivering internal analytics to offering Big Data as a service to external clients. The company has since gained clients such as Nestlé, General Mills, and Target, among others. In 2013, the business expanded further by launching the “Luminar Audience Platform” for buying targeted online audiences. The company now collects and analyzes data for fifteen million US Latino adults, representing around 70% of the US Latino adult population's transactions in brick-and-mortar, online, and catalog. The company that traditionally saw itself as a broadcasting group now sees itself as an integrated media and information technology company serving the Latino market²⁹.

Similarly, tire manufacturer Michelin has moved away from just selling tires to providing the mobility and safety of tires as a service. The company installs telematic sensors within its customers' vehicles and a team of data scientists analyzes the performance of the driver and the vehicle, to constantly provide real-time advice on cutting fuel consumption³⁰.

Re-Design Value Chain Linkages

A key component of every business is how the entire value chain of suppliers, distributors, marketers and service experts connects to deliver products and services to customers. This group forms a delivery network where each element serves to add value over the previous one, before the end-product finally reaches the customer. Many companies want to have tighter linkage with their customers, without antagonizing the third-party distribution model that they have carefully built and nurtured over decades. This challenge is evident in industries that are largely B2B. Take the case of the automotive industry. Most automakers are B2B companies that produce cars and sell to dealers. Dealers own the customer relationship and automotive companies, more often than not, have little direct connect with the customer.

“
Entravision, a media company, created a dedicated analytics business based on its internal expertise of analytics and data processing.
”

Swedish car corporation Volvo decided to do something about this traditional model. In 2012, the company relied on a network of 2,300 dealers in 100 countries worldwide to sell its products. Volvo was trying to tackle the question of how it can develop a more direct relationship with end customers without disrupting its dealers' relationships. Its answer was a transformation of the company's business model from B2B to B2B2C, where Volvo would provide some services directly to the end consumer. The services reinforced the attraction of Volvo cars, thereby benefiting dealers. To evolve to this new B2B2C model, the company relied heavily on digital technologies — mobility, social media, analytics, and smart embedded devices. The company used social platforms such as Facebook, Twitter and YouTube to dramatically increase their engagement and create a two-way conversation. Simultaneously, Volvo started developing its own version of the connected car. It introduced a push-to-talk service that is connected to a call center that can help provide breakdown services. By doing so, Volvo enabled the creation of a direct-to-consumer service that bypasses dealers, without antagonizing them. Running a call center is an expensive task for a dealer and they were glad to have Volvo step in, while at the same time, a call center helps significantly in cross/ up-selling cars. Volvo is using information gained through this channel by redirecting it back to its dealers. Volvo now has integrated existing data from dealers with a constant feed of information from the car itself. It is a win-win business model enabled by digital technology³¹.

Devising a Successful Business Model Reinvention Approach

Many companies typically stick to the same strategy playbook that has served them for years. However, successful business models are only transient. Incumbents need to constantly revisit their business model to ensure it is not outdated. There are five practical steps that companies can follow to rethink their business model.

Assess Current Business Model

Enterprises should begin with a thorough understanding of their current business model. Senior leaders should ask themselves some key questions. Which one of our customer's problem are we helping to solve? Are we delivering what our customers want? What type of relationship does each of our customer segments expect us to establish and maintain with them? Through which channels do our customer segments want to be reached? What data do we possess/can access that no one else can? There are some practical frameworks, such as the business model canvas developed by Alexander Osterwalder and Yves Pigneur³², that senior executives can use to assess their business model.

“Emergence of new competition from unexpected places is a sign that organizations need to start looking at their business model.”

“Constant reinvention of the business model holds the key to continued relevance in the digital world order.”

Spot Potential Disruptions

Organizations should constantly monitor signs that might indicate potential threats or opportunities. Are we experiencing a gradual decline in traditional revenue streams or margin erosion due to commoditization? Are new competitors emerging from unexpected places or adjacent industries? Are cheaper digital substitutes for the organization's products or services making inroads in our market? Are traditional barriers to entry coming down in the industry?

Define Nature of Response

Organizations can choose to operate defensively or offensively. When in defensive mode, companies often use data and any other advantage they can muster to slow the decline of the old model. In addition, aggressive operational cost cutting can release cash and investment capacity to support the transition.

Organizations can also choose to go aggressive and be a first mover in rethinking the business model of their industry. They can try to disrupt competitors, or other industries, by substituting a traditional product or service with a new digital offering. Or use any of the other approaches we have outlined in the earlier part of the paper to innovate their business model.

Focus on the Value Delivery

Each approach to business model innovation will open up several possible avenues. Organizations will need to prioritize options that generate the greatest value to customers, that are operationally hard to copy, and that can provide them with a profitable economic model. Organizations will also have to lower their risk by running controlled experiments on their new model.

Implement from the Top

Designing, experimenting, and implementing new business models is a task for senior business leaders. It is a strategic activity. Functional heads will not have sufficient authority to drive new business model experimentation across business silos. The implementation of a new model requires vision, leadership, and governance. If the new model is ultimately designed to replace the old, organizations need to know when to shift resources and at what rate. The transition will not happen overnight. If the old and the new are designed to coexist, they will need to carefully manage potential conflicts and resource allocation between the two. Business model innovation needs to become a core capability for organizations, with knowledge, best practice, and the right talent. Incumbents need to be the agents of their own destiny – shifting their business models to secure their continued relevance in a new digital world order .

“Organizations need to use a continuous evaluation approach in order to devise a successful business model reinvention.”

References

- 1 The New York Times, "With a Focus on Its Future, Financial Times Turns 125", February 2013
- 2 Capgemini Consulting Digital Transformation Review 7, "Strategies for the Age of Digital Disruption", February 2014
- 3 Capgemini Consulting Digital Transformation Review 7, "Strategies for the Age of Digital Disruption", February 2014
- 4 Michael Fitzgerald, Nina Kruschwitz, Didier Bonnet, and Michael Welch, "Embracing Digital Technology: A New Strategic Imperative", MIT Sloan Management Review, October 2013
- 5 Reuters, "Drug industry treading water on R&D productivity", December 2012; Applied Economics, "Diminishing marginal returns from R&D investment: evidence from manufacturing firms", Volume 45, Issue 5, 2013
- 6 Capgemini Consulting Digital Transformation Review 7, "Strategies for the Age of Digital Disruption", February 2014
- 7 Harvard Business Review, "When Business Models Trump Technology", November 2012
- 8 Company website
- 9 TechCrunch, "Tesla Shows Off a 90-Second Battery Swap System, Wants It At Supercharging Stations by Year's End", June 2013
- 10 Company website
- 11 HBR, "The Best Digital Business Models Put Evolution Before Revolution", January 2015
- 12 Company website
- 13 Company website
- 14 The Wall Street Journal, "Making Email Pay Its Own Way", November 2010
- 15 Company website
- 16 Company annual report
- 17 The Wall Street Journal, "Deutsche Post DHL to Deliver Medicine via Drone", September 2014; Company website
- 18 Businessmodelcommunity.com, "Business Models, Business Strategy and Innovation", 2009
- 19 Ibid.
- 20 Company website
- 21 Company website
- 22 theweek.com, "Netflix's first original movie is coming in 2015", September 2014
- 23 InformationWeek, "Starbucks' Stephen Gillett: InformationWeek's IT Chief of the Year", December 2011
- 24 Forbes.com, "What Best Buy Will Gain from Starbucks' Loss", March 2012
- 25 Company website
- 26 Wired, "Forget Apple Pay. The Master of Mobile Payments Is Starbucks", November 2014
- 27 Geekwire, "Starbucks CEO throws down gauntlet on mobile payments, says coffee company will have 'major role to play'", October 2014
- 28 As of March 2015
- 29 HBR, "The Best Digital Business Models Put Evolution Before Revolution", January 2015
- 30 Information Age, "Pay-as-you-go ERP underpins Michelin's services strategy", July 2013
- 31 "Leading Digital: Turning Technology into Business Transformation", George Westerman, Didier Bonnet & Andrew McAfee, Harvard Business Review Press, October 2014
- 32 Alexander Osterwalder and Yves Pigneur, "Business Model Generation: A Handbook for Visionaries, Game Changers and Challengers", 2010

Authors

Didier Bonnet

Senior Vice President
didier.bonnet@capgemini.com

Jerome Buvat

Head of Digital Transformation
Research Institute
jerome.buvat@capgemini.com

Subrahmanyam KVJ

Manager, Digital Transformation
Research Institute
subrahmanyam.kvj@capgemini.com

Digital Transformation Research Institute

dtri.in@capgemini.com

Digital
Transformation
Research Institute

The authors would like to thank **Amol Khadikar** from **Digital Transformation Research Institute**.

For more information contact

France

Stephane Regnier
stephane.regnier@capgemini.com

Norway

Anders Rygh
anders.rygh@capgemini.com

United States

Chris Miller
christoper.miller@capgemini.com

Germany

Thomas Friedrich
thomas.friedrich@capgemini.com

Sweden/ Finland

Ulf Holmgren
ulf.holmgren@capgemini.com

Netherlands

Mark Burger
mark.burger@capgemini.com

United Kingdom

Didier Bonnet
didier.bonnet@capgemini.com



Capgemini Consulting is the global strategy and transformation consulting organization of the Capgemini Group, specializing in advising and supporting enterprises in significant transformation, from innovative strategy to execution and with an unstinting focus on results. With the new digital economy creating significant disruptions and opportunities, our global team of over 3,600 talented individuals work with leading companies and governments to master Digital Transformation, drawing on our understanding of the digital economy and our leadership in business transformation and organizational change.

Find out more at: www.capgemini-consulting.com

Rightshore® is a trademark belonging to Capgemini



About Capgemini and the Collaborative Business Experience

With almost 145,000 people in over 40 countries, Capgemini is one of the world's foremost providers of consulting, technology and outsourcing services. The Group reported 2014 global revenues of EUR 10.573 billion. Together with its clients, Capgemini creates and delivers business and technology solutions that fit their needs and drive the results they want. A deeply multicultural organization, Capgemini has developed its own way of working, the Collaborative Business Experience™, and draws on Rightshore®, its worldwide delivery model.

Learn more about us at www.capgemini.com.