BUSINESS MODEL, DISRUPTED: INNOVATIVE BUSINESS MODELS FOR THE DIGITAL ERA

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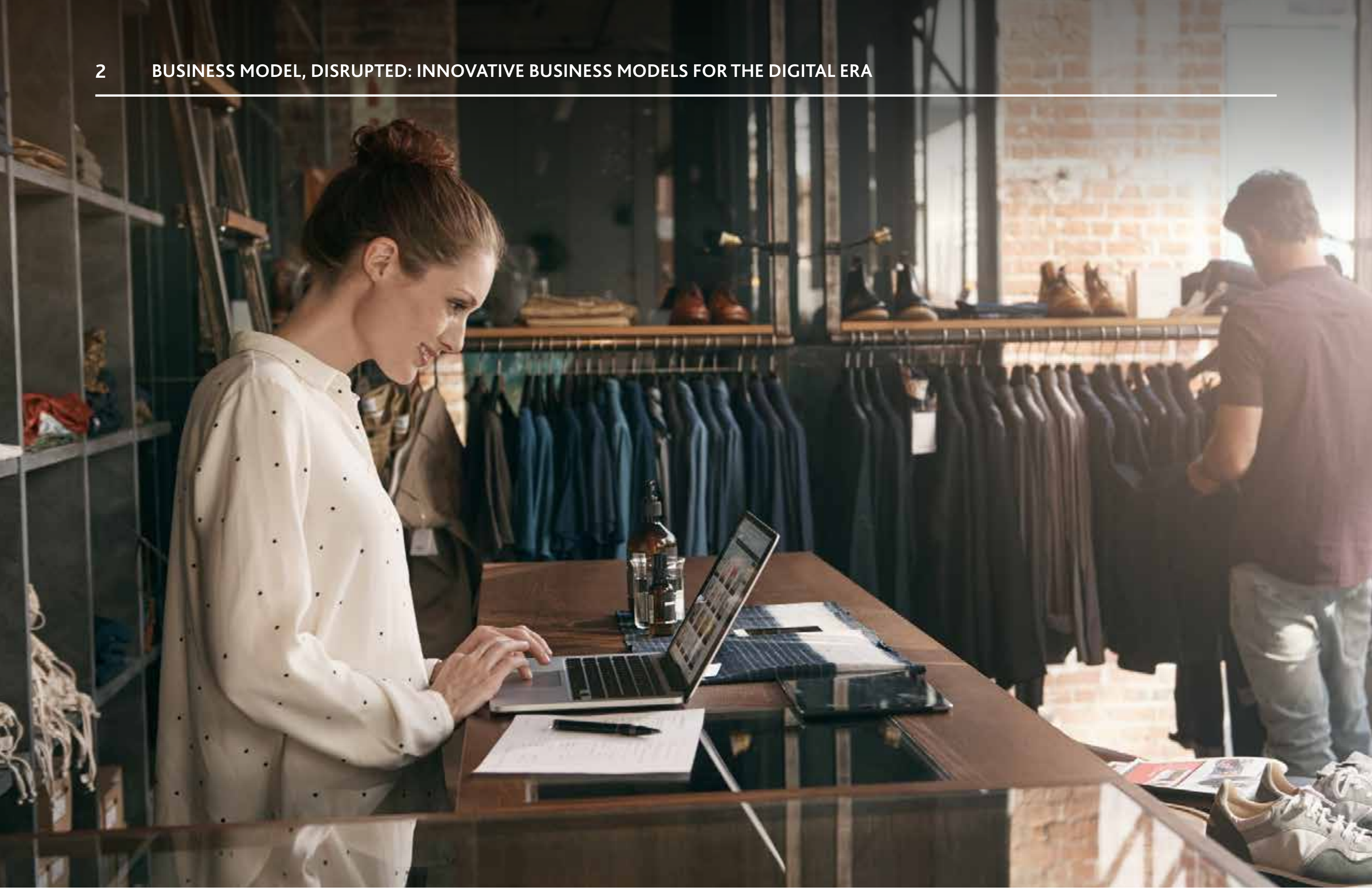


Looking toward the digital economy of the future—one dominated by services and ideas rather than goods—the greatest opportunity for value creation may come from business model innovation, either through diversification or total business reinvention, in a way that fundamentally changes outputs, outcomes and stakeholder relationships. Digital disruption is the catalyst—and digital technology the enabler—but business model transformation is the ultimate goal.

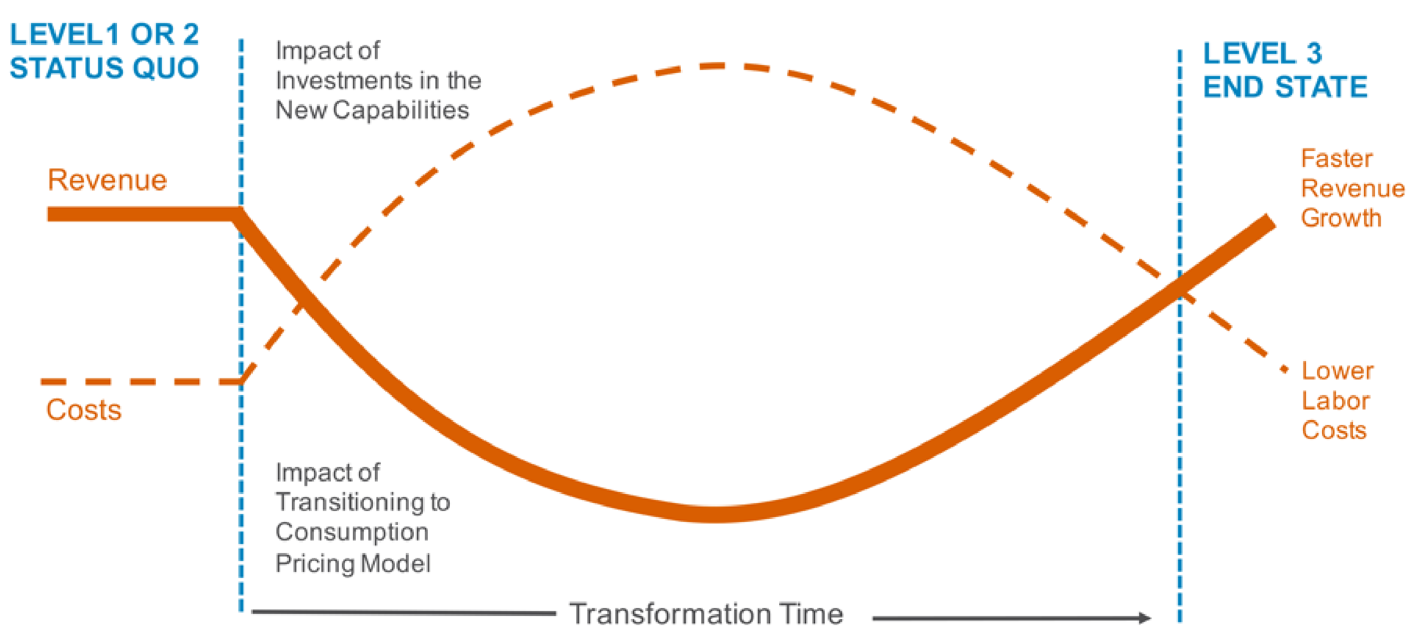
SUBSCRIPTION SERVICES

The subscription model popularized by software-as-a-service (SaaS) companies is gaining traction well beyond Silicon Valley. The subscription box economy is booming: as of May 2018, there are 3,500 subscription box options for consumers to choose from, indicating the entrenchment of new buying behavior.

The appeal of the subscription model, where customers pay a recurring fee for continued access to a product or service, isn't hard to grasp. Recurring revenue offers more stability and predictability, and also fosters stronger relationships with customers through more frequent engagement. It's also not an either/or—you can continue to sell your product in one-time transactions and create a new revenue stream via a subscription service. Per the "Fish Model," a total transition to a subscription-based service model will, short-term, result in higher costs and lower revenue, but the trend reverses once the transition to the new model is complete.

To avoid a shock to the system, many organizations transitioning to a SaaS subscription model take a gradual, cautious approach. Microsoft, for example, launched its Office 365 cloud product in 2011, but continued to offer its traditional on-premise solutions. The impact was far less jarring: Revenues have increased every year through their Q4 2019 earnings report, with the exception of their 2016 fiscal year (though even in this one "off" year, net income actually increased). Easing into the transition—while maintaining traditional revenue streams—is the best route for most middle market organizations.

THE FISH MODEL



Source: Technology-as-a Service Playbook 2016 (TSIA)

PAY-PER-USE

Pay-per-use models sell capacity as an alternative or supplement to subscription-based access to a product or service. It's a variable cost structure tailored to individual need: Customers are charged based on usage or consumption levels. Access to a product or service can be provided on an on-demand basis (like a Zipcar) or capacity can be scaled up or scaled down (like data storage or computing power). Billing is contingent on the ability to meter use.

A standard revenue model in the utilities and telecom industries, pay-per-use is hardly new. Rolls-Royce's "Power-by-the-Hour" pay-per-flying-hour service offering is over 50 years old. What has changed is the potential universe of what can be delivered on an on-demand or flexible consumption basis in conjunction with the advent of cloud delivery models. The elasticity of cloud infrastructure enables businesses—like Amazon Web Services' pay-as-you-go revenue model—to sell products with add-on services or premium features that can be turned on or turned off, and paid for accordingly.

The universe of what can be metered as a basis for billing has also changed, thanks to data analytics and the Internet of Things. Any internet-connected device can now be metered based on the data collected. For example, some car insurance organizations now offer flexible "pay-per-mile" coverage options through telematics-based programs.

The value proposition to the customer is clear: greater flexibility, lower upfront investment, and faster access. For the business, the affordability of a pay-per-use model can help it expand to new customer segments, address downward pricing pressure from commoditization, or provide a supplemental revenue stream in existing markets. The downside is revenue unpredictability and lower profit margins.

PRODUCT-AS-A-SERVICE

The rise of the sharing economy—collaborative consumption in which customers pay for access to a shared asset—has called into question both the very definition and the appeal of traditional ownership. Ridesharing services, for example, are already impacting consumer interest in purchasing personal vehicles. Every business wants a piece of the pie: By 2022, revenues for the global sharing economy are expected to reach $40.2 billion, according to Juniper Research.

Taking a page from the sharing economy, "product-as-a-service" reimagines value in terms of the benefits of a product rather than the product itself. In its purest form, the service replaces the product: instead of purchasing a car, the customer pays for the ride. More frequently, manufacturers dip their toes into the water by offering value-added services on top of their traditional products. Physical products become a platform for service delivery, vastly expanding the aftermarket opportunity to a whole new realm of digital services.

Arguably the most exciting product-as-a-service innovations are those that serve as a vehicle for novel service delivery. Think of the Peloton stationary bike – customers don't just buy the bike (a one-time upfront expense), they buy the monthly subscription to live-streamed and on-demand classes

Services can be sold using a subscription-based revenue model or a pay-per-use model, or both. A manufacturer might offer supplemental remote diagnostic and maintenance services where customers pay based on how frequently the equipment is used, or instead allow customers to lease equipment on a subscription basis.

SERVICE-AS-A-PRODUCT

On the flip side of the coin, traditional professional services providers are starting to productize their service offerings, building tools that automate once-manual service delivery. "Product" does not mean physical. Productized services include application programming interfaces, dashboards, or fully fleshed-out SaaS offerings. Candidates for productization are low-margin, high-volume services with systemized (or systemizable) processes. These are services that are commoditized or at risk of being commoditized. The productized service can stay internal or be spun off into its own self-service product, or both.

Productizing the service offers a way to slash prices, scale up delivery, and free up resources to focus on higher value, more profitable work—but only if appropriately monetized. If, for example, a law firm introduces an automated tool that drastically reduces project time, continuing to bill by the hour will significantly reduce profits.

Technology organizations and startups may focus on converting services into SaaS products as an alternative, more cost-effective option for customers—a disruptive business model intent on displacing industry stalwarts in existing markets. For the traditional players in the space, productized services should ideally augment existing services rather than replace them.

DATA-AS-A-SERVICE

Inspired by the SaaS delivery model, data-as-a-service reimagines information as an asset that can be shared via the cloud. What distinguishes DaaS from SaaS is that the data can be decoupled from a specific platform, though it doesn't have to be. The value to the customer is in aggregating and distilling large data sets into meaningful information that can be published using an API. Additional data services, such as predictive modeling or custom reports, can also be sold to the customer. Organizations can go a step farther, providing customers with a self-service portal to access real-time data and analytics via the cloud.

For customers to bite, the data, or at minimum, the aggregation and analysis, needs to a) be relatively hard to access, and b) address a relevant customer need. Information can be internal, external or a combination of the two. HR SaaS provider Workday got into the DaaS game in late 2017 by leveraging private client data in aggregate, providing a competitive benchmarking service while preserving customer anonymity. Google Maps illustrates a combined approach: It collects third-party data from various credible sources through its Base Map Partner Program to construct its digital map. It then supplements that data with its own proprietary imagery captured by cars patrolling and photographing various streets and neighborhoods. The imagery is synced up with locations by combining signals from sensors on the patrolling cars that measure GPS, speed and direction.

DIGITAL PLATFORMS

"Platformication" is the creation of business ecosystems that exponentially increase value through the network effect; the more participants, the greater the effect. Platform ecosystems reposition businesses as connectors—between customers, partners, vendors, or even competitors—facilitating new ways of collaborating and co-creating value and reducing transactional costs. Examples include development platforms like the Apple Appstore, cloud platforms like Microsoft Azure or Salesforce, asset sharing platforms like Zipcar or Citi Bike, social platforms like Facebook or Twitter, or marketplaces like eBay or AirBnB. Midsized organizations can benefit both from creating a new digital platform or participating in an existing one, leveraging the network effect to provide resources and capabilities beyond their size.

Capturing economic value from a digital platform can happen in several ways: as a data aggregator and source of customer intelligence; as an enabler of more meaningful customer interactions; or as more extensive offering through strategic alliances and complementary solutions.

Once you have that captive audience, there are other ways to monetize it: AirBnB, for example, charges a commission for bookings made through the platform, while others charge membership fees or offer "premium access" for additional cost.

For markets in the midst of or at risk of disruption, digital optimization may not be enough to ride out the storm. Nearly half of organizations report their business model is changing or has already changed, according to a recent survey from analyst firm Gartner. That percentage will only creep higher as digital technology becomes increasingly intrinsic to the way business is conducted.

Business model change has never been easy. And in today's fast-paced digital environment, organizations don't have the luxury of time to decide on the right course of action. To remain relevant in the still-nascent digital economy, businesses need to challenge commonly held assumptions, assess shifting market dynamics and harness the power of foresight to take bold but necessary risks.

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