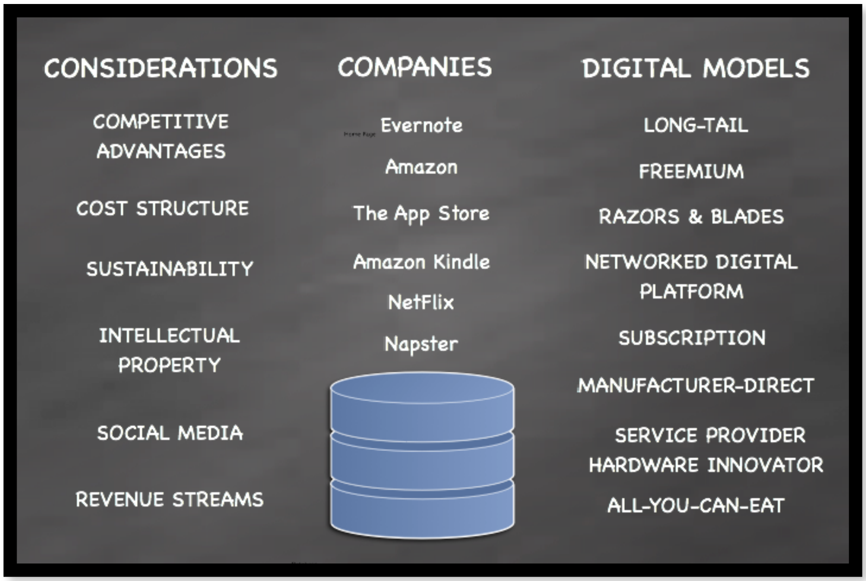

Digital Business Models in Action

BY GREGORY PETERSON

In startups and corporate boardrooms across the country, a leading agenda item today is business model innovation — a capability that FORTUNE Magazine has called “the new essential competency.” And with web assets, social media, and mobile technologies playing increasingly crucial roles, it’s the digital business models that matter most of all.

Unlike the traditional business models of a pre-digital era, today’s strategies are fluid, adaptive, and undergoing rapid change. No longer the hidebound product of a few managers in a corporate hierarchy, innovations are fueled by intensive collaboration in hyper-connected environments. In these hotbeds of experimentation, the ideas of many creative individuals are being continually shared, tested, revised, tweaked, measured, and baked into digital business model experiments.

Here are brief snapshots of several representative digital business models — and examples of successful companies that employ them to varying degrees.

Digital Business Model Elements

Business analysts and scholars offer numerous spins on what constitutes a business model, but the *Harvard Business Review* offers this straightforward definition: "A business model describes how an enterprise proposes to make money."

How are digital models different from traditional business models? Essentially, digital business models employ websites, social media, and mobile communications assets to engage customers, create value, and compete successfully.

There are three areas considered critical to success: Content, Customer Experience, and Platform as outlined in "Optimizing Your Digital Business Model" (*MIT Sloan Management Review* | Spring, 2013 — Subscription Req.). These three areas are part of the MIT professors Peter Weill and Stephanie Woerner's framework for digital business model success, which provides a useful lens for anyone for anyone seeking to make sense of the wide variety of digital models today.

The Growing Interest In Digital Business Models

Why should companies experiment with digital business models?

Because they have to: Customers increasingly expect (and demand) the ability to engage with brands whenever they choose — and through the channels they prefer.

Because a better digital business model means better financial performance:

In the MIT Sloan survey mentioned above, researchers found that "organizations that were in the top third in terms of digital customer experience had 8.5 percent higher net margins and 7.8 percent higher revenue growth than their industry competitors."

Because their competitors are engaged in digital innovation: For companies in highly competitive markets, a culture of "always on" innovation has become the norm — the way business is conducted as a matter of course.

Because digital strategy is transparent: When it comes to online customer experience, companies have no place to hide. So any branding flaws or website errors are immediately apparent to stakeholders — who can (and do) conduct side-by-side comparisons with the digital presence of competitors.

Because lower barriers to entry make experimentation easier: In the bricks-and-mortar world, significant changes come at a high cost — typically requiring major investments of time, capital, and human resources. Granted, a digital makeover (new websites, re-branding, IT infrastructure upgrades, etc.) also can require significant investments. However, many such innovations are implemented (and evaluated) over shorter time frames — and with "switching costs" that are a fraction of the expense required for changes involving physical assets.

If one looks for a poster child company that is an industry leader in all three of the Weill/Woerner elements, the name Amazon.com comes up time and time again. Even if the MIT authors are correct in their assessment that market success doesn't yet require excellence in *all three* areas, other analysts suggest that these capabilities — showcased so effectively by Amazon — are quickly becoming table stakes for every serious player in the game of digital business.

Digital Business Model Examples

Listed below are samples and brief descriptions of several successful digital business models. (Note that the free model, pursued by many startups as a way to generate advertising revenue or gather user analytic, is omitted.)

Let's begin with a few additional comments about Amazon:

RETAILER | SERVICE PROVIDER |HARDWARE INNOVATOR (Example: Amazon.com)

"We can't count how many business models Amazon has used in its 18 years of existence. The model is changing continually," said *FORTUNE* Magazine editor Geoff Colvin in "Your Business Model Is Obsolete." He also declared Amazon.com "the new normal" after tracing Amazon's 18-year progression (from bookseller to online retailer to Kindle creator to web storage provider, etc., etc.).

Another Amazon assessment? "The key lesson to be learned from Amazon is that to thrive in the digital era, it's often better to execute your business model well than to invent new business models from scratch," says Eric Noren (of the *Digital Business Model Guru* site). His assessment emphasizes how well Amazon has leveraged internet technologies to execute on traditional business strategies.

SUBSCRIPTION (Example: Netflix)

In both old-school and online subscription models, customers are charged a recurring fee for convenient, ongoing access to a service. However, digital subscriptions typically include a user agreement that includes an "automatic renewal" provision — reducing the costs of maintaining a subscriber base. (Note: These auto-renew clauses sometimes come at the cost of disgruntled — and often vocal — customers.)

Unlike "physical world" subscription models (requiring physical distribution of a product or service), digital subscriptions are eminently scalable. Once a company has set up an IT infrastructure, its distribution costs are relatively insignificant. The bigger challenges come in creating differentiated products and services that provide an experience which attracts (and keeps) a profitable base of customers.

MANUFACTURER-DIRECT (Example: Dell)

Manufacturers today can leverage information technology resources to create direct relationships with their customers. Back in the 20th century, the dominant model for product sales was a hub-and-spokes arrangement. In that now-receding paradigm, a company's distributors and retailers largely insulated it from the costs (and opportunities) of direct relationships with consumers.

A company-in-transition often needs a diplomatic touch to manage relationships with the distribution chain links that are being downgraded — or phased out of the sales equation entirely. The switch to direct sales is rarely an overnight affair. Newly-launched manufacturers are increasingly likely to skip over the middleman phase altogether.

LONG-TAIL (Examples: Netflix, Amazon.com)

This model leverages IT resources to move niche products to niche buyers, as first expounded in Chris Anderson's 2006 book, "*The Long Tail*". Big players (like Amazon) have enjoyed a long ride on this digital wave. Maintaining relationships with all these tiny niches does require a lot of resources, however — and some analysts predict a market shift (heads, not tails) in the years ahead.

FREEMIUM (Example: Evernote)

Freemium models offer consumers free, entry-level access to a service — betting that a substantial portion of these users will discover value that prompts their desire for the expanded services available to subscribers. Evernote (the popular information-management site) also has partnered with third parties, whose innovative add-ons make a premium subscription increasingly attractive.

RAZORS AND BLADES (Example: Amazon Kindle)

How it works: Amazon sells the Kindle at below-market-value, then reaps a handsome profit when we load the device with media. The name of this model may conjure up 20th-century images of your father (or grandfather) opening paper packets of Gillette razor blades for insertion into their Gillette razor. The same strategy is alive-and-well in the digital age — most notably in the Kindle.

NETWORKED DIGITAL PLATFORM (Example: The App Store)

In this model, a business develops an "online ecosystem" — monetizing a network of developers, consumers, devices, and applications. For Apple, this model also provides a gated community — which facilitates rampant innovation from developers, but allows Apple to exercise quality control over the products that are allowed access.

ALL-YOU-CAN-EAT (Example: Napster)

As with lunch buffets in the bricks-and-mortar world, All-You-Can-Eat services in the digital world provide customers with a measure of risk reduction — an enjoyment of services (gaming or movies, for example) with no worry of being charged for additional use. For subscription businesses that adopt this model, a key challenge is to continually refresh the content resources that provide a compelling experience for subscribers with big appetites.

Looking Forward

Needless to say, digital business model transitions are not without risks. Nor are they inexpensive, painless or permanent fixes. Nevertheless, forward-thinking companies increasingly are accepting these risks and costs as unavoidable investments — and are engaging the lion's share of available resources to compete successfully in "the new normal" of digital business model innovation.

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