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It is not the strongest of the species that survives, nor the most intelligent that survives. It is the one that is most adaptable to change.

Charles Darwin

THE DIGITAL ECONOMY IS REAL AND IT’S HERE TO STAY

Nearly 90% of the Fortune 500 companies have disappeared, merged, or contracted in the last 60 years. During the same period, the average life span of companies has gone down from 61 years to 18 years.\(^1\)

Digital transformation started two decades ago with the fast adoption of Internet 1.0 (World Wide Web, wireless, e-commerce, social). This completely transformed how we communicate, live, and work. It also had a massive impact on many industries.

The next 10 years are going to be even more disruptive with the advent of Internet 2.0, where everything is connected (Internet of Things, connected homes, connected cars), value is exchanged in new ways (blockchain) and software runs the world (artificial intelligence, augmented reality). All of these technologies will find new applications that dramatically transform every industry in every region. At the current market disruption rate, 75% of S&P 500 companies from 2012 will be replaced by 2027.\(^2\)

Internet 2.0 will drive massive opportunities and threats for every company. It’s not just about productivity or business process optimization; it will impact the very essence of the business – the business model.

It is paramount in today’s reality that every CEO and management team are well versed in digital technologies and have clear plans to reimagine their business models to meet the challenges of the new reality.

In this article, we present a simple framework on the art of the possible in business model innovation. We will discuss the six most successful and proven digital business models that companies can evaluate as part of their digital strategy.
The 2016 World Economic Forum in Davos was a pivotal event for the entire business community. The official theme of the meeting was “mastering the fourth industrial revolution.” The aim was to understand the impact of new technologies that are blurring the boundaries between people, the Internet, and the physical world. Digitally transformative technologies are already a reality, and they are constantly improving. The key now is to find disruptive business applications that can transform industries and value chains.
HURRICANE
Industries that are primarily consumer driven, such as banking, retail, telecom, media, and entertainment, are already in the eye of the storm. As more and more consumers search, shop, and socialize online, having an Omni-channel presence is becoming critical for survival. That alone is a stretch for most companies with archaic business processes and technology infrastructure. Now most of these companies have to go a step further as more agile and more disruptive digital natives enter their industry (Amazon, Apple, Alphabet, Alibaba).

TROPICAL STORM
The Internet of Things and hyper-connectivity are transforming the most conservative industries (manufacturing and services). When everything is becoming connected (cars, homes, farms, patients, logistics), business as usual is thing of the past. The plummeting cost of sensors and computing power and smarter algorithms are accelerating the transformation of many industries.

TROPICAL DEPRESSION
While there are pockets of innovation in asset-intensive industries, such as oil and gas, chemicals, and mills and mining, they have some catch up to do in embracing digital transformation. Nevertheless, the Internet of Things will also impact these industries in a significant way. Increasing plant and equipment uptime through predictive capabilities and improving return on assets will be their primary focus in the first phase. Significant productivity gains will reshape these industries, resulting in a major restructuring of the existing landscape.

In the digital age, every industry will eventually be in the eye of the storm. It is not a question of if, but a question of when.

Over the last 2 decades, most digitized industries (media, high-tech, banking, etc.) of the US economy have grown average profit margins two to three times as much as those in less digitized sectors.4
NEW BUSINESS MODELS DRIVEN BY DIGITAL TECHNOLOGY

Global trends have surfaced that are necessitating changes in the way that companies operate their business. Hyper personalized products are becoming the new normal, instant gratification is expected, companies and individuals are operating 24x7, artificial intelligence and machine to machine communication are becoming widely adopted. These and other trends are driving companies to rethink not only what they do, but how they do it and who it is done for.

Reimagining business models was once something only for innovative start-ups and Silicon Valley entrepreneurs. Today however, the largest global corporations must learn to do this, or face the risk of becoming quickly disrupted or displaced.

We believe all CEOs, boards, and their management teams have a duty to reimagine their business model and identify ways to adjust or diversify their revenue streams and start their digital transformation journey.

Our research shows that more and more companies are embarking on the first step of the digital journey by defining a compelling and realistic digital strategy.

To help demystify digital strategy, we studied the most prevalent and effective approaches used by digital leaders, and we came to the conclusion that six innovative digital business models are really making a difference.

A Business Model is defined by the following characteristics:

- Value proposition and how it is delivered to the target customers
- Innovative ways to make money and maximize shareholder value
- Core competencies and assets needed to create competitive advantage
- Strategic suppliers and partnerships critical to a successful business
- External market forces and regulations that could impact the business
Business model innovation is a CEO and Board driven mandate. The organization then needs to align with this new vision and strategy to drive a successful transformation. There are two compelling reasons for companies to evaluate new business models:

- **Grow Revenue**: Business leaders engage their customers and monetize their assets and brand in innovative ways for revenue growth. However, they are now moving from omni-channel strategy to omni-business models. Instead of just selling products and services, they are now selling outcomes. The emergence of a shared economy opens up new avenues for value creation. The new digital business models are data driven, powered by digital technologies, and enabled by strategic partnerships and acquisitions.

- **Stave off Threat**: New digital entrants are already posing serious threats to consumer oriented industries such as banking, insurance, retail, and telecommunications. The incumbents have no choice but to adopt to the new digital reality or they will struggle to survive. The time is of the essence and they need to adjust or innovate their business model before it is too late.

The six new business models shown below are becoming a reality in the digital economy. These models are not exclusive and more than one can be used simultaneously to drive a successful digital transformation. More often than not, they are used side by side to the existing business models and usually require very different skillset and capabilities.

The following pages describe the six business models, the industries that are most impacted, and how innovative companies are adopting these models to exploit the opportunities that have been presented to them by the digital economy.
Outcome Based Models

Move beyond selling products and services to delivering on measurable business outcomes. The customer pays for business outcome or impact.

Key Figures

Forecasted savings of $1 trillion over the next decade on successful rollout of an outcome based payment model in U.S. government healthcare spending. The number of consumer subscribers to usage-based insurance is expected to grow to 142 million globally by 2023, from the current 12 million.

The World Bank has highlighted outcome based contracting as a key area of focus for enhancing procurement efficiency.
In order to change market dynamics, companies are piloting new ways to deliver value to their customers, grow their share of wallet, and gain access to new customers. One of the most innovative ways to achieve this goal is to reengineer products and services for a final measurable outcome.

- Insurance companies are implementing new approaches to insure customers for specific needs (for example, ski trips, car usage) instead of using general insurance contracts
- Industrial companies are charging for the measured outcome (tonnage of minerals produced, megawatts produced, compressed air consumed, flown airplane hours)
- Software companies are packaging the total stack (hardware, data centers, software, support) into an end-to-end cloud solution that can be deployed in a matter of days and offer great pricing and consumption flexibility
- Construction companies are designing, building, and maintaining large commercial infrastructure (roads, commercial and office space, museums, hospitals, stadiums) and charging for use only

Very often, this business model is additive to the existing business. Companies benefit from revenue diversification, and customers benefit from more choices.

Examples of Innovation

**Kaeser Kompressoren**, an industrial product company, has a go-forward strategy to charge for “air-as-a-service.” With its Sigma Air Utility offering, customers pay for the volume of compressed air consumed, instead of buying, installing, and operating air compressors.8

**Komatsu** intends to charge for tonnage of minerals hauled instead of selling mining equipment. Rather than creating additional value through manufacturing at its plants, it is doing so through outcome based services in customers’ operations.9

U.S. insurer **Progressive** currently generates roughly $2 billion in premiums from usage-based insurance. In usage-based auto insurance, policyholders’ driving data is reported via telematics devices to the insurance carrier for the purposes of adjusting premiums.10

Earlier this year, **Novartis AG** set prices for heart drugs with two U.S. insurers based on health outcomes. Its heart drug, Entresto, proved to be minimizing the risks of re-hospitalizations and hence the payment is linked to reduction in patients who are admitted to hospital for heart failure.11

Key Figures

Companies considering outcome based models need to:

- Reengineer products and services to deliver a fully integrated, end-to-end experience at the lowest cost possible
- Build a cloud infrastructure to collect, share, and analyze product and sensor data to monitor and optimize outcomes
- Implement new pricing model, order to cash, financial accounting, and risk management processes
02 Expansion into New Industries and Markets

Enter and disrupt other industries or markets by leveraging core assets and capabilities (customer base, assets, channels, IP)

Key Figures

The ability of technology and innovation to reshape industry norms and boundaries was cited by Accenture research as the most important structural shift that businesses will face over the next five years\(^\text{12}\)

In next five years, \textit{60\%} of the businesses looking to grow plan to pursue \textbf{new market opportunities} in (or collaboration with) other industries\(^\text{13}\)

“Expanding reach into new markets,” cited by 40\% of businesses surveyed, is the top reason for building digital partnerships\(^\text{14}\)
Expansion Into New Industries And Markets In Action

It is much easier to enter and disrupt other industries and markets than to change your own. Any value chain with significant inefficiency offers opportunity for new players to enter and disrupt.

• High-tech companies like Google and Apple are disrupting many industries, such as media, automotive, and music
• Telecommunication companies in Africa are leveraging bitcoin and blockchain technology to enter retail banking
• Chemical companies are disrupting entire agribusiness value chains
• Manufacturers are entering retail and distribution to control the end-to-end consumer experience (direct to customer model, digital channels)
• Insurance companies are leveraging low-cost online offerings to enter new markets and regions (Asia, Latin America)

Examples of Innovation

Enel manages over 2 million kilometers of electric cable transmission. By adding fiber optics to its existing infrastructure, Enel delivers a high speed telecommunication infrastructure that supports growing demand for Internet traffic (video, Internet of Things). Enel delivers communication bandwidth at a very low cost, as the infrastructure is already in place.15

Google is well known for its search engine, but over time it has expanded to many industries. YouTube is becoming a big competitor to media companies. Self-driving cars are being seen as disruptive technology to the auto industry. Google Robotics and artificial intelligence could disrupt many other manufacturing industries (military suppliers, smarter homes, logistics providers, etc.)16

Amazon is now officially going into the air freight business by signing a five- to seven-year lease for 20 cargo planes. These planes provide critical capacity expansion to support the growth of its lucrative Prime business. With this move, Amazon is bringing more of its logistics in-house, from supplier to fulfillment to delivery.17

Under Armour is entering the healthcare space with “Connected Fitness” products and apps. Smart apparel, accessories, and connected apps can track biometrics. This data is aggregated for larger communities, providing significant opportunities, such as for doctors to have greater access to health information, and for insurance companies to optimize premiums and costs.18

Key Considerations

How can the industries benefit?

• Evaluate your core competencies that can be leveraged to change the market dynamics
• Identify the most effective areas to diversify (M&A, joint ventures, unit incubation)
• Evaluate and build execution capabilities (talent, technology, business processes)
03 Digitization of Products and Services

Disrupting entire value chain by rethinking how products and services can be delivered faster and at a lower cost

Key Figures

- $550 billion a year is the expected economic impact of 3D printing by 2025

- $5.6 trillion savings potential with driverless cars by 2026

- 66% of consumers in the United States plan to buy connected technology for their homes by 2019
Digitization Of Products And Services In Action

We are accustomed to a physical world where products are designed, produced, moved, and maintained by different value chain players, which adds cost and increases cycle time between innovation and consumption. It also creates a massive gap between those using the products and services and those engineering and designing them. Digitization is changing all of this.

• With 3D printing, wholesale distributors can store an “infinite” catalog and deliver products and services much faster and at lower cost.
• Medical device companies can tailor their products to each patient and close the loop by tracking patients’ performance and adjusting design and engineering.
• Automotive companies can improve car performance by remotely installing software that improves performance, thereby reducing the need for service engineers or visits to a dealer.
• Farmers can now get more yield from their farms by deploying strategies based on weather, soil and other farm data components.

Examples of Innovation

Apple is a leader in digitization of physical assets (music, videos, books, games). Applepay is digitizing money.22

UPS invested in a large 3D printing operation. Instead of moving goods, UPS plans on using digital product information to accelerate the manufacturing and delivery of critical machinery spare parts.23

Heijmans is leveraging 3D printing to print the first bridge in Amsterdam. It is expecting a much cheaper way to build and maintain infrastructure in the future. As an approach to construction, 3D printing is also a lot less disruptive to daily life in already congested cities.24

Key Considerations

In order to digitize products and services, companies need to:
• Implement a structured digital warehouse for storing product data and intellectual property
• Deploy tools to manage the full data lifecycle
• Implement new processes for revenue share models
• Integrate the digital world and the physical world
• Build talent and new capabilities
04 Competing as an Ecosystem

Digital and seamless connections of products and services from several companies deliver better outcomes for the end customer.

Key Figures

- **$149 billion** estimated sales of connected car products between 2015 and 2020\(^\text{25}\)
- **$977 billion** estimated revenue from smart city-related information and communications technology products and services by 2022\(^\text{26}\)
- **400 million** customized phones sold each year by vendors of the Shanzhai ecosystem in China\(^\text{27}\)
To win in a digital economy, companies need to have a laser focus on delivering higher value customer experience. This has to be done with speed and agility.

Companies are finding that the most effective way to succeed is to complement their core competencies with those of other partners, jointly build new products and services, and leverage their combined go-to-market forces.

- Retailers are offering retail banking and insurance services through partnerships
- Banks are working with high tech companies to build the next-generation value exchange platform to enable the “Internet of Value” to become a reality through blockchain.
- Outsourced manufacturing will continue to offer companies the agility and scale to execute with a much lower cost structure, especially when partners digitally connect business processes such as design, manufacturing, and supply chain.
- Automotive companies are accelerating their race to produce self-driving cars by partnering with high tech companies.

Examples of Innovation

- **Roche Diagnostics** has built a digital solution to help people with pre-diabetes change their lifestyle. The solution uses wearables that collect and visualize behavioral data on a smartphone and share that data with a physician or coach, and insurance service provider. The connected care solution will bring down healthcare costs significantly.  

- **Monsanto** and another leading competitor are building a precision farming ecosystem, making the entire process of planting, fertilizing, and irrigating highly specific and automated.

- **Shell** and **Volkswagen** in co-innovation with SAP, are working on a range of connected services including an integrated system for connected fueling.

- **Karlsruhe** together with SAP and energy provider EnBW, is running a pilot project called “Smart City Light.” New lampposts are equipped with a host of sensors, WiFi, emergency buttons, and e-charging points. Town administrators can monitor traffic and emissions and other data in real time and take corrective actions much faster.

Key Considerations

Companies intending to compete as part of digital ecosystems need to:

- Identify the full customer value proposition to be delivered and the key partners to deliver it
- Identify partners that complement your core competency and validate the revenue sharing model
- Integrate the products and services and ensure high quality
- Develop a proof of concept; refine and deploy in a select market before scaling
Shared Economy

Facilitates peer-to-peer-based sharing or access to underutilized resources through a community-based digital platform

Key Figures

Top five sectors for shared economy – peer-to-peer (P2P) finance, online staffing, accommodation, car sharing, and music/video streaming. **$335 billion** market size by 2025 for these areas, up from just $15 billion in 2014.

66% of online consumers are likely to use the products and services from others in a shared community.

Annual global investments in sharing economy startups has risen to **$12 billion** in 2015, up from **$300 million** in 2010.
In a hyperconnected world, asset owners and those seeking to use those assets can connect with each other easily. The sharing economy allows the owners to monetize their unused or underutilized resources, while consumers have convenient and cost-efficient access to resources without the financial, emotional, or social burdens of ownership.

- Uber, the world’s largest taxi company, owns no vehicles
- Facebook, the world’s most popular media owner, creates no content
- Airbnb, the world’s largest accommodation provider, owns no real estate

Such peer-to-peer marketplaces are emerging in almost every industry:

- Financial services (LendingClub, Friendsurance)
- Clothes sharing (Yerdle)

In a hyperconnected world, asset owners and those seeking to use those assets can connect with each other easily. The sharing economy allows the owners to monetize their unused or underutilized resources, while consumers have convenient and cost-efficient access to resources without the financial, emotional, or social burdens of ownership.

**Shared Economy In Action**

Examples of Innovation

**Uber** is redefining the transportation and logistic services. It already has more drivers than UPS. It is rapidly expanding across the globe. Uber owns very few physical assets. The cycle time from recruiting a driver to generating revenue is less than 24 hours. Uber is expected to expand its services beyond taxi rides to food delivery and self-driving cars.35

**Airbnb** is becoming the world’s largest accommodation company – without owning any assets. It offers a wide variety of accommodations in 190 countries and more than 34,000 cities. Airbnb already has over 60 million customers and lists over 2 million accommodations listed on its Web site.36

**Lending Club** is publically listed U.S. peer-to-peer lending company. Lending Club operates an online lending platform that enables borrowers to obtain a loan, and investors to purchase notes backed by payments made on loans. The company claims that $16 billion in loans have been originated through its platform through 2015.37

**EasyPark**, one of the leading parking aggregators is leveraging SAP Vehicles Network solution to improve customer experience and utilization of parking slots. The solution enables convenient end-to-end vehicle and mobility-centric services such as parking and fueling.38

Key Considerations

Companies considering a sharing economy business model need to:

- Build a cloud and app infrastructure to support the acquisition of new providers and users and facilitate transactions
- Enforce a compliance framework to address local regulations
- Implement new order-to-cash, automated billing, and revenue sharing capabilities
- Leverage user data to refine the model and differentiate on services
Monetizing a large, captive community of users and customers by charging transaction fees and opening access to marketers (for advertising, analytics, research)

Key Figures

- 20+ virtual communities with more than 100 million active users
- In last five years, e-commerce and digital market places have the highest number of unicorn companies (35+) and venture capital investments ($120 billion+)
- The top 15 public “platform” companies already represent $2.6 trillion in market capitalization worldwide
Building and growing a community of loyal, vibrant customers is and has always been a powerful way to drive profitable new revenue streams. Digital platforms are even more powerful as they can be ubiquitous, borderless, and more agile in terms of speed of innovation and value creation.

- High tech companies are the leaders when it comes to the digital platform. They offer free, innovative services to attract and retain a large, loyal customer base and then find smart ways to monetize and further grow that base
- Fashion companies are leveraging the power of the brand as a platform to enter new product categories, open new digital e-commerce channels, and build new kinds of digital loyalty
- Large e-commerce players are opening their platform to smaller companies and individuals who want to access a large customer base and reduce sales and marketing costs
- Telecommunication companies are building the infrastructure to manage all connected things
- The high tech industry is using open source to build digital platforms for business communities to collaborate and conduct business at a global scale

Examples of Innovation

**Facebook** has a platform that brings communities of interest together. People use it to keep in touch with friends, post photos, share links, and exchange other information. It has also become a platform for businesses to advertise and promote their products.  

**Siemens** MindSphere is a cloud system to help manufacturing companies leverage power of IoT, and optimize and automate chain of processes for mass production. This open IT ecosystem powered by SAP will allow OEMs and application developers to access the platform via open interfaces and use it for their own services and analyses.

**Powershop**, an online electricity retailer in New Zealand and Australia, allows consumers to choose between different brands of electrical power listed on the Web site and switch between them with the click of a button. Users can either let the system automatically buy power from the cheapest supplier, or log in regularly to take advantage of specials.

**SAP Ariba**

More than 2 million companies are connected to the Ariba Network and conduct ~$1 trillion in business commerce through the digital platform.

Key Considerations

These players are able to monetize user data (attributes such as location, age, likes, dislikes) and offer platform-based services for additional revenue.

Companies looking to leverage digital channels and business platforms need to:

- Identify and implement the “freemium” model to accelerate user adoption and community build-out
- Leverage old channels with a big focus on mobility to accelerate the adoption of products and services
- Identify revenue and go-to-market models for selling products and services
- Implement the right technology and adjust back-end business processes
KEY TAKEAWAYS

Digital will impact every industry, and business model discussion needs to be at the core of every CEO and board agenda. The end goal has to be clearly defined, but how you get there can differ from company to company.

Disruptive business models are a reality now and proven across all industries

Companies are moving beyond “omni-channel”; they are going to be “omni-business” enterprises

Digital business models are not exclusive and quite often organizations will deploy more than one model to add new revenue streams

Digital innovations are data driven and they will require a modern IT architecture and new skill-sets and capabilities

New strategic partnerships and a strong ecosystem will be critical for successful execution of the digital business models

Speed matters: companies should adopt fast and agile processes for innovation to bring new products and services to their customers
BOARDROOM
KEY CONSIDERATIONS

Business model innovation requires a completely new way of thinking around digital strategy, people, talent, and technology. Regardless of where the companies are on the digital maturity curve, they need to consider the following key enablers of Digital Transformation.

Define your Digital Destiny
Companies need to drive new business models alongside their current business model.
• Start with customer needs and customer experience
• Identify new business models that do not diverge too far from core competencies
• Consider the best approach to implement new business models; organic, M&A, partner, spinoff

Raise Digital IQ
Invest in understanding digital capabilities and potential applications in your business.
• Conduct a management offsite for 1-2 days to raise digital awareness
• Embrace new ways of innovation and crowdsourcing such as Design Thinking
• Avoid long planning cycles and strive to quickly pilot, learn, and scale new ideas

Invest in New Technology
Upgrade your technology infrastructure with new digital capabilities.
• Simplify and consolidate your current landscape to free up cost
• Deploy an integrated data and business process platform with the capabilities of smart analytics and real time business
• Leverage cloud infrastructure for faster adoption and scale

Upgrade Talent and Skills
Invest in required new capabilities and skills at all levels within the organization.
• Appoint Chief Digital Officers
• Grow and attract new talent such as data scientists, customer experience designers, and digital technology experts
• Build a network of strategic partners for new products, services, and capabilities
HOW SAP CAN HELP COMPANIES
DRIVE BUSINESS MODEL INNOVATION

74% of the world’s transactions run on an SAP system, putting us in a unique position. We have the experience, solutions, and ecosystem to streamline value chains and drive efficiency for our customers. We believe it is our duty to work with our customers to facilitate and guide their journey of gaining speed and agility with digital technologies.

SAP has invested over $35 billion in acquisitions and R&D in breakthrough technologies such as in-memory computing with SAP HANA and innovative cloud solutions. To make our value proposition even stronger, we are forging strong partnerships and working hard to embed the latest innovative technologies like artificial intelligence, machine learning, augmented reality, and blockchain in our platform. This would enable our customers to access the latest and greatest solutions that are easy to consume, can solve big business problems, and create significant value for their stakeholders.

End-to-End Business Solutions and Platform

SAP offers the most comprehensive digital platform that includes 4 key components:

- A digital core that spans business processes across 25 industries and allow companies to adapt their business model on the fly
- Advanced analytics, predictive tools, and machine learning to improve decision making in real-time
- Internet of Things that integrated the physical world to enterprise applications
- A business network that brings the world to companies’ doorstep

Unique Approach to Tailoring Digital Transformation

Applying digital innovation to solving business problems or unlocking business opportunities requires a fresh approach

- Executive Immersion Day which brings executives together to understand digital capabilities and formulate a strategy suitable for their business
- Proof of Concepts (PoC) for new ideas leveraging our infrastructure and talent
- Helping companies build their own design thinking capabilities to sustain the innovation culture

Innovation Community

SAP’s new EDX (Executive Digital Exchange) community enables digital transformation leaders across the globe to:

- Foster cross-industry digital innovation exchange through live and virtual events
- Share best practices and business success stories
- Identify technology merits and pitfalls
- Discuss change management, innovation culture, skills development and digital IQ
- Meet industry experts and digital transformation thought leaders
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