

EIU Digital Economy podcast
Episode 4: Rethinking business models for the digital age

Pete Swabey

Hello and welcome to the EIU Digital Economy podcast. My name is Pete Swabey.

The EIU Digital Economy podcast is sponsored by DXC, an independent IT services company that specialises in digital transformation. We thank them for their support.

In this episode, we're looking at the evolution of business models as a result of digitisation.

Technology innovation alone is rarely enough to be truly transformational. More often and that not, the commercial potential of a significant new technology is only realised when a company figures out a new business model to extract its value most effectively.

Digital technology has been no exception, and for reasons we're about to hear, it has challenged businesses to rethink their own business models, and adapt or replace them accordingly.

To discuss the theory behind business model innovation, we are joined this month by Charles Baden-Fuller, centenary professor of strategy at Cass Business School in London, who leads the Business Model Zoo research project. And to explore how companies can manage business model innovation in practice, our other guest is George Walkley, [group digital and development director at the publisher Hachette UK](#).

I started our discussion by asking Charles a simple but fundamental question: what is a business model?

Charles Baden-Fuller

That's a great question, indeed. When somebody asks me what is my business' business model, I think the most important thing to think about is what is the value creation mechanism or what is the value capture mechanism. It's the emphasis on the second that's so important; not only what are you trying to deliver to a customer, but how are you going to get them to pay for it, or how you're going to get someone else to pay for it.

Conceptually, there are four basic types of business models, three of which are fairly novel and one of which is very old. The oldest one, of course, is the product business model. I put a product on the market. You buy it from me. You give me some money. You take it away and you use it. The second one is a solutions' business model. The

solutions' business model is when I work with you and you work with me and we co-create something that is really effective, like a service delivery mechanism.

The third one, of course, is well-known, is the matchmaking business model. Airbnb exemplifies this perfectly. You don't buy accommodation from Airbnb. You actually trade with someone who has accommodation over the Airbnb platform. The last one is a multi-sided business model, the most famous of which is Google.

These four business model types are really important because almost all business models we see are some combination, derivation of these four types. These four ideas about business models challenge many of the core ideas of strategy, which tend just to think about how you deliver something and not how you charge for it.

Pete Swabey

My sense is that as a result of the digital revolution, companies are thinking more explicitly about their business models and we seem to be discussing business models a lot. Why is that? What is it about digital technology that prompts companies to consider their business model and perhaps explore new ones?

Charles Baden-Fuller

These business model types, which I just talked about, are things that have come to the fore because digital has allowed us to engage with customers more effectively and more innovatively. That is, the solutions are able to scale. The idea of solutions, instead of being the haircut, which is so labor-intensive, you can do video streaming digitally, which also engages the customers. You can do platforms, which engage with people in matchmaking and you can do multisidedness, and so digital has enabled things to happen, both on the supply side and on the demand side.

Pete Swabey

You mentioned some of the business models that have emerged in the digital economy, but why is it that these, for example, matchmaking business models or platform business models are now so prominent and what impact do you think that has on the economy as a whole?

Charles Baden-Fuller

Part of our research project was to study what firms actually do, because academics sometimes spend too much time not looking at what people do. Our Business Model Zoo website documents more than 100 unicorn companies and how they engage differently with customers. About half of them are engaged in multi-sided platforms and the other half are engaged in really interesting ways of monetizing traditional product business models in new ways.

What's interesting about these businesses is many of them are actually delivering very old-fashioned products in new ways. It's not all digital. Digital enables physical products to be transformed. Digital enables not just the driverless car, but all kinds of

things like the airplane engine, which used to be a real pain to service and cause lots of breakdowns, now can be monitored in the air and when you arrive at your destination, you don't see it, but the airline company will have an engineer on-site, repairing that engine in a few minutes, knowing what's wrong with it instead of the old-fashioned way of having to wait many hours and you having to sit around in the departure lounge.

Pete Swabey

George, publishing is an industry that seen huge disruption as a result of digitisation. You join us from Hachette, one of the world's largest publishers. What implications has digitisation had on your company and in particular, what has it meant for the company's business model?

George Walkley

Thank you very much. Let me start by giving a little bit of context about Hachette for your listeners. We are the second-largest book publisher in the world. Hachette UK, the unit that I work for, is around \$350,000 million of turnover. Much of that is general consumer publishing, the sort of thing you might have received for Christmas or that you would buy for your summer holiday. But we have important segments in educational publishing, children's books, illustrated books and other areas.

Now, our fundamental business model is actually relatively unchanged. We take someone else's idea to a broader audience than they would have achieved single-handedly. That's been relatively constant since the earliest part of the group was founded in 1768. The basis for our business model hasn't changed fundamentally, but in many cases, the unit of value has changed. We're looking at slightly different products and the route through which we sell them has changed completely.

To give you some context, in 2009, our digital business accounted for just over a half million pounds of turnover. Five years later, that had grown to over 70 million pounds, which is, I guess, the corporate equivalent of going into insane mode on a Tesla. That rate of growth was quite extraordinary.

Pete Swabey

When you say your digital business, is that the business for e-books or is that also just digital distribution, as well, of paper books?

George Walkley

That is—I'm talking exclusively there about our e-book business. There is, of course, a significantly older and very important e-commerce business online for filling physical books, but here, I'm talking specifically about the digitisation of content and its exploitation in that format.

As things stand today, our digital business, which now includes e-books, audio books, educational content, apps, games and various other formats, would account for a little over a quarter of our group turnover. We still have nearly three-quarters of the business

going through traditional print formats and business models, so it's very important that we don't throw out that business in the race to do digital.

However, we do also have to respond to the availability of new opportunities. We have to have a relationship with new players. I think for us, one of the other implications is our changing relationship with our retailer. We've been very used to the idea that our relationship with the end consumer is mediated through a book shop and we, in the old days, had very little data about what happened once we had sold a book to a book shop. We didn't really know much more other than that.

For us now, we have far more data about what is sold, where the end consumer is located. In some cases with our own products, we know exactly when someone is reading something, what their reading pattern is, whether they make it through the book at all. I think that there are some really interesting changes there that we've had to focus on.

Pete Swabey

Can you tell us a little bit about how the company adapted in response to these? How has the organisation pursued digital innovation?

George Walkley

I think we've tried to take a fairly balanced view of the business. I don't think it's a good idea to look at any one business model channel or segment in isolation and try and optimize just that line of business.

You have to look at all of this in the round. Yes, there may be a particularly exciting digital opportunity here, but if that is going to cut into your print business, it may not be a very good idea in the round. Conversely, there may be things that historically we would have done in print that simply no longer make sense in a digital context. But someone at a very senior level has to look at those things across the board and take that balanced view.

My second point is that in general terms, I would say that solving for the consumer is a really good idea here. We've always tried to start from the point-of-view of what is easy and convenient for a consumer. If you make it easy for someone to lay hands on a product, the likelihood of them spending money on it increases sharply.

Now, I think the third thing is that we have had to rethink the business in certain aspects. On a tactical level, day-to-day, there are certain skills that we need. It's a very different discipline to market a product directly to the consumer, or even market a product in combination with an online platform compared to putting a product into traditional retail.

There are completely different approaches needed, as well. Historically, each of our publishing units was very, very autonomous. They had their own sales and marketing

teams. They could really do their own thing. With the rise of very significant digital platforms, the Amazons, Apples, Googles of this world, actually you need far more centralisation. My entire team was put together to help serve those customers more effectively, which was a really big change for the organisation.

Pete Swabey

Why would you say that is? What is it about these big platforms that requires the degree of centralisation of certain functions and is that centralisation across the board or is it centralisation according to strategy on particular channels?

George Walkley

I think you've got to look at what your business is doing. We looked at certain creative aspects. For example, the decision on which books to publish, let's say, or what covers to put on them, these sorts of creative decisions can be devolved to the individual publishers. But actually, when it comes to things like delivering those digital assets to a retailer, delivering metadata, delivering very complex pricing, let me give you a specific example.

We would deliver pricing in over 55 different currencies to our major digital retailers. It's an extremely complicated endeavor. You do not want to be replicating that 10 or 11 times. Doing that once for those really big customers makes a great deal of sense. There is something, I think, about just the sheer scale of those businesses, the pace at which they operate that means you have to be very, very effective in dealing with them.

But I think beyond those sort of day-to-day approaches to how we do business, there's also a final, more fundamental reaction from us, which was how we shaped our business overall. Publishing is basically a portfolio business. I mentioned earlier that we operate in different segments. We have a very significant consumer segment. We're also in education, which is an area where we're actually interacting far more often with say, schools, than with an intermediary like Amazon or Waterstones or anyone else. We also have a children's business, which has some very different segments and channels. And over the years, we've had a very deliberate strategy of acquiring companies who serve different markets to ours. For instance, we acquired a digital-only startup called Bookouture last year. We acquired a gift book publisher called Summersdale in the same year, who specialize in creating products for general retailers, let's say anthropology or Oliver Bonas, for example.

All of those are very different routes to market. Our reason for doing that is that we don't want to be overly-reliant on any one channel. We'd like to have multiple routes to market and have a balanced portfolio of businesses. Those acquisitions, I think, have really come out of the market context and what we've seen with the digital revolution.

Pete Swabey

Charles, many of our listeners will be from traditional companies, maybe who've had a very tried-and-trusted business model, but might be wondering how long their current business model can last and what the implications are of digitisation. What are the

signs for a traditional company that perhaps their business model needs updating or replacement? What are the first signs of trouble?

Charles Baden-Fuller

One of the things that we've learned about the digital revolution is that resources are not the key issue. Very large, well-endowed firms have got into trouble and less endowed, agile firms have done extraordinarily well. It's a cognitive, organisational challenge, not as much a physical challenge. That was very different from 15 years ago when superior resources were a way to superior profitability.

Pete Swabey

Even just 15 years ago, you think that has changed?

Charles Baden-Fuller

Yes, yes. I think that's because of the speed—so, what's happened about digital in technological terms is, let's face it. The transistor was invented a long time ago, before most of the people who listen to this program were born and indeed, before some of their parents were kids. We've been very slow in incrementing the things. What's happened now in terms of what's happening with the customer is that 3G, 4G and 5G has allowed the acquisition of real-time data on consumption to occur. The computing power has allowed us to capture that data and make sense of it. You might call it big data or artificial intelligence. It's actually quite simple stuff, but it means that before, we were not able to get hold of this data and use it.

George is right. He pointed out very simple kinds of data—like when do people read the book, how long do they read it for, when do people use a product, how much do they use it for—tells you a lot about pricing, a lot about how to distribute, what to distribute. This very simple data is incredibly important for success. That's really important.

I think the second thing I want to say is it's really interesting how markets believe that traditional firms are facing a big barrier. If you look at the car industry, it's fascinating. GM spends far more money on digital than Elon Musk and yet, Elon Musk's company is worth as much as GM. Why? It's not because people don't think that GM doesn't have the resources to become digital. It's clear they do. If they think that the legacy mindset of the company will never really let go of the things they have to let go.

One of the things I'd love to talk to George about is how do you overcome this challenge in a traditional firm of actually realizing you have to let go of stuff that is not going to be important and it's very, very difficult to do that because I think that's the major challenge.

Pete Swabey

Let's ask him right now.

George Walkley

I think it's a really interesting question. I remember in 2016, Walmart paid \$3.3 billion for a startup called Jet.com, an e-commerce startup. I think at the time, markets and quite a lot of analysts were quite scathing about that decision. Now actually what's happened since then is that they've executed it extraordinarily well. They've had a really good track record of growing their e-commerce sales versus Amazon. They are probably, Charles, a great example of that business at 15 years ago had a scale that would have been very, very difficult to compete with. But they've recognized that and so, they've brought people in from outside who can challenge their thinking.

I think the fundamental here is that it has to start with people realizing at all levels of the organisation that change is needed. Now, I think at a C-suite level, change is quite easy to diagnose. Often, I think, the real challenge there is having that cascaded down through the organisation, so middle managers, divisional managers, are echoing that and feeding that through and that tactically, day-to-day, the people in the business units are executing against that same strategy. I think quite often you can see mismatches in that.

We were very lucky at Hachette that from the very outset, we had a very supportive senior management and we were also very careful to engage the entire business. I remember in 2010, we took over the IMAX theater on the south bank here in London and had an all-hands, offsite to talk about digital, to talk about what this meant for the organisation. I think the fact that that was a fairly unprecedented thing for us to do, at least, was a signal to our colleagues that this was pretty important and that they should get behind it. Then, once that happened and we started having some early signs of success, nothing convinces people to double down on a strategy like some early good results.

But we had to get some outside inspiration. Over the years, we've acquired businesses that have told us a lot about this market. We bought a very good educational technology startup called Rising Stars and then, last year, we bought a digital publishing business called Bookouture, who were one of the earliest digital-only publishers, in our segment at least. They had really been able to lean into the digital business model unencumbered by the need to support a traditional print business model. In the same way that Walmart learned from Jet.com, I think we've learned quite a lot from them.

What do you see the role of startups in helping traditional firms adopt and explore new business models?

Charles Baden-Fuller

I think it's incredibly important for large firms to look at startups. One of the things that we love to get executive students and other students to do is to look through the Business Model Zoo, which I mentioned, and to see that what these new unicorn companies do. They take the four simple business models I talked about and actually put them onto the market in so many different, creative ways, that it's extraordinary in almost every line of business: healthcare, technology, simple stuff of fun video games.

But it's the other areas where you would not expect these unicorn companies to appear, which is probably so important. It's the ubiquity.

I think, though, that the value of these things is twofold. One of them is to really make it clear that the digital business model challenge is in every part of the economy. No one's escaping it. Secondly, there is a great deal of technical detail involved in the execution. I think what the startup lab doesn't do very well is many of these small firms are very, very small and they don't really know how to execute very much. They're not a benchmark for execution. They're more a benchmark for energy.

I would say the unicorn companies, studying unicorn companies, which are billion-dollar valuations, many of which have seriously good execution, are the places where people are going to buy companies; to understand actually how to execute these challenges into practice, which I think is one of the big challenges.

Pete Swabey

George, you mentioned earlier Hachette's acquisition of Bookouture. Could you tell us a little bit about the thinking behind that, but also how you've integrated it organisationally, but also a different business model into your overall company?

George Walkley

Bookouture is an extremely successful digital-only publisher. It's fundamental business model is the same as ours. It creates content to entertain, but it does that in different ways, both upstream and downstream. Upstream, it has a very different relationship with the authors who create the content. They're remunerated on a very different basis to a traditional publishing contract.

Downstream, it does some things very differently around very low pricing compared to many mainstream publishers, but extremely high-volume sales. It's tried some very different business models and those are things that our mainstream business had not done.

I think the acquisition for Bookouture meant that it could continue to grow within a large and supportive parent company. As part of the acquisition, we've left them alone. They are autonomous. They continue with their own separate business model. However, we learn a lot from them. They also learn something from us, I think. It's been a very useful relationship.

Charles Baden-Fuller

I think one of the big challenges to companies is that the digital age has really undermined inferior quality delivery at a high price. It's interesting, for instance, in the education market. Most people now won't want to buy Encyclopedia Britannica, expensive, which is a defunct product, but go for Wikipedia, which provides high quality information, but at the same time, they will pay a lot of money for a university education.

It's the same kind of thing in products. The basic standard product must be really cheap, cut-down. Those inferior products at a medium price doesn't have much future. But you can still have a premium offering if you really understand what the consumer wants, exactly as George said, and are able to give them that unique experience which they value, be it consumer product; content online through newspapers, which is personalized; music, which is streamed, which you exactly want at that moment when you want to be entertained; whatever it is, those things command a high price. The middle ground will be eroded completely.

George Walkley

I think that's exactly right and if I look at, say the newspaper landscape, I really see just in my own consumption, that polarisation; that on the one hand, there's a free evening newspaper which has sort of done away with commercial alternatives and then, at the other end of the scale, there's the amount that I pay to subscribe to, say, the *Financial Times* or the *Economist*.

Pete Swabey

What does the future hold for Hachette's business model? What can you tell us about future directions of innovation in publishing and what's to come in 2019 and beyond?

George Walkley

We foresee a broadly-mixed economy. We continue to see healthy print sales and we need to support that traditional channel. Our digital sales are fairly well established and we now see audio books, podcasts and other listening becoming an important segment a bit.

There are completely new areas that we're looking at more. So, our parent company has, in the last three years, invested in two games' development studios and an app producer. It's the same basic business model. It's producing content in exchange for something from the consumer, but it might be a completely different way of doing that. It might be a monthly subscription. I think that's fundamentally new for us.

Then, I think the other thing which is really interesting is the idea of going direct-to-consumer. For a traditional business, this is a very complex thing to do. We can go direct-to-consumer, but we have to do that in a way that is balanced with our other channels.

I don't think there are many consumers out there who will come to us to buy best-sellers at Christmastime or over the summer because there are other channels that just do that better. Most people will go to one of the three or four places that they go to already. But there are areas of our publishing where we have a particular niche, a particular relationship with our audience and therefore, we can have a transactional relationship from it.

A couple of years ago, we did a product with the writer, Julian Fellowes, called *Belgravia*, which was a multimedia story. It was told by serialized audio, direct e-book

downloads and there, we had a direct relationship with the consumer. We could close the loop in terms of the data that Charles and I talked about earlier. We could see exactly what they were doing.

But even there, we thought very carefully about how do we include our existing channels within this, so there were also e-books that were for sale on Amazon. There was also a hardback book that was for sale through Waterstones and many other very good booksellers. I think direct-to-consumer is extremely interesting to us, but we want to do that very carefully and I wouldn't expect to see us attempting to compete with Amazon any time soon.

Charles Baden-Fuller

I think that the first generation of digital transformation has been in the digital-only space. I do not expect in the next five years to see much innovation of a fundamental kind in video games and probably, much of what the story is in areas like publishing and online content has been played out, although there's still some plays to come. But big plays are clearly in the physical-digital divide. The really large parts of the economy which are just beginning to be transformed, where the real opportunities are, areas like healthcare, like transportation. If you look—again, going back to the Business Model Zoo and the kinds of things which are coming up in the new unicorn companies—those are companies which are worth more than a billion—it's in this physical/digital divide space that's really important.

This is where we're seeing the transformation. This is where the real opportunities lie in trying to transform the cost and efficiency of healthcare, which at the moment is in the Stone Age of how we're going to make what everybody wants—transportation to be more efficient and more effective, which consumes large parts of our lives and causes umpteen cost to the economy, these are the areas where we're just beginning to see a real transformation. There's much more to do.

Pete Swabey

Charles, to close, what advice would you give to a traditional company who may feel, "Hold on. Our business model has been in place for a 100 years or more. We've yet to feel the full ravages of digitisation," but anyone should surely feel it coming their way. What is a good first step or how do they need to be thinking about this challenge?

Charles Baden-Fuller

I think I would leave with two messages. First of all, the challenge of digitisation is an opportunity, as well as a threat. People who are able to transform their company digitally often also transform their balance sheet and their income statement and their profitability, so it's not all downside.

Secondly, I would say that most of the problem is cognitive. It's where you are, so thinking that you could set up a separate task force or put it in a small division, or somehow or other postpone it, it's a board-level issue and if you don't solve it, your

better employees will leave you and probably should leave you to go and find an opportunity somewhere else.

George Walkley

I think for me, the two fundamental things here are firstly, understand what business you're really in. I read a great interview a couple of weeks ago with the general manager of Nintendo in North America, who said very bluntly that his competitors are not Play Station and Xbox. His competitors are Netflix and every other call on peoples' discretionary time. I think having a really clear understanding of that is very important.

Our competitive landscape is not just Penguin, Random House and Harper Collins and other producers of books. We're competing with anyone else who might want to entertain or inform you.

I think the second thing is that technology is hugely important, but if I look back on my personal experience on missteps that I've made, nearly always the missteps have been around people and culture and organisation rather than specifics of technology. I think really addressing that upfront is very important.

Pete Swabey

Charles, George, thank you both very much for joining us.

Charles Baden-Fuller

Thank you.

George Walkley

Thank you.

Thanks for the listening to the EIU Digital Economy podcast. Tune in again next month, when we'll be discussing the growing influence of Asia in the global digital economy. To make sure you don't miss an episode, please subscribe on your preferred podcast platform. Thanks again to our sponsors DXC, an independent IT services company that specialises in digital transformation. And thank you for listening.