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Initiatives: Executive Leadership: Digital Business; CIO Leadership of Strategy, Governance and Operating Models

True business transformation (especially “digital”) means changing at least three of four business model components. Clarifying what this term really means will help executive leaders set the right business strategy and make adequate investments in it.

Quick Answer

What is digital business transformation?

- Digital business transformation means a change in three of the four components of a business model (customers, value propositions, capabilities and financial model).

More Detail

Any business transformation involves changing at least three of the four components of the business model (see Figure 1). The same is true of digital business transformation. Anything short of that will not fundamentally change the way the enterprise competes, whether or not business performance materially changes. Executive leaders should undertake digital business transformation when the competitive landscape in their industry requires it.
Many business transformations (digital or otherwise) fall well short of goals due to a lack of investments and ongoing resource commitments. Misunderstanding “transformation” invites this kind of mistake. Often misunderstanding arises because leaders confuse changing operations with changing the business. True business transformation almost always requires significant investments over five to 10 years or more. Transformation is expensive and risky because:

- Targeting and attracting new customers for products or services requires significant multiyear marketing campaigns and ongoing investments in sales, new channels, e-commerce platforms and partnerships.

- Creating new value propositions (products and services) that are embraced by the target market as superior (for example, better price/performance, more functional or easier to use) often includes adding new services to a product mix to increase customer engagement.
True business transformation takes five to 10 years — and often longer. For example, IBM has spent 25 years transforming from a hardware infrastructure and software company to a (primarily) services provider.

Axon: Over the past 10 years, Axon ($750 million in revenue in 2020) transformed from a product company (hardware such as tasers and body cameras accounted for 90% of its revenue) into a continuous services company. Almost 50% of its revenue now comes from collecting, managing, analyzing, archiving imaging data collected from its body cameras. It also uses this information to provide training services. Consequently, Axon has:

- New customers (first responders, like emergency medical technicians, and more law enforcement)
- A different value proposition
- New capabilities (especially data and analytics)
- Evolving financial models

Two other examples:

- Nokia started as a leather working company, then evolved into telecom equipment, then into mobile phones and now back to being primarily a telecom equipment vendor.
- Auto manufacturers want to attract new customers using a range of vehicles and services (new value propositions), with a pay-for-use or subscription revenue model.
Executive leaders can work with the board of directors to set the right degree of business model change and the right level and duration of investment. This can be achieved by defining the business outcomes they want to achieve over the next five to 10 years. Leaders should develop leading indicators that anticipate future results on the balance sheet or income statement metrics (see Figure 2), such as:

- Customers’ use of e-commerce platforms and online channels (increasing frequency and duration)
- Growth in virtual (versus people-based) customer support
- Growth in average customer spending (wallet share)
- Use of online platforms for customer product/service fulfillment
- Increasing the use of a digital platform by supply chain partners
- Exploiting online marketing channels (such as social media and websites)
- Increasing the use of alternative (more efficient) supply chain fulfillment
- Improvements in order-to-cash

If three or four components must change, leaders should plan for true digital business transformation, including large, long-term investments. Leaders don't have to change the whole enterprise at once. They can start by digitally transforming one business unit while building infrastructure and other capabilities for wider transformation.
Figure 2. Leading Indicators for Digital Business Transformation

Leading Indicators for Digital Business Transformation

<table>
<thead>
<tr>
<th>Customer Experience and Service</th>
<th>Sales and Marketing</th>
<th>Operations</th>
<th>Products</th>
</tr>
</thead>
<tbody>
<tr>
<td>Digitalizing Customer Service</td>
<td>Digitalizing Marketing</td>
<td>Digitalizing Sales</td>
<td>Digitalizing Supply Chain</td>
</tr>
<tr>
<td>20% to 25% Lower Call Center Cost</td>
<td>3% to 5% Lower Cost of Acquisition</td>
<td>1% to 3% Lower Mfg. Operations Cost</td>
<td>20% to 30% Higher Utilization</td>
</tr>
<tr>
<td>20% to 30% Lower Time to Resolution</td>
<td>7% to 12% Higher Conversion</td>
<td>10% to 15% Higher Asset Uptime</td>
<td>50% % of Operational Assets That Are Connected</td>
</tr>
<tr>
<td>% of Interactions That Are Digital</td>
<td>% of Interactions That Employ a Smart Machine</td>
<td>% of Marketing Spend That Is Digital</td>
<td>% of Revenue Through Digital Channels</td>
</tr>
<tr>
<td>50%</td>
<td>15%</td>
<td>50%</td>
<td>12%</td>
</tr>
</tbody>
</table>

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Outcome-Driven Metrics for the Digital Era

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