

Past Experience May Not Prepare Today's Businesses For A Digital Future

Many small to medium sized businesses, with established and still profitable markets, have been slow to embrace a Digital future, they are comfortable with what has worked well in the past (and is still working now).

However, past experience, well established markets, and tried and trusted business models may not adequately prepare today's business leaders to withstand the competitive forces that are being created by digital technologies.

Here we use an established business framework to explore how digital technologies are influencing competitive business forces.

In 1979 Michael Porter, a Harvard University Economics Professor, identified that in any industry competition is driven by five competitive forces, the:

- bargaining power of buyers
- nature and intensity of the rivalry among existing competitors
- threat of new entrants
- threat of substitute products or services
- bargaining power of suppliers

In 2008 Professor Porter published a follow-up to his original research ². In an interview ³ in 2012 with Divina Peredes (Editor, CIO New Zealand), Porter re-affirmed that: "the fundamental way of thinking about competition" doesn't change, but "new technology changes how those forces are applied".

Using this frame-work we demonstrate how digital technologies have the power to unsettle (or disrupt) any and all of these forces; not just for small, medium and large scale businesses, but potentially whole commercial sectors and entire industries.

We hope that small to medium sized business managers, seeking to develop their strategies for the coming year, find this model, and our analysis, useful in widening their understanding of the digital context in which their organisation operates.

Customer Power

The internet enables customers to source and compare products, services, pricing and reputation through: web-sites that offer this service (e.g. PriceSpy, Amazon, TradeMe), Social Media and other on-line information sources. Recent research by Deloitte ⁴ identified that:

"although perhaps only 3-5% of domestic sales are online ... at least 80% of domestic apparel sales are influenced by online research"

Even in Business to Business relationships, customers may be looking to maintain their own competitive advantage by analysing and where necessary changing their current supply chains, to take better advantage of digital resources and technologies.

Businesses operating in the Digital era, need to recognise that the balance of power has shifted in favour of the customer. They will need to identify suitable strategies for establishing and maintaining profitable and long-term customers; an approach that may require closer co-operation and tighter integration with customer's and with their customer's digital environments (see Power of Suppliers below).

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It will also require co-operation and tighter integration within the business, e.g. between those charged with product development, marketing, sales and business technology.

Existing Competitors and New Entrants

Businesses know that they need to be on the lookout for “bottom up” competition. These traditional competitors start with a lower-priced, inferior alternative or one that focusses on less profitable “niche” segments that are not well served by current products and services.

Digital new entrants can enter in a similar manner or look very different:

- Digital technologies provide opportunities for businesses to deliver more services to end users directly: meaning that your current supplier may become your future competitor.

For example, many airlines have circumvented their traditional intermediary, Travel Agents, by offering easy-to-use on-line ticketing at slightly lower pricing. They have also been able to establish a higher level of customer loyalty and a more personalised service (e.g. customer on-board preferences noted, frequent routes travelled, faster check-in) through their existing airline membership schemes.

- New digital platforms can provide an opportunity for apparently non-related businesses to undermine existing business models, redefine industry boundaries and disrupt entire business sectors.

An early example of these forces at work in New Zealand is TradeMe. What appeared to be direct competition only for auction houses and second hand dealers, has emerged as a significant competitor for the newsprint advertising business, the second hand car trade and real-estate sales and advertising models.

TradeMe was not developed by Auctioneers, Amazon was not created by a Publishing Company or a Bookseller; both were conceived and launched by entrepreneurs and software developers, taking advantage of emerging digital technologies.

- Digital technologies can reduce traditional barriers to entry for some business types. New entrants often trial a number of different strategies before they find the right price/market/product profile.

They utilise digital platforms and other digital technologies, and often develop new ways of generating income. Their businesses can quickly grow and gain momentum through social media and other digital marketing strategies.

In this way they are able to enter an existing industry or business sector at a relatively low cost, often under the radar. An apparently poor performer becomes a major competitor before existing market leaders are even aware of the threat (e.g. AirBnb took over 4,500 room bookings during the London Olympics while tens of thousands hotel rooms remained vacant⁵).

Today's businesses will be better able to maintain their competitive advantage by making critical first moves (e.g. by collecting and accumulating product and customer data to improve their own products and services and by developing strategies that create closer ties to their customers) or by broadening their product definitions (e.g. the iPod became more than an MP3 player when it added

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the iTunes data base functionality - other MP3 players suppliers could not compete, because they did not have the same service available for their customers).

Digital Substitutions (This for That)

Digital technologies have the potential to create new substitution threats:

- the wider product capabilities of smart devices can cause existing product types to merge and disappear. For example, smart phones merged: mobile phones, cameras, satellite navigation products, music players and many more. The combination of apps, sensors and in-built functionality, have made these physical products all but obsolete;
- new digital services have emerged (e.g. Infrastructure as a Service, Product as a Service, Shared Service and Software as a Service), that replace physical products or ownership models, with virtual solutions and pay per use and subscription models services. In some instances customers appear to pay nothing at all (and it is very difficult to compete with a zero cost competitor!).

Today's businesses need to explore the potential threats and opportunities arising from the wider product capabilities offered by digital technologies and, where appropriate, implement new business strategies to take full advantage of these opportunities and manage or mitigate the threats.

Power of Suppliers

Product suppliers in the digital era are subject to a number of competitive forces that have the potential to reduce their power:

- Physical components may become: the least valuable part of an end-product offering (e.g. where they form part of a smart device or service offering); commoditised, or replaced by software (or "virtualised") over time. This trend has been common in the IT sector for some time. Both scenarios can significantly reduce the bargaining power of product suppliers.
- Online accessibility may reduce or remove the location advantage of local suppliers. Lower cost "digital" suppliers may emerge: competitors who were not deemed a threat because of distance, may now be digitally more accessible; or customers may decide to no longer purchase from a local supplier, but instead use web-sites and other online sources to find more feature rich, or lower cost products, and then buy direct from the manufacturer.
- Poor digital integration may reduce the power of traditional suppliers. A business that provides digital integration (for example solutions that integrate purchasing, inventory, invoicing, and payment between supplier and customer) may become a more attractive supplier.

Product suppliers also have the opportunity to increase their power in the digital era:

- Closer digital integration may result in higher switching costs for customers. When switching costs are high, supplier power increases.
- Suppliers can take the opportunity to widen their customer base. Where a supplier does not depend on a single customer or industry for its revenues, its power increases.

Today's suppliers need to explore the potential for "smartening" up their physical product offerings, identify new non-traditional customers for products (and use digital marketing techniques to attract them), offer closer integration of business systems with their customer and ensure that they meet all of their customer requirements (i.e. the whole product) where-ever they wish to do business.

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1. "How Competitive Forces Shape Strategy" Michael E Porter, Harvard Business Review 1979. A simple framework for assessing and evaluating the competitive strength and position of a business organisation.
2. "The Five Competitive Forces That Shape Strategy" Michael E Porter, Harvard Business Review, January 2008. In this article, the original work is updated by the author, common misunderstandings are addressed and implications for strategy in the 21st Century are explored.
3. Divina kindly sent a link, so you can read her article and watch the interview.
4. Source: "Harnessing the 'bang' Stories from the digital frontline"
http://www2.deloitte.com/content/dam/Deloitte/au/Documents/Building%20Lucky%20Country/Deloitte_au_technology_digital_disruption_harnessing_the_bang_2014.pdf
5. Source: Bloomberg <http://go.bloomberg.com/tech-blog/2012-07-25-airbnb-scores-off-london-olympics-with-jump-in-bookings/> and CBS News <http://www.cbsnews.com/news/london-2012-olympics-gives-airbnb-a-boost-in-bookings/>