Digital Transformation: Managing a Dual Approach to Business Model Innovation

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Recently, Karolin Frankenberger from the University of St. Gallen gave a worthwhile presentation, one chart of which neatly illustrates why **Dual Innovation** is essential nowadays: Digitally transforming a company calls for **true ambidexterity**, i.e. simultaneously succeeding on the S-curve of today's business model AND that of the future business model which is supposed to eventually supersede the existing one. This dual approach to business model innovation is most likely the **greatest challenge companies' CEOs are facing these days**. In their work, Frankenberger et al. refer to this as *The Transformer's Dilemma*.
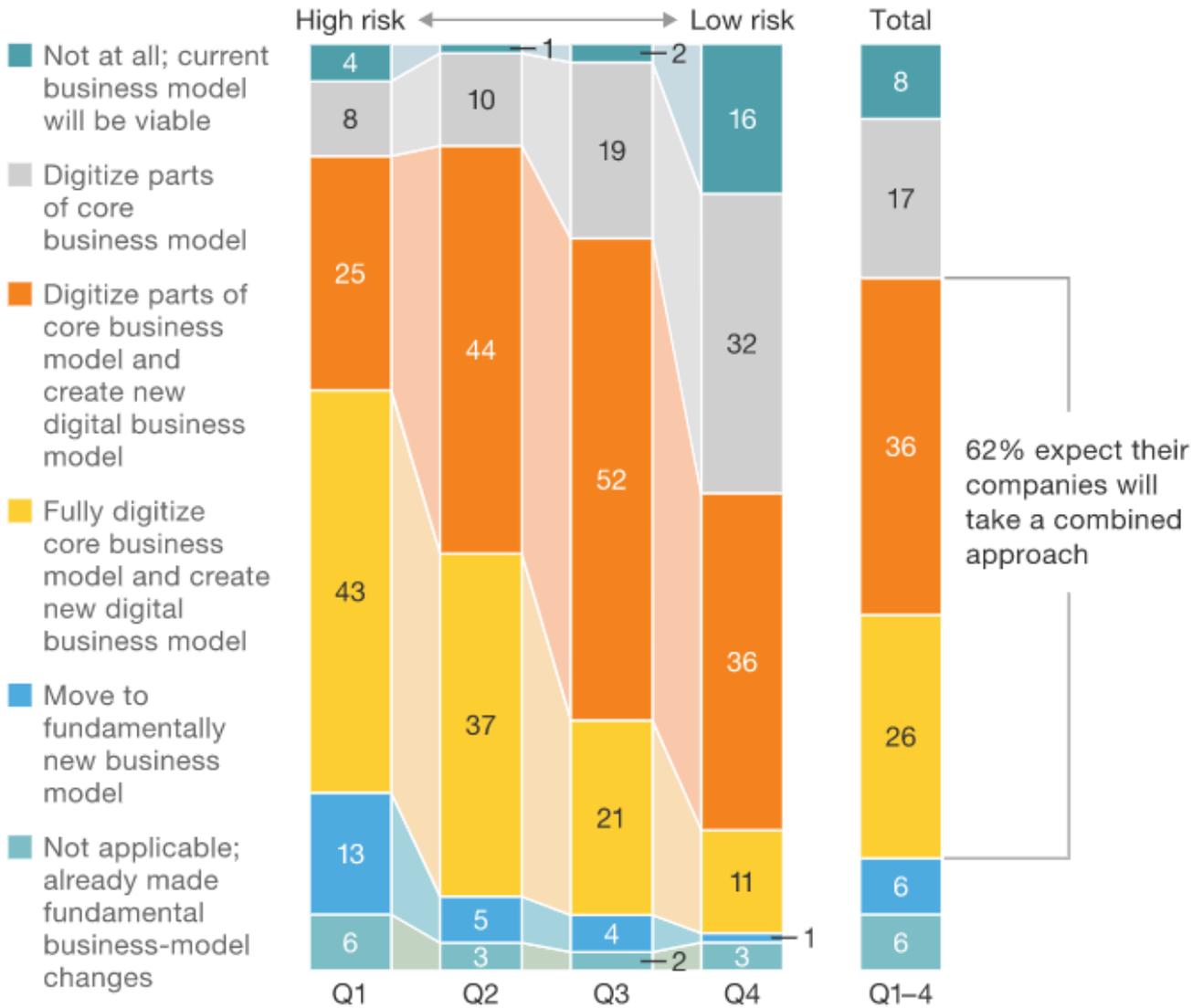

Digitally adapting and prolonging existing business models involves creating digital or digitally-enhanced offerings, digitizing the operating model and its backbone processes, improving the digital customer experience, adapting the commercial model, and increasing overall efficiency (*Defense*). In contrast, inventing a future, natively digital business encompasses developing an entirely new digital (e.g. platform-based) business model which ideally enables exponential growth, and defining an appropriate role for the company therein (*Offense*).

A recent study from McKinsey revealed that **62% of the survey respondents - on average and across industries - have expected their companies to adopt a dual approach to Digital Transformation.**

This is true even for respondents reporting the highest levels of revenues at risk, though tackling both the core business and new business models typically involves a more complicated strategy and operating model than focusing on one or the other.

Companies expecting the greatest revenue losses will need to digitize the core business fully or jettison it entirely.

Extent to which companies' business models should change to be economically viable, by quartile of perceived revenues at risk, % of respondents[1]

Legend:
- Not at all; current business model will be viable
- Digitize parts of core business model
- Digitize parts of core business model and create new digital business model
- Fully digitize core business model and create new digital business model
- Move to fundamentally new business model
- Not applicable; already made fundamental business-model changes

High risk ← → Low risk | Total

	Q1	Q2	Q3	Q4	Q1–4
Not at all	4	1	—	2	8
Digitize parts	8	10	19	16	17
Digitize parts + new	25	44	52	32	36
Fully digitize + new	43	37	21	36	26
Move to fundamentally new	13	5	4	11	6
Not applicable	6	3	2	3 / 1	6

62% expect their companies will take a combined approach

[1]Figures may not sum to 100%, because of rounding.

McKinsey&Company

What are companies that consistently embrace digital change doing differently? The study further indicates that those *Digital Reinventors* are all outperforming their non-digital peers in revenues and earnings. The **practices of the reinventors** differ from those of traditional incumbents in three critical areas:

- **Approach to investments**: Digital Reinventors are likelier to invest more - and bolder - in Digital than traditional incumbents are. The percentage of annual revenues invested by incumbents playing digitally (which have the greatest market share) is more than three times as high as that of traditional incumbents.
- **Degree of innovation**: Digital Reinventors are at least twice as likely as traditional incumbents to report modifying their long-term strategies in response to digital-related changes. Moreover, they are much more likely than their peers to have launched new businesses and to have built new digital business models. Most notably, they are almost seven times more likely than their traditional counterparts to have fully digitized their core business models.
- **Application of digital technologies**: Digital Reinventors are more likely to use cutting-edge digital technologies - and to use them at scale - than are their counterparts, which tend to spread investments thinly across technologies, without scaling them up.

The Digital Reinventors appear to be using these practices both to digitally transform their core businesses and to grow new digital businesses.

Ownership and accountability for coming up with new business models are (ideally) assigned to a **dedicated unit** which we typically name *Exploration Unit* in our work. It is **organizationally separated** from core business units that own the existing business models, yet operates at eye level with them. The reason behind, as we have frequently pointed out: Optimizing/extending existing businesses (*Exploit*) and validating/growing new ones (*Explore*) build on disparate, virtually incompatible paradigms and management systems. Let's bear in mind: ***Systems do not collaborate*****!**

As delineated in the table below, businesses in a corporate setting traverse a **sequence of innovation targets** along their life cycle: *Discovery – Validation – Scaling-Up – Growth – Efficiency – Transformation*.

- **Discovery** and **Validation** of new business models should be driven by the Exploration Unit and be run on an Explore-paradigm. (*Create the New*)
- **Growth** and **Efficiency** are typically pursued by the Business Units which operate the established business models and build on an Exploit-paradigm. (*Optimize the Core*)
- **Scaling-Up** of new business models and **Transformation** of existing business models (which essentially involves Digitalization) require a blend of Explore and Exploit as those activities operate at the interface of both paradigms. (*Reshape the Core*)

Dual Innovation		
Perspective/ Stakeholder — Business Unit Core Business		Exploration Unit Corporate
Innovation Scope — Compatible with BU		Incompatible with BU
Digital Transformation — Digitalizing existing BM		New digital BM
Playing Field — *Optimize the Core*	*Reshape the Core*	*Create the New*
Innovation Targets — Efficiency → Transformation / Growth ← Scaling-Up ←		Discovery ↓ Validation
Operating Model/ Management System — Exploit	Exploit/Explore	Explore

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Create the New and *Optimize the Core* activities can be run independently from each other by the corresponding organizational units as they can be regarded Explore- and Exploit-only, respectively. By contrast, *Reshape the Core* activities call for

- **close collaboration and capability exchange** between Exploration Unit and Business Unit(s).
- **sustainable integration** of the disparate Explore and Exploit management systems/operating models across their dimensions - such as mandates/objectives, leadership/governance, metrics, resource access, organizational structures/processes or culture.

When it comes to **replacing** an existing (digitalized) business model by a new (digital) one, attuning both S-curves proves key. If the simultaneous work on both curves (grey-colored area in the adapted chart from K. Frankenberger below) is roughly divided into two parts, the 'later stage' (2) combines *Validation* and *Scaling-Up* of the new business model with *Efficiency* and *Transformation* of the existing one.

Adapted from: K. Frankenberger, 'Digital Transformation: Mastering Change with Business Model Innovation' (2019)
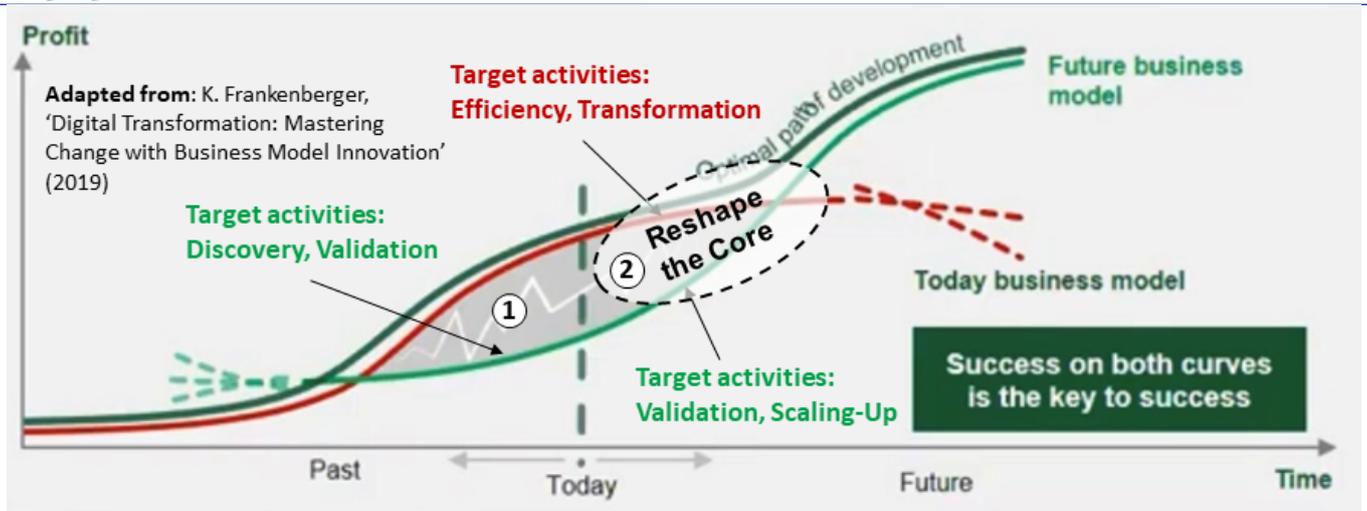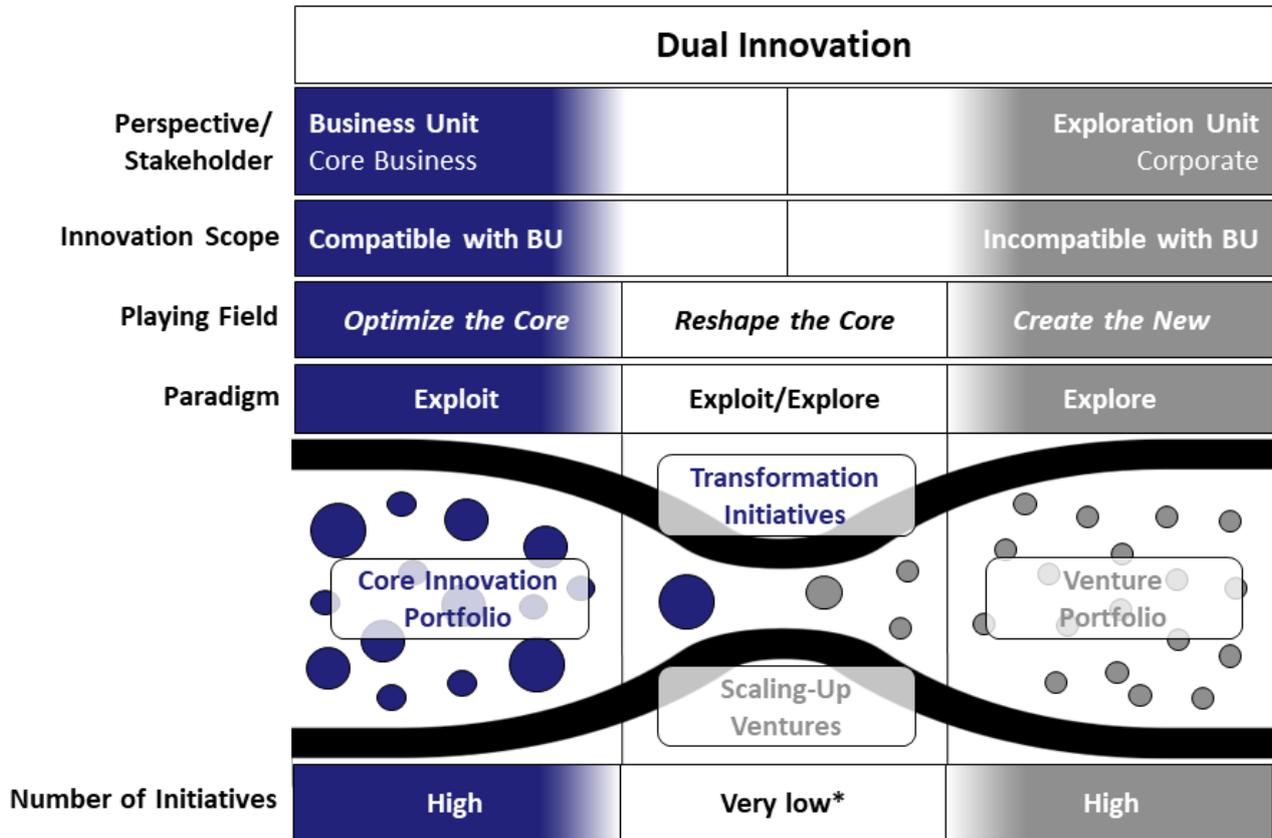
Specifically, the intersection of both curves, that characterizes the overtaking of the old by the new business model is determined by a

- **Transformation** phase: **protecting and prolonging the existing business model** by (digitally) adapting it.
- **Scaling-Up** phase: growing the new (digital) business model up to a **sizable business** which carries the potential to financially compensate the breaking away old business model.

An optimal overall **path of development** is passed through if the life cycle of the existing business model can be extended and stabilized, while the new business model is scaled up quickly. As *Transformation* and *Scaling-Up* make use of similar pools of resources and competencies, it's essential that both activities play out in a concerted action: Transformation makes the existing business model more (cost-) efficient and more competitive - which results in higher flexibility and frees up financial and human resources to scale up the new business model.

As can be taken from the following table, *Transformation* and *Scaling-Up* initiatives reshape the core by

- **operating at the interface** of corporate Exploit and Explore environments.
- **engaging collaboration** between Business Unit(s) and Exploration Unit.
- **exchanging explorative and exploitative capabilities**, i.e. Transformation initiatives selectively draw on the Exploration Unit's competence in emerging technologies, business building and innovation methodology - while Scaling-Up ventures leverage core business capabilities for an *unfair advantage*, such as customer access, SCM/operations or brand image.

Dual Innovation

	Business Unit Core Business		Exploration Unit Corporate
Perspective/ Stakeholder	Business Unit Core Business		Exploration Unit Corporate
Innovation Scope	Compatible with BU		Incompatible with BU
Playing Field	*Optimize the Core*	*Reshape the Core*	*Create the New*
Paradigm	Exploit	Exploit/Explore	Explore
	Core Innovation Portfolio	Transformation Initiatives Scaling-Up Ventures	Venture Portfolio
Number of Initiatives	High	Very low*	High

* One at a time if initiative is highly disruptive to core business.

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Therefore, *Reshape the Core* activities demand a **dedicated corporate environment** (*Playing Field*) that meets these requirements, thereby providing an **adequate organizational interface** between Explore management system/Exploration Unit and Exploit management system/Business Unit. Due to their disruptive potential to the broader organization, Transformation and Scaling-Up initiatives should be kept **very low in number** - occasionally one at a time, focusing on either Transformation (*Defense*) or Scaling-Up (*Offense*).

Takeaway

Digital Transformation of companies comes in large part down to managing a dual approach to business model innovation: protecting and adapting the existing business model through Digitalization vs. validating and growing a new digital business model. Properly attuning *Defense* and *Offense,* and thus ensuring an optimal replacement of the existing by the new business model, hinges on two innovation key activities: Transformation and Scaling-Up. Both activities draw on a blend of Exploration and

Exploitation in respect to the needed capabilities and the underlying mode they are managed.

Acting truly ambidextrous and getting the critical business model transition phase right requires having a dedicated environment for these key activities in place. Here, *Explore* and *Exploit* connect and the corresponding organizational units collaborate. **An interfacial environment and the corresponding capability proves vital for a company's long term success.** Adequately designing this intermediate, still widely disregarded *Playing Field* to successfully *Reshape the Core* is at the heart of our proposed Dual Innovation approach.

The post "Digital Transformation: Managing a Dual Approach to Business Model Innovation" was first published by Dr. Ralph-Christian Ohr here https://www.linkedin.com/pulse/digital-transformation-managing-dual-approach-business-ohr/

https://thehumancapitalhub.com/articles/digital-transformation-managing-a-dual-approach-to-business-model-innovation