VIEWPOINT

IS YOUR ECOSYSTEM REALLY ONE?

Established companies that want to compete with wave after wave of startups cannot succeed on their own. A strong ecosystem is necessary, but the traditional, linear ones are no longer adequate.

The next generation of digital natives is coming for you. And the best — and maybe only — defense is calling for reinforcements.

Incumbent enterprises have long nurtured business ecosystems but not necessarily ones with the same maturity level needed now. As established businesses increasingly model themselves after digital natives, it has become clear that strong, collaborative ecosystems are among the most important differentiators.

Increasingly complex, symbiotic relationships are replacing traditional linear value chains. Each member of the ecosystem wants to own part of the customer relationship and use that data to monetize innovations faster. That knowledge is particularly important when interacting with today's sophisticated customers, who are more informed about products and experiences, and more discerning in how they choose and use them.

To build a sustainable strategy, organizations need to design new ecosystems that encourage customer centricity and innovation, and take full advantage of their benefits.

> A sustainable organizational strategy aims to design ecosystems that promote customer centricity and innovation

However, not every ecosystem model is equally effective. What can we understand about the shortcomings of various models, and can incumbents strike back with renewed vigor? How can they capture value in new opportunities that continue to emerge in today's digital society?

Remaining competitive

Global logistics leader FedEx spent much effort to advance its digital capabilities through cloud computing and the use of drones and blockchain. Yet, it is the last-mile delivery — generally outsourced — that makes or breaks value for FedEx's business customers. The static multiyear operations contracts, however, leave partners unable to participate in this value creation. Conversely, if deliveries get delayed, it is highly probable that end customers will automatically place more blame on the logistics provider.

McKinsey research projected that digital platforms could mediate more than 30% of global economic activity by 2025.[1] Stand-alone digital platforms are facing the inevitable fate of being imitated over time. Since Alibaba first launched its digital platform, it was synonymous with e-commerce and dominated the Chinese market with virtually no competitor through the early 2010s. Today, Alibaba is still a giant but not undefeatable. With thousands of platforms, Alibaba's market share shrank from more than 90% to 50%. In a crowded market, Alibaba enhanced its platform's attractiveness by offering extension services such as advertising, logistics, and financing. However, rivals will only accelerate and eventually match all offerings.

An effective way to remain competitive is to take advantage of ecosystems. They provide speed, diverse ideas, and multidimensional capabilities. Loosely constructed ecosystems can emerge over time as businesses interact. But they typically work as a variation on the hub-and-spoke model — with a primary company owning the ecosystem and end customer while other participants provide support.

> Ecosystems help an organization stay competitive as they foster speed, diverse ideas, and multidimensional capabilities

These ecosystems tend to narrowly focus on specific outcomes needed by the primary company, such as:

- Accessing consumer and market information (usage and personalization data providers).
- Enabling market distribution (sales channels, dealerships).
- Smoothing service delivery (logistics partners).
- Building resilient supply chains (chip manufacturers).
- Encouraging new solutions (software developer communities).
- Rapidly launching new joint go-to-market offerings (bank and retail partnerships).

It's doubtful that many of these arrangements deliver the potential of a true ecosystem. The nature of the operating and commercial arrangements between parties offers lesser incentives to attract the best innovation and create the personalized experiences that customers demand. A recent example is the Epic Games vs. Apple legal fight, where each party is vying to own the end customer and extract a greater value from their innovations. Ecosystem models have evolved in recent times and fall into three categories: assembly chains, conglomerates, and platform-based. However, when viewed from the lens of enabling and incentivizing customer centricity and rapid innovation, they each fall short.

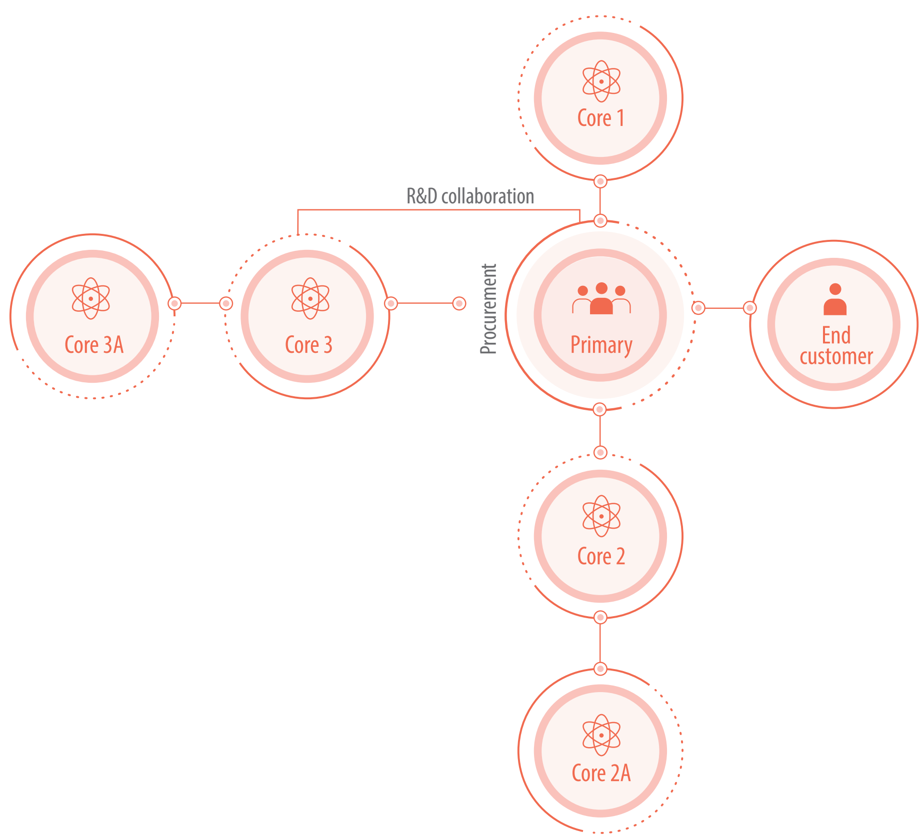
Assembly chains

Assembly chains are a traditional, linear ecosystem model. The interconnected string of core capabilities across company boundaries helps increase the value of an end product. Each entity in the chain has a different core competency, which leads to higher-quality assembled products and efficient supply chains. Recently, these systems have also created a reverse loop to gather end customer feedback and preferences, and transfer those insights back down the pipeline to aid continuous improvement to the ecosystem.

One potential problem with this model is that the ownership of the end customer lies solely with the final company in the chain. The speed at which the whole assembly chain can monetize new innovation is dependent on the ability of that one company. The rest of the chain is often in the dark about the customer's needs, even as the customers themselves are becoming more demanding. Existing commercial models force the assembly chain to optimize for cost rather than for innovation. Trust issues often prevent the primary company from allowing others in the chain to access customer data. Any attempts to own more of the chain will stifle their innovation agility.

L'Oréal, the French beauty multinational, has invested heavily in smart devices, customized packaging, and other digital innovations to meet the demand of the next generation of customers. L'Oréal acquired the skincare augmented reality (AR) leader Modiface to advance its virtual "try-on" offerings. But now, Modiface's

Figure 1. Core capabilities flow toward the primary business before reaching the end customer



ability to innovate is limited with only L'Oréal's consumer data. For L'Oréal, it is challenging to rely on Modiface for all AR innovation needs and to nurture what is arguably a noncore business.

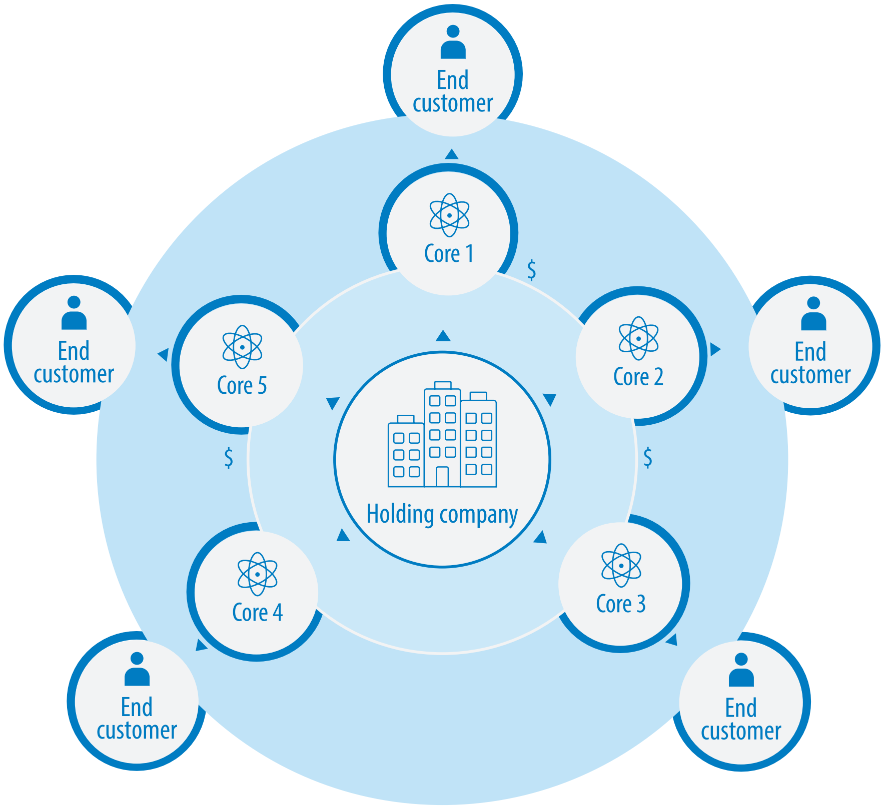
Incumbents need to expand incentive models beyond purchase-oriented constructs, such as contracting capacity or strategic partnerships. Only with a network of trusted providers and open data sharing can incumbents make full use of assembly chain ecosystems.

Conglomerates

In the conglomerates model, organizations build or acquire diversified businesses that serve a variety of customer needs. The parent company maintains capital control over these acquisitions. They often enjoy strong brand power, which, along with scale and scope, can allow the conglomerate to increase its share of the customer's wallet.

The strategic moves of India-based Reliance are good examples of leveraging conglomerate

Figure 2. The conglomerates model has more touchpoints with the end customer



power. The company diversified into telecommunications, retail, payments, media, health care, and energy businesses. The Jio Platforms subsidiary serves as a foundation to connect millions of Indians online and has that country's largest mobile subscriber base. The group is now launching offerings, such as Jio TV+, Jio Meet, and Jio Mart, which bring together the conglomerate's capabilities in a unified experience. Jio is not only consolidating platforms into a single, simpler user experience, but it also showcases the company's ability to offer enhanced features. All its enterprise assets give it a competitive advantage.

The ability to remain agile to dynamic customer preferences is perhaps the conglomerates' biggest challenge. It has traditionally been an investor-centric model: a holding company diversifies capital risk and allows extreme autonomy to individual corporate entities. Each entity has its own priorities for financial performance and market share. The challenge is to rationalize business silos into one cohesive consumer-centric offering and exploit synergies. This requires joint investments into technology platforms and a need to address white spaces in capabilities. Owing to the scale and influence of this fully owned ecosystem, there also tends to be resistance to truly partner with other external innovation ecosystems.

> A conglomerate's top challenge is to remain agile to dynamic customer preferences

Platform-based ecosystems

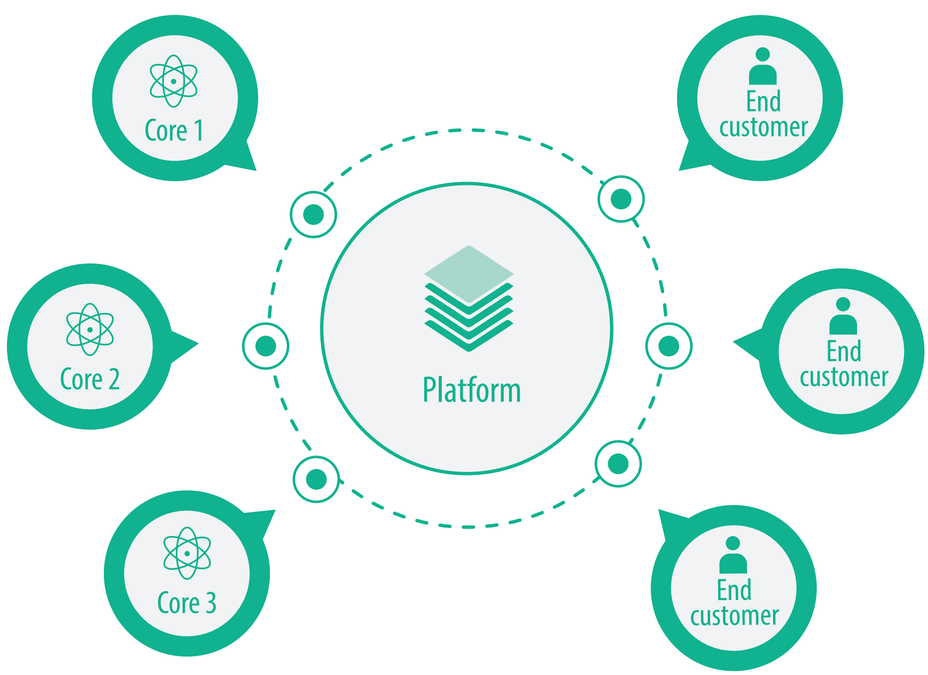
In this model, the dominant partner owns and runs a platform — increasingly digital in nature — that serves as a middleman. The platform-based ecosystem matches providers of services or products with customers. With increased online connectivity, these partnerships are frequently transaction based and offer unique propositions. The platform allows the companies to profile end customers, recommend products, and create a network on both sides that can become an entry barrier for competitors.

A Boston Consulting Group study found that 83% of digital ecosystems involve more than three industries, and the most successful ones have about 40 partners.[2] Nevertheless, when a majority of their revenue comes from charging transaction service fees, platforms face the inevitable fate of being imitated over time. Competitors will eventually offer a lower rate to incentivize customers to switch platforms.

Netflix famously outcompeted Blockbuster by introducing monthly subscriptions and no late fees for DVD rentals. As broadband penetration advanced, Netflix transitioned to online streaming and gained market dominance with licensed content and its recommendation algorithm. Once success metrics were established, companies with deep pockets, such as HBO, Disney, and Amazon, have aggressively crowded this playground. The newly launched Disney+ uses the entertainment giant's extensive archives as a differentiator. Furthermore, Disney+ is strategically priced below Netflix. For the same price, consumers can also access Hulu and ESPN since Disney controls all the content.

The center of this ecosystem is the network interface function of the platform provider. Stickiness can suffer as customers begin to use other similar platforms and providers use other distribution engines. Eventually, a larger part of the transaction value will move to the content providers — even if the value is perceived to be emanating from the platform's capabilities. Should platform owners focus on creating and owning their

Figure 3. Competitiveness of the platform model is increasingly dependent on the content it serves



own product or content and thus build walled gardens? But then, will that not stifle the very innovation they are trying to bring to their customers? And if they stay where they are, will their value to the providers erode? As customers now begin to use multiple competing platforms, does it open up room for yet another aggregator? Recently, Google announced that its new Chromecast streaming device can aggregate suggestions across multiple streaming services, including Disney+, Hulu, and Netflix.[3]

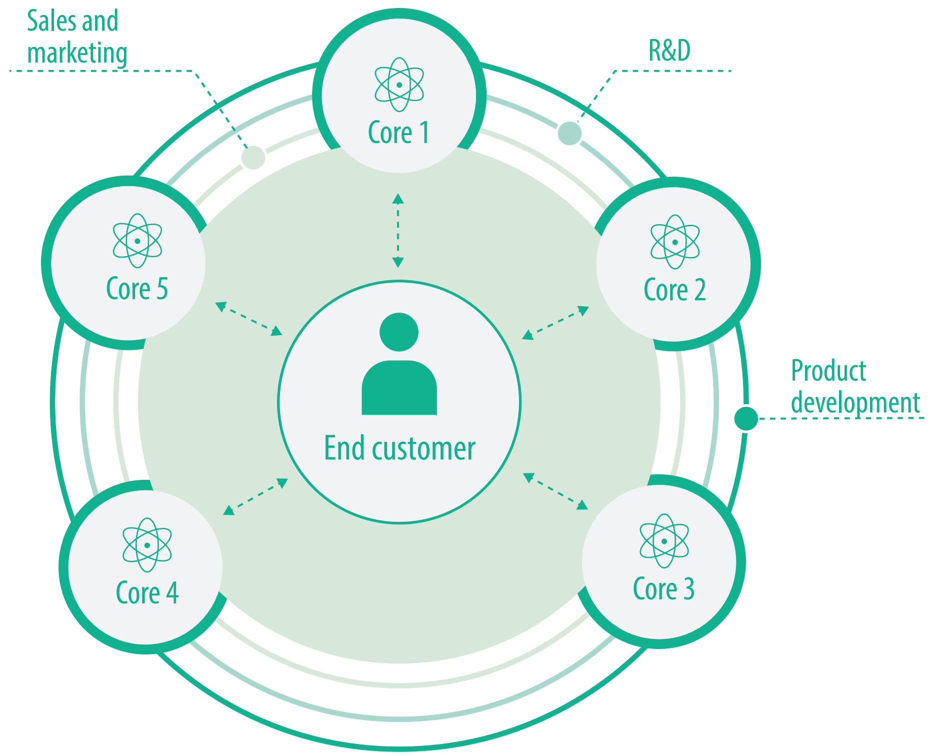
An opportunity to differentiate

The forces that bind an ecosystem together are extreme customer-centricity and innovation agility. The customer needs to be at the center of the ecosystem model. They each need to be present at that moment of truth, when the customer experiences the whole ecosystem.

Consortium and joint venture structures have tried to address this in the past. But again, they fall short due to the walled nature of those relationships and skewed incentives of the participants. Truly enabling this requires:

- CXO stakeholders in each entity to be aligned strategically and operationally. Trust is a key factor — to be nurtured by defining how the success of the ecosystem as a whole is greater than what any one participant can accomplish on its own.
- Dynamic collaboration and communication channels across the departments of each participant. Sales and marketing teams need to talk to each other and work together on product development, finance, procurement, commercial, customer service, and research and development. Insights need to be shared. Plans need to be conceived together. And problems need to be solved jointly.
- Addressing privacy issues that can result from sharing customer data across an ecosystem.
- Joint technology investments as the underpinning that enables the ecosystem.
- Intellectual property preservation in joint product development, and research and development.
- Legal safeguards to prevent unethical exploitation of customer relationships and competitive boundaries.
- Accountability guidelines that make customers comfortable about outcome guarantees.
- Reimagination of commercial models — yardsticks for how individual contribution to the success of the ecosystem-based transaction will be measured and how the spoils of a transaction are shared.
- Educating investors on the value of ecosystem approaches.

Figure 4. The ideal ecosystem would connect core capabilities with each other and the end customer



As we move into a digital society, more growth opportunities are waiting to be captured by organizations that can successfully build a fully integrated and trusted ecosystem. When a multitude of partners are working as a team rather than in a hierarchy, consumer-centric solutions created at a rapid pace can become a reality.

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Authors

Deepak Padaki

EVP & Group Head of Corporate Strategy
deepakp@infosys.com

Amar Harish

Associate Group Manager, Corporate Strategy
amar_harish@infosys.com

Dharma Nadipilli

Program Lead, Corporate Strategy
dharma.nadipilli@infosys.com

Tongyu (Sherry) Zhao

Management Intern

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