



## BIG IDEA

October 2, 2006

# Digital Conglomerates: Setting the Agenda for Enterprise 2.0

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## The Story in Brief

Google, Amazon, eBay, Yahoo, and Microsoft represent a new business species—the Digital Conglomerate (DC). These expansionist business engines present both threats and opportunities for industry incumbents, from automotive manufacturers to telecoms. In their attempt to respond, traditional firms face hurdles that range from legacy offerings and technologies, to creaky cultures and entrenched business models. Some seek anti-competitive regulatory protections like the elimination of Net neutrality, but the likely winners will be more adaptive. Strategies for exploiting the opportunities include partnering, acquisitions, and adoption (or at least mimicking) of DC business practices. But competitive success depends on matching the differentiators that distinguish DCs as Enterprise 2.0 (Open Networked Enterprise) exemplars.

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## DCs are a New Class of Conglomerate, Rooted in the Internet<sup>1</sup>

**A CONGLOMERATE IS A LARGE COMPANY** (like General Electric) with a number of divisions that operate in seemingly unrelated businesses. Digital conglomerates depend primarily on an information and communications technology infrastructure, rather than a “bricks and mortar” infrastructure. They use digital engines to drive innovation, diversification, and growth. Their digital nature and emergent Internet 2.0 technology architectures enable them to blur boundaries among previously unrelated industries. Leading examples are Google, Amazon, eBay, Yahoo, and Microsoft.

Some (like Google) are young and aggressive, while others (like Microsoft) are in catch-up mode, despite evident strengths. They don’t always meet market expectations, as illustrated in the disappointing results of Amazon, eBay, and Yahoo in July 2006. But their ups and downs reflect the vagaries of competition and the management challenges of a maturing marketplace—not the survivability of these companies or their approach to doing business. All, to varying degrees, are now challenging incumbents in a variety of traditional industries (see Figure 1). Especially under attack are traditional players in advertising, retail, telecom, media, real estate, and software. Also notably threatened is the banking industry, where eBay subsidiary PayPal processed \$27 billion in payments in 2005, and Google has entered the market with the GBuy payment system.

**Figure 1: Digital Conglomerates Operate in Many Industries**

|                                       | Amazon           | eBAY                   | Google              | MSFT                       | Yahoo!                     |
|---------------------------------------|------------------|------------------------|---------------------|----------------------------|----------------------------|
| <b>Core offer</b>                     | Retail           | Auction                | Search              | Software                   | Media / search             |
| <b>Main revenue</b>                   | Retail sales     | Auction fees           | Advertising         | Software                   | Advertising                |
| <b>Secondary offer</b>                | Online mall      | Payments               | Software            | Media content              | Retail listings            |
| <b>Digital Conglomerates partners</b> | –                | Google, Yahoo          | eBay                | –                          | eBay                       |
| <b>Advertising</b>                    | –                | AdContext              | Agency, syndication | Syndication                | Agency, syndication        |
| <b>Location services</b>              | No               | No                     | Maps, mashups       | Maps                       | Maps                       |
| <b>Retail</b>                         | Direct           | Listings               | Listings            | Listings                   | Listings                   |
| <b>Telecom</b>                        | No               | VoIP                   | Wi-fi, VoIP         | VoIP, mobile               | VoIP                       |
| <b>Media content</b>                  | Limited          | Limited                | News, entertainment | News, games, entertainment | News, games, entertainment |
| <b>Payments</b>                       | No               | PayPal                 | Gbuy                | No                         | PayPal                     |
| <b>Real estate</b>                    | No               | Yes                    | Yes                 | No                         | Yes                        |
| <b>Auto sales</b>                     | No               | Yes                    | No                  | No                         | Yes                        |
| <b>Software / APIs</b>                | APIs             | APIs                   | SW / APIs           | SW / APIs                  | APIs                       |
| <b>Community</b>                      | Yes              | Yes                    | Yes                 | Yes                        | Yes                        |
| <b>User content</b>                   | Yes              | Yes                    | Yes                 | Yes                        | Yes                        |
| <b>Search technology</b>              | Alexa / A9 (own) | Yahoo / Magellan (own) | Google (own)        | MSN (own)                  | Yahoo (own)                |

Source: New Paradigm research

Digital conglomerates are increasingly challenging incumbents in industries such as retail/wholesale (up to and including automotive sales), telecom, publishing, music, news media, entertainment media, financial services (for now mainly payments), advertising agencies and syndication networks (including classifieds), desktop software, dating services, real estate, photography, research, and travel.

Coming out of the dot-com crash in 2001, several of these companies (Yahoo, eBay, Amazon) were shaky, weakly profitable at best, and had revenues of under \$1 billion. Google barely existed. Five years later they had revenues in the \$5–10 billion range. Takeovers and mergers may shift the balance of power among them but no one doubts their overall sustainability. New players could join the list: Apple with its iTunes/iPod franchise, MySpace (now part of the Fox empire) and perhaps even craigslist.<sup>2</sup> AOL is essentially a DC, but due to its many challenges we have chosen to omit the company from this analysis.

While still a tiny part of the U.S.—let alone world—economy, DCs have unique capabilities and business models that can change the game for a variety of businesses. Like all companies, they also have issues—be it anti-competitive behavior at Microsoft or click fraud at Google. These companies are also vulnerable to challenges from new entrants—and one another.

### ***Digital conglomerates have powerful collections of attributes***

Leading DCs support big, agile, online consumer businesses. The advantages are numerous and, for an old-style organization, tough to replicate. Not all DCs are best of breed, nor do all exemplify the full list of attributes we have identified.

### ***Leading DCs mastered value innovation for “Web 2.0” long before the term became fashionable***

- Attractive, cost competitive, and continually innovative customer-centric value propositions
- Strong end-to-end customer experience design
- Ability to exploit the long tail phenomena (offerings, partners, customers)
- Customer lock-in (to varying degrees) combined with high market share (customer and supply side), exploiting network effects and being first to market
- Effective brand management
- Human capital: Concentrations of brainy, creative people with permission to innovate and take risks

### ***Their modus operandi harnesses the low transaction costs of the Internet economy***

- Innovative, slick business models and innovative use of technology to alter traditional business models
- Ability to scale, enter new markets, and add offerings and capabilities relatively easily
- Effective design and implementation of trust syndication
- Effective management of customer/partner communities and related issues

### ***DCs are effective at boundary decisions, co-creation, and coopetition***

- Create value outside the walls of the organization by harnessing co-creation by customers, partners, developer communities, even competitors

- Ability to coopt competitors as partners by providing them with customer access and technology-based tools

### *DC technology platforms are their secret weapons*

Its executives describe Google as a technology company, rather than a search or advertising company, for good reason.

- Leverage use of commodity and open source software to create high performance, cost-efficient, scalable, quickly deployed technology infrastructures
- Judicious combination of proprietary and “open” strategies. For example, Google opened an API to its Maps offering, but keeps its search technology proprietary.
- Advanced business intelligence technologies enable core value propositions; customer tracking; highly targeted (customer of 1 at a particular point in time and place) “instant of truth” marketing, customer experiences, and segmentation; business process and performance management; and competitive intelligence.
- Technology enables
  - » Rapid innovation
  - » New kinds of continuous, ongoing product and service improvements
  - » Insightful, targeted, and comprehensive real time business and cultural intelligence
  - » Changing the stakes in various markets
  - » High margins that fund investment, growth, and acquisitions

Despite these advantages, each of these companies has captured only a tiny portion of its domestic and international markets, not to mention new industries that appear vulnerable to their strategies. The upsides remain huge, perhaps much larger than is apparent. Further growth will depend on judicious and agile adjustments of their business models on a continuous basis.

## **Five Core Competencies Distinguish Digital Conglomerates in the Marketplace**

1. Engineering prowess and terabytes of real time customer data help achieve supremacy in the informatics battleground.
2. Peer production enables DCs to collaborate externally and enrich their offerings.
3. They are effective at organic diversification, and also know how to integrate acquisitions.
4. DCs design and deliver seamless end-to-end e-experiences that engage and captivate customers. They turn myriad brief encounters and transactions into long-term commitments.
5. “Just do it” business practices enable DCs to excel at agile, near-continuous innovation.

Now that it’s playing catch-up to Google and other Web 2.0 innovators, it’s easy to forget that Microsoft pioneered many of these attributes. It has:

- Gathered and analyzed consumer usage data from Windows users for decades

- Built a powerful network of independent software vendors who leveraged its platforms (by no means an “open” or peer-based model, but one that popularized API sharing and technology “ecosystems”)
- Diversified from operating systems to user applications to consumer devices
- Broadened its applications portfolio from desktop experience design to networked gaming and enterprise management tools

**Figure 2: Five Core Competencies**



Source: New Paradigm research

Google and Yahoo have taken these competencies to new levels and, as a result, now present serious competitive challenges to Microsoft. But they must still leapfrog the master in the marketplace. Microsoft’s past victims include leaders like IBM, Netscape, and Apple. It took on Sony and Nintendo in the gaming industry, and despite a thousand cuts it holds its own against Linux and the open source movement. Microsoft may not be as effective as Google in the five competencies listed above, but it has strengths, experience, and the finances to catch up, and it remains to be seen who will emerge at the top of the heap.

We discuss each of the core competencies below.

***DC supremacy in the informatics battleground stems from engineering prowess and terabytes of real time customer data***

Arguably, Google’s hardware and software architecture is the future of enterprise computing. Behind the split-second speed and accuracy of its searches is a parallel, highly redundant grid of over 450,000 Linux-type servers.<sup>3</sup>

The company spent \$838 million on custom technology and operations centers in 2005 and will invest \$1.5 billion in 2006.<sup>4</sup> Google is a significant hardware company, though most of what it makes is for internal use. Unlike most companies, which lease hardware from IT vendors, Google buys low cost commodity parts and builds its servers in-house. It can rapidly deploy homegrown, prefabricated data centers anywhere in the world by packing them into standard 20- or 40-foot shipping containers.<sup>5</sup> These achievements of control and capability deliver cost-effective, blazing performance, scalability, and agility.

Much has been made of Google's differentiating PageRank system, which ranks a Web search result based on the number of other pages that link to it. This much-tweaked algorithm is essentially a large-scale citation-based ranking technique. But there's a lot more to Google's informatics supremacy than PageRank. Google's homegrown software infrastructure includes several powerful applications that are central to its performance. For example:<sup>6</sup>

- MapReduce assigns programming instructions for parallel execution on many computers. It breaks calculations into two parts. The first stage produces a set of intermediate results. The second computes a final answer.
- The Google File System (GFS) contains a mirror of the public Internet, several petabytes (a million times a billion 8-bit characters) of data. For every file, at least three copies are stored on different computers in a server cluster. If a computer program tries to read a file from one computer and it fails to respond in milliseconds, at least two others can fulfill the request.
- BigTable, a homegrown database management system, stores huge structured data sets for applications like Google Maps, Google Earth, and My Search History. (Google also uses standard relational databases like MySQL in lighter situations.) For tables that are too big for one server, BigTable chunks database tables into smaller pieces called tablets for storage on different computers in a GFS cluster.

With 44 percent of the search market as of July 2006,<sup>7</sup> Google translates computing power into popularity. Terabytes of user data allow it to tailor search results and contextualize ad placements with laser-like precision. This capability has made Google the world's biggest ad agency, with 2005 revenues of over \$6.1 billion. The company plans to invest \$1.2 billion in research and development in 2006, a 148% increase over 2005, signaling that Google knows it must continuously innovate in order to stay ahead. About 70% of the company's R&D budget goes into its core search and advertising businesses.

More than half the world's population accesses Yahoo every month, its Canadian general manager, Kerry Munro told us. "We gather 10-15 terabytes of data every day. It takes a very unique skill set and mentality to think about the problem statement that this entails, and to solve it. It needs to be at least as bullet proof as a carrier, have the storage of an Akamai, plus the ability to do multiple video streaming, understand and support every user's navigation paths, and so on. Imagine the network operating centre that manages this every day at multiple levels!"

Kerry foresees a new kind of architecture. "It will not just ingest vast amounts of content; it will also categorize it, leverage new tagging solutions, and openly represent it on any device at any point in time for 500 million to a billion users. This is much more fluid than the technology you see in financial services. When you look at, for example, the evolution of chip card tech, by the time they have gone to the end of this single technology, we will have evolved 4-5 times."

Microsoft is using a similar strategy in an effort to reposition itself as an online services leader. In June 2006 the company announced a \$2 billion increase to its \$6.2 billion R&D budget, much of which is earmarked to be spent on the company's Windows Live presence (see Figure 3), and at least \$500 million for online services, notably search and advertising. These moves mark Microsoft's entry into direct

competition with other DCs such as Yahoo and Google in the provision of an online platform for communication and services. The Live offering will enable Microsoft to target both consumers, including over 230 million Hotmail users, and corporate clients. The question remains, however, whether this platform will offer enough to compete with Yahoo and Google. Some observers suggest that the company might acquire fellow DC eBay, which would provide a combination of search, auction, payments, and telephony.

**Figure 3: Microsoft's Windows Live Platform Straddles Multiple Application Domains**



Source: Microsoft Financial Analyst Meeting 2006, July 27th 2006.  
<http://www.microsoft.com/msft/speech/FY06/OzzieFAM2006.msp>

Like Google's contextual advertising, Amazon puts user data to work, with collaborative filtering algorithms that provide customers with recommendations on products that fit similar search patterns, preferences or the recommendations of others who have purchased the same product. Similarly, past purchases are reconciled against those of other consumers allowing Amazon to tailor product offers based on sales trends. The ability to capitalize on this real-time data helped Amazon achieve \$8.5 billion in 2005 sales, albeit with disappointing profit results. Amazon has also entered the search market with its A9 search engine, essentially building on top of Google's search platform but with added functionality such as the ability to search through its catalog of books.

***DCs harness peer production to collaborate externally and enrich their offerings***

DCs excel at engaging external developers into communities that benefit both the developers and their host. The Microsoft Developer Network (MSDN) existed offline through most of the 1980s and went online in 1993. It provides a set of online and offline services designed to help developers write applications using Microsoft products and technologies. MSDN engages with hardware developers interested in its operating system, and software developers who leverage Microsoft programming languages, APIs and scripting languages. MSDN's developer centers pull together content and resources around specific products and technologies. They connect users to code samples, community sites, training and certification programs, conferences, technical articles and documentation, and so on. Its Codezone

initiative hosts a series of forums where members self-organize to share advice, experiences, concerns, and application code with one another and with Microsoft.

Recently, Microsoft, emulating the likes of Google and Amazon, began releasing APIs for its online services such as search, mapping and Microsoft Live. A programmer will now be able to combine information from an e-commerce site with Microsoft's Live Local application to provide users with detailed directions from a customer's home to a physical storefront. A spokesperson for Microsoft's MSN division notes, "We think we need to evolve the platform and development story to keep pace with developers who want to build these experiences that reach across the Internet...The more applications, the more value to the user and the more people gravitate to our platform."<sup>8</sup>

Peer production extends to end-customer co-creation. Yahoo Answers gives users the opportunity to ask and answer the questions posed by other members of the Yahoo community. This added-value service sees users who consistently provide constructive answers rewarded with incentives that enable them certain privileges on the site.

Yahoo manages this environment with care and forethought. Prabhakar Raghavan, Head of Yahoo Research, notes: "As a community like that takes off, you want its value to grow faster than the membership. To get that done, you need to find a better way of routing answers to people with questions. Quite likely, after a while, the question that you've asked has been answered by someone already, except in a different guise. How do we play this matchmaker role? How do we create a reputation system that rewards good answers and mitigates poor quality? How do we create an incentive structure for people to exhibit the right kind of behavior for social welfare?"<sup>9</sup>

Others engage their communities—in both active and implicit ways—to create core value offerings. Active engagement results in offerings like eBay's Feedback Forum and rating tools as well as Amazon's product reviews. Amazon's collaborative filtering technique implicitly engages users, milking information about their buying choices to help shape those of others. The most powerful example of implicit co-creation is the Google PageRank system that ranks a Web site on the basis of the sites that link to it, and the relative importance of each of these.

eBay has a small scale developer network. Nevertheless, its initiatives are instructive. The eBay API provides external software developers access to its database of product and sales information that lets them create business-to-business applications and sales tools. When it launched in 2001, eBay charged developers for access. In November 2005 the company made its APIs free in order to accelerate the pace of innovation tied to its auction and retail site. As of June 2006, the eBay Developers Program claimed 30,000 developers and 2,200 applications. Third party applications that drive transactions or provide sales channels into the site now account for 25% of eBay listings.<sup>10</sup> Two of the company's subsidiaries have similar strategies. PayPal's program hosts 2,500 developers who support over 350,000 Web integrators. Skype's community of 3,500 developers have created 350 associated applications and 400 hardware devices. Amazon has a similar initiative; it says that 40% of its revenue comes from third party applications.<sup>11</sup> Meanwhile Yahoo's Developer Network offers 20 APIs for its search function, maps, Flickr, and even its messaging service, and has resulted in 175 different applications.

Sometimes the benefits are more about building the brand than building a revenue generating, or value creating, product or service. The Google Maps API, released in June 2005, has led to over four hundred "mashups"—content and programs from two or more Web sites combined to create a new service. The eBay Real Estate Map, for example, overlays eBay real estate listings on the Google Maps platform. The Forbes Gas Watch mashup parlays content from Gaspricewatch.com to help users to find cheap fuel. Google has released APIs for 19 of its 36 services.

Drawing developers into your network and making it attractive for them to drive traffic and revenue is increasingly essential to competing online. Harnessing the Internet's best minds via peer-production has



itself become a competition. Doing so means providing access not only to software and data but also incentives, be they fun, financial gain, or participation in an engaging and productive community.<sup>12</sup>

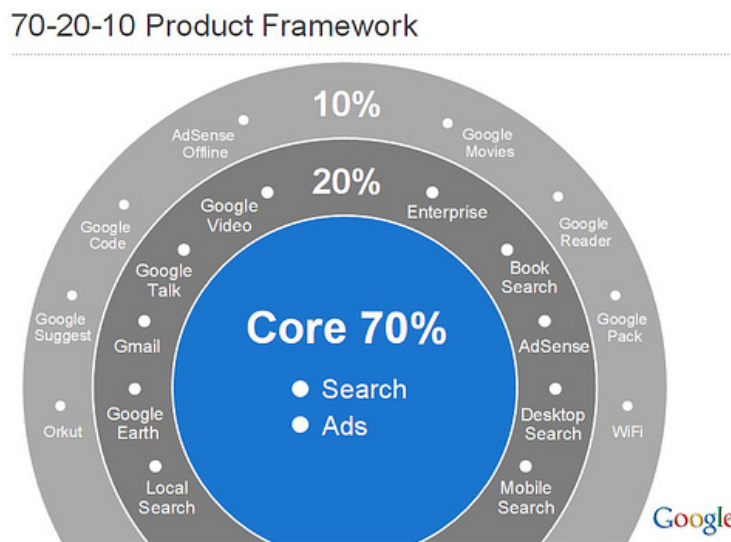
***The core competencies of the Digital Conglomerate enable organic diversification as well as effective acquisitions***

From its beginning in 1975 as the producer of a programming language interpreter (Altair BASIC), Microsoft has balanced organic diversification with acquisitions to enable near-constant market leadership. The MS DOS operating system set the stage for Microsoft’s play in desktop applications, where it crushed early movers like Lotus 1-2-3 (spreadsheets), WordPerfect (word processing) and Netscape Navigator (Web browser).

This organic growth was abetted by a series of acquisitions, such as the 1994 acquisition of SoftImage, a maker of 2D and 3D computer animation graphics, and Vermeer Technologies, whose 1996 purchase provided a position in the growing market for Web page development. The mid-90’s also marked the creation of MSN Online Services and in 1996 Microsoft purchased Hotmail for \$400 million. Since then the company has continued its shift from a pure software developer, heavily dependent on the PC, to a diversified hardware, content, and services provider. This shift was enabled by a slew of acquisitions, from Lionhead Studios—a developer of games for the Microsoft Xbox—to the May 2006 acquisition of Massive Inc., a move the company hopes will help it leverage more advertising dollars from its Xbox and MSN games properties.

Google, which likes to describe itself as a technology company, has been called an advertising agency masquerading as a search engine<sup>13</sup>—so it is already in three industries. The company has leveraged its software and hardware platforms to move into new markets like payments (GBuy), desktop applications (Gmail, Google Spreadsheet and word processing via the Writely acquisition), cartography (Google Maps), telecommunications (WiFi networks in San Francisco and New York City’s Bryant Park) and media (News, Video). It is important to note, however, that despite this steady string of innovations, Google’s revenue is still mostly from advertising (Figure 4). Long-term success depends on rolling out more new services that keep users coming back.

**Figure 4: Sources of Revenue for Google**



Source: Google Analyst Day, March 2nd 2006. <http://investor.google.com/webcast.html>

Since 2003 Google has acquired online properties to enhance its own applications and enter new markets. In February 2003 it acquired Blogger, a leading blog host. A year later it bought Picasa, an online photo-sharing site, in part to provide picture management tools for Blogger. The acquisitions allowed Google to integrate the content held by both into more accurate Web searches, and built the company's photo capabilities at a time of growing competition from sites like Flickr. In May 2005 Google acquired Dodgeball, a social networking software provider for mobile devices, and thus opened up possibilities for location-based services that tie into Google Maps.

Yahoo's rebirth as the Net's most trafficked property has been enabled by acquisitions that gave what was once "Jerry and Dave's Guide to the World Wide Web" (named after co-founders Jerry Yang and David Filo) a broad portfolio of services. In 1997 the company, having lost in a bid to purchase Hotmail, settled for Rocketmail, which it renamed as Yahoo Mail. A July 2003 deal for Overture gave Yahoo its own search engine and ended its reliance on Google. Since then the company has bought properties that integrate into existing products, purchasing social media sites Flickr and del.icio.us to capitalize on their content's advertising potential. These recent acquisitions support an ability to apply tagging to Yahoo search engine results. While Google has focused almost exclusively on technology, Yahoo also draws on the human element, such as user-created tags and on-demand query research.

eBay has spent big dollars on acquisitions. It purchased PayPal for \$1.5 billion in 2002 and Skype for \$2.6 billion in 2005. PayPal is more profitable than eBay's auction business, but the jury is out on the Skype deal. Will a "call me" button on high-priced items increase sales enough to justify the company's investment? Unlikely. We believe that the Skype purchase may have been a move to make the company more attractive to a suitor like Microsoft.

***Digital conglomerates design and deliver seamless end-to-end e-experiences that engage and captivate customers: they turn myriad brief encounters and transactions into long-term commitments***

Providing a seamless experience is what Amazon and eBay do so well. Despite the customer service challenges inherent to retail—not to mention the transparently multisourced retail that these companies provide—both excel at providing a one-stop shop. Amazon now offers 34 product categories, having recently entered the grocery business, and is without equal as a fixed price retailer in the depth and breadth of its offerings. Its peer recommendations and product feedback provide something that users can't find offline—trusted third party voices inside the store that help with buying decisions.

eBay keeps users coming back by building on the trust that is established on the user-driven Feedback Forum, and PayPal integration helps make the experience seamless. Experience is a large part of what drives the eBay Research Labs. Eric Billingsley, a senior director, says, "We're trying to get better at understanding the intent of a buyer. The way we see it, if you're looking for a piece of electronics, you are thinking about very different things than if you're looking for a glass collectible. You're thinking about, how does it fit into my living room? Does it take U.S. power? What's the shipping cost going to be on this thing? You're going to get a list of products and you're going to make a comparison between this, that, and the other... What's of value to you may be very different from what's of value to someone else. We're trying to get a little further down the road of making those into customized experiences."<sup>14</sup>

In addition, Amazon and eBay use online forums, wikis, blogs and other tools to engage and collaborate with users.

Google, Yahoo, and Microsoft offer users suites of products to keep them engaged. Google has evolved: from simple searches on the Web to a complex user relationship that involves search, content, software and now, even the desktop. While search underpins the company's success, Google's ability to keep users on board in the face of growing and more sophisticated competition is due to an ever

expanding offering—an extensive set of tools and applications that provide the starting point for a Net-based “thin client” personal computing environment. Similarly, Yahoo has grown from Web guide to portal host, providing a one-stop shop for everything from shopping to dating to finding your next job. Personalization is central to retaining the DC’s customers.

But customization only takes you so far. The ability to channel users from a personal portal into revenue-generating services that utilize home grown payment systems and communication tools will determine success. DCs proffer a long-term relationship that extends beyond any one function and focuses on providing a variety of services and products. These conglomerates have defined a new set of expectations for e-commerce and e-services that incumbents must increasingly match. Ease of use, variety and speed have allowed the DCs to turn what most incumbents would experience as brief encounters into long-term commitments, and subsequently into mountains of advertising revenue.

And while Microsoft has been slow in its efforts to deliver online services platforms comparable to Google and Yahoo, the company’s shift has accelerated with the release of Windows Live. In late July 2006, Microsoft Chief Software Architect, Ray Ozzie, told shareholders that success means delivering a seamless experience across any and all media. The company’s latest strategy is to use its Windows Live platform as an “experience hub” that locks in customers whether they use a mobile handheld, computer, or Xbox. Ozzie notes, “in developing applications and solutions in this new era, we use an experience-first, service-centric approach—a holistic approach across the Web, the PC, and other devices, an approach that uses the Windows Live services platform to kind of bring it all together.”<sup>15</sup> These efforts will determine the balance of power among Google, Yahoo, and Microsoft.

***“Just do it” business practices enable the DC to excel at agile, near-continuous innovation***

One thing that differentiates Google is its pace of innovation. By releasing new offerings as beta projects, it floods users with new choices, and captures valuable feedback so it can continuously improve, re-releasing updated and improved versions. While many products released this way have gone nowhere, the successes provide competitive advantages.

Google Maps is an example. It spent six months in a public beta before released as part of Google Local in October 2005. In its early beta stages the application supported only Internet Explorer and Mozilla browsers; by the end of its beta term, all major Web browsers were supported. Satellite images were subsequently introduced and later, a hybrid view that combines satellite images with road maps. Google first released its Maps API during the beta phase, allowing outside developers to build adaptations of the product and suggest improvements and fixes.

This technique of rapid, iterative releases is now being mimicked by others such as Yahoo, who released a beta of its user interface in 2006, and Amazon who released a new beta of their A9 search engine. These initiatives extend Microsoft’s long-held “eat your own dog food” beta testing approach outside the organization, capitalizing on the *all bugs are shallow* mantra of peer production.

Google’s innovation strategy also allows it to “just do it” across a wide range of industry applications. From logical extensions of search, such as mapping and Desktop, to new kinds of applications such as payments and spreadsheets, its innovation process facilitates diversification. Its next target will perhaps be the \$14 billion Yellow Pages industry—the natural destination for local queries. A combination of search, mapping data, and a mobile partnership could create a feasible, if not outright dominating, alternative to the big yellow book.

But Google isn’t alone. The company’s dominance is food for thought for other DCs like Amazon and Microsoft that see innovation as the key to success. Both are rolling out digital offerings to compete

with the iPod. Amazon's A9.com search product and Microsoft's MSN Live raise the bar for search and communications respectively and prove that continuous innovation is critical.

## Incumbents Should Consider a Portfolio of Strategies in Response to the DC Challenge

The challenge affects many industries: finance, retail and telecommunications to name but three.

- eBay's PayPal payment system processed \$27.5 billion in 2005, in 55 markets and 7 currencies. The company's planned expansion will place it in 103 markets and 17 currencies.<sup>16</sup>
- Amazon and eBay together process over \$50 billion in annual sales, and in eBay's case, a growing number of retail storefronts are run by both small and large businesses.
- Amazon, albeit with help from the iPod and illegal downloads, helped knock Tower Records into bankruptcy as consumers flocked to online music retailers instead of brick and mortar stores.
- Meanwhile the American Booksellers Association has lost nearly half its members, dropping from 3,500 in 1990 to 1,700 in 2005.<sup>17</sup>
- Wikipedia today gets most of the blame (or credit) for damages to the *Encyclopedia Britannica*, but Microsoft's Encarta CD encyclopedia was the initial perpetrator.
- Skype—home to over 113 million registered VoIP users—processed 7% of all international long distance minutes in the first three months of 2006.<sup>18</sup>

But while DCs represent challenges or threats to some, to others they provide new potential partners, sources of technology and capabilities, and new pathways to customers.

We've identified four response strategies that incumbents can embark upon to help meet the growing challenge provided by these new business models.

1. Get into the game via acquisitions
2. Exploit DCs as a new channel to market
3. Partner with a DC and align interests
4. Embrace DC strategies at your own company

While each strategy has its merits, we believe that sustainable success combines immediate tactical defence and offence, with long-term competitive strategies that embrace DC type transformations.

### ***Missing the point: The use of regulatory and market constraints to limit DC effectiveness***

As we'll describe in detail later on, we believe the key to competing in the age of the DC lies in embracing the core attributes of their success. Others, however, have looked to regulation to limit the success of these new competitors, rather than view them as potential harbingers of new markets, sales channels, and opportunities for growth and innovation. While regulatory and legal stratagems may be based in law, they often seek to avoid the inevitable.

Regulation has been a response to competition since the beginning of commerce. During the 1940s, RCA led the AM radio industry's efforts to have the Federal Communications Commission put a halt to FM-band innovations. Patent and copyright holders routinely seek legislative extensions to their protections. Copyrights, which didn't even exist at the time of the American Revolution, now last over 70 years—and many holders believe that's not long enough.

Today such responses serve the same purpose: to protect industries and business models that face challenges from innovative technologies and the people and companies that have identified new ways to use them. The telecommunications industry's effort to nullify so called Net neutrality is an example. As DCs, notably Google, Microsoft and eBay's Skype, encroach on phone and cable markets, incumbents led by AT&T, Verizon, and Comcast have sought support from the U.S. Congress to end Net neutrality—a concept that does not distinguish between types of, or sources of online content. Today's Internet is "neutral" in that anyone can transmit or receive anything. Tomorrow, ISPs would like to be able to favor their content (e.g., movies that they sell through Web sites that they own) and charge an up-fee to third parties (e.g., movie distributors that they don't own). Their argument: content providers earn revenue without having borne the costs of the networks that deliver it. Differentiated pricing, the incumbents argue, will support infrastructure development and innovation.

Now what they would like to do is use my pipes for free, but I'm not going to let them do that because we have spent this capital and we have to have a return on it. For Google, Yahoo or Vonage to expect to use these pipes (for) free is nuts!

—Ed Whitacre, CEO, AT&T

DCs, whose business models depend on cheap neutral bandwidth, have responded with lobbying efforts of their own. They argue that a market-priced approach would favor big companies. Innovators (like them) and small entrepreneurs and individuals—the sources of many innovations and jobs in the Internet economy—would be at a significant disadvantage.

Beyond the widely-hyped discussion about broadband video is an effort by telecom industry incumbents to stymie voice over IP (VoIP). Making money from selling videos is a big upside—but still an unproven revenue stream for cable companies and telcos that double as ISPs. Meanwhile the likes of Skype, AOL, and MSN are eating up the telcos' voice revenue stream. Today, it's traditional land-line telephony. Tomorrow it will be the far more profitable and rapidly growing mobile services.

But is regulation the answer? The DCs accurately gauged a big shift in communication methods and have used it to bolster their user-centered platforms. AT&T, which spends only \$130 million per year on research and development despite revenues of over \$44 billion, relies on an increasingly archaic business model.<sup>19</sup> Whether or not it has the right to filter and segment traffic on its pipes avoids this much bigger issue.

Innovation is at the heart of another battle—this one between Google and the Association of American Publishers (AAP). Google plans to scan and digitally distribute texts from library collections, providing full text from works whose copyright protection has expired, as well as searchable snippets from works still under copyright. The Association of American Publishers believes the search giant's plans violate copyright. Google says the project is consistent with fair-use copyright doctrine under U.S. law, which allows for excerpts in book reviews. It plans to let people search the texts while collecting advertising revenue from marketers. The AAP suit seeks a court declaration that Google commits infringement when it scans entire books covered by copyright, and a court order preventing it from doing so without permission from copyright owners.

The publishing industry may indeed be correct in its interpretation of the law. But regulatory action to impede Google's quest to digitize published works fails to take into account the potential upside. By opening their content in this way, publishers can exploit a new channel to readers. In addition, publishers might negotiate an agreement with search operators like Google that lets them share in the advertising revenue that is associated with book content searches. Relying on regulation once again sidesteps a necessary evolution by the industry in question.

*Response Strategy 1: Get into the game via acquisitions*

Incumbents can use acquisitions to gain access to the kinds of businesses and customers that characterize the DCs. Media firms such as The New York Times Company (About.com) and News Corporation (MySpace) have led this trend. Of course, the challenge is leveraging the assets of such properties into traditional businesses.

The New York Times has a thoughtful multi-platform strategy, aimed at finding new ways to monetize the company’s content. With 1.1 million daily subscribers and nearly 4 million daily readers, the company’s online strategy was bolstered by the acquisition of About.com in March 2005. Senior Vice President of Digital Operations, Martin Nisenholtz notes, “We need to find ways to monetize our content and not necessarily think of that in the immediate future as a dramatic transformational event but rather as an evolutionary one. So we need to keep our existing businesses in balance and invest appropriately to ride the transformation with just the right wave.”<sup>20</sup>

The Times bought About.com, a consumer-oriented “how to” site from Primedia, for \$410 million. Content for the site is provided by paid “guides” who must publish a full length article every 14 days and update their blogs three times each week. The acquisition, according to Nisenholtz, reflected three strategic trends:

- The centrality of search: “Search has become an important new paradigm for consumer use of the Web. It has become the way that people use the Internet now. You need to be able to have a library of content that is visible in search, well optimized for search, and is the end point of a search.”
- Low cost, user-driven content creation: “You can’t support the creation of high-cost content at this point, so the content creation methodology is one where guides or experts own particular categories. The community itself will ultimately make judgment about whether the content is valuable or not.”
- Targeted advertising at the instant of truth: “Specificity will be rewarded as interactive advertising is all about interactivity with the end-user, and therefore when the consumer is faced with advertising that’s highly relevant to them, at that time.”

According to Nisenholtz, adding About.com’s 57,000 discrete topics and over 1.3 million articles has delivered synergies in content and advertising. An additional benefit has been About.com’s search engine optimization (SOP) and advertising inventory management tools that have been extended to the company’s new Times Select offering as well as regional sites like Boston.com. With About.com’s SOP the Times has been able to “dramatically increase the number of users and the number of paid views to its free site, while at the same time getting a new revenue stream for Times Select.” About.com also benefits. Through June 2006 its revenues increased 78% over the previous year, while operating profit grew by 177%.

More widely publicized was NewsCorp’s July 2005 purchase of MySpace.com. The \$580 million deal was a drastic departure from NewsCorp’s traditional content and advertising businesses and signaled a bold entry into DC territory.

NewsCorp Chairman and CEO Rupert Murdoch noted, “We’re looking at the ultimate opportunity. The Internet is media’s golden age.”<sup>21</sup> He admitted that his company had previously failed to engage successfully with the online world. A self-styled “digital immigrant,”<sup>22</sup> Murdoch has spent nearly \$1.5 billion on Internet properties including MySpace and news site IGN.com. MySpace possesses a log of 100 million user preferences, online behavior and personal information which NewsCorp believes will help it tailor lucrative contextual advertising on the site.

MySpace advertising and site search will be handled by Google, which, in August 2006, agreed to pay \$900 million over three years for these rights. By virtue of this deal, NewsCorp combined its acquisition response to the DC with a major partnering initiative. In just twelve months, NewsCorp recouped its investment in MySpace. Meanwhile membership on the site quadrupled and page views came to rank second only to Yahoo. Then, in September 2006, NewsCorp announced a dramatic indie-music initiative that challenges incumbents like Apple and major music publishers.

“To find something comparable, you have to go back 500 years to the printing press, the birth of mass media—which, incidentally, is what really destroyed the old world of kings and aristocracies. Technology is shifting power away from the editors, the publishers, the establishment, the media elite. Now it’s the people who are taking control.”

—Rupert Murdoch, Chairman and CEO, NewsCorp<sup>23</sup>

A similar, though more modest, strategy was employed by HP in its March 2005 purchase of Snapfish, an online image printing and sharing service with over 24 million registered users and a billion photos stored online. According to HP, the acquisition leverages Snapfish expertise in online photo services and complements its existing imaging businesses. The acquisition marks a recognition that HP must also respond to retailers that provide photo printing outside the home.<sup>24</sup> The purchase provides access to a community of users that is growing by more than 1 million per month; 90 percent of Snapfish customers have recommended the service to others. If Snapfish can improve the digital photo experience, it could build a bigger market for digital cameras. As part of the deal, HP products are available via the Snapfish store, and photography tips and information are provided via HP to Snapfish members.

The key to an acquisition strategy is finding assets that are complementary to your brand, offerings, and business model. What will help drive traffic to your business, like Snapfish users search for HP products? What will drive revenue, like MySpace’s deal with Google? And finally, where are the synergies between an online business model and your portfolio of businesses, as the New York Times identified with About.com? Acquisitions must help provide advantages that differentiate your offerings and not only tie into existing lines of business, but also generate synergies that keep users engaged with your site or product. All three of these examples also point to the rise of user-created content and its importance in the growing sphere of Web 2.0.

### ***Response Strategy 2: Exploit DCs as a channel to market***

While DCs may offer incumbents cause for concern, they can also provide new channels to market. Be it eBay as a new sales channel, pay-per-click advertising from Google and Yahoo, or a partnered storefront on Amazon, the opportunities are as real as the threats.

Since 2001, Best Buy, Fujitsu, IBM, HP, and many others have taken up the massive market of eBay consumers. The site offers online storefronts at eBay Stores, a channel dominated by small- to medium-sized businesses but increasingly the domain of large multinationals looking to offload excess or refurbished goods. In fact, IBM is rumored to be eBay’s biggest customer.

These companies rarely deal directly with eBay. To avoid the hassles of shipping one-off items to consumers around the globe, most outsource their eBay storefronts to service providers like Accenture’s Connection to eBay or ChannelAdvisor. Its clients include IBM, Best Buy, Sears, and Motorola. Sears, for example, has seen monthly eBay sales rise to over \$1 million. And rather than recover just 10 to 15 percent of its costs through traditional product liquidators, the company, according to ChannelAdvisor CEO Scott Wingo, realizes five times as much via eBay.<sup>25</sup> Sears operates two primary eBay storefronts, a liquidation centre for returned items ranging from diamond earrings to power tools, and an overstock

centre that dishes out brand new items from its network of U.S. stores. Since its establishment in 2003 the Sears liquidation centre has accumulated over 65,000 positive sales reviews. It now runs 300 to 1,000 auctions each day.

eBay has moved beyond simple online auctions. Its growing fixed price and storefront presence provides retailers with both threats and opportunities. With over 383,000 “stores” and nearly 34% of its products now sold at fixed prices, eBay touts a “shopping mall” with over 71 million potential customers.

Google, Microsoft, and Yahoo offer platforms for advertising and content distribution that for many incumbents exceeds the threat they represent. Google, which industry experts estimate holds 57% of the online advertising market, grossed \$6.1 billion in 2005, with an estimated 99% of the revenue coming from its AdSense and AdWords services.<sup>26</sup> As consumers spend more media time online, this number will continue to increase. Though U.S. consumers now spend 23% of their media time online, the Web gets only 6% of advertising expenditures.

As with eBay, the model is built on engagement: connect with users in a context that reflects their search needs. Be it via pay-per-click or pay-per-view video, search advertisers provide an unmatched ability to identify a customer and what she wants at a moment in time. Tapping into this ability, and the database of information that a DC uniquely possesses, is crucial to capitalizing on these new opportunities.

Incumbents need to realize that DCs are as much a blessing as they are a curse. While companies such as IBM, Sears, and Fujitsu may today use eBay as a sales channel, this is not enough. Incumbents also need to build DC-type tools into their core offerings. Exploiting the potential offered by an online presence supported by DCs, be it localized search, contextual advertisements, or a linked storefront can bring substantial value to those who act quickly to build their products or services into the tools enabled by DC capabilities.

### ***Response Strategy 3: Partner and align interests***

While exploiting DCs as channels to market can provide value, any of your competitors can do it. A more differentiating approach turns DCs into partners. DCs have hooked up with one another to build their product or service offerings, such as Yahoo and eBay, or Google and AOL, each capitalizing on the other’s unique competencies. Much of this also reflects competitive jockeying for position among the DCs themselves.

True partnerships (as opposed to supplier deals) between DCs and traditional incumbents can be hard to pull off. Examples of successful partnerships are rare. Most are superficial, based on advertising or distribution, in reality just glorified examples of our second response strategy—channel to market.

Prudential Real Estate’s online marketing program is “powered by Yahoo” in what both companies describe as a joint endeavour. In fact, Prudential promotes the relationship in its television advertising. At the same time, Yahoo ensures that the Prudential relationship does not bias the real estate listings on its own site. Says its Canadian General Manager, Kerry Munro, “We have a group of people called the ‘paranoids’ who can force us—right up to the executive level—to change something that denigrates the user experience. Their mandate is to ensure that we are unbiased, that users gain access to the information they are looking for in an unbiased format. So they’ll see Pru listings, but also those of other companies. Otherwise we’d end up cutting off our fastest growing channel.”

Sun Microsystems and Dell have partnered with Google to distribute Sun’s software with Dell’s hardware, providing added value to consumers and building off Google’s brand. These deals deliver added benefits for Google, helping its move into the desktop and workstation software markets.



Google's entry into user applications, be it Google Desktop, spreadsheets, or word processing represents a growing (and value-destructing) threat to Microsoft Office. SAP faces a similar potential threat as the leading supplier of enterprise application software. The solution is a partnership that draws business data from SAP's accounting, human resources, and inventory applications into Microsoft Office. The deal makes Office more useful for corporate customers and does the same for SAP, adding value and differentiation from its competitors' products.

These examples have a common thread: partnering to provide a differentiated offering that competes with DC's initiatives. With it comes the convenience and value that enables customer lock-in and retention, and further ingrains partners' brands into the lives of their users. This strategy also allows incumbents to benefit from the engineering prowess and data dominance of the DCs to create their own competencies without investing independently in technology or infrastructure. Could a retail chain partner with Google to revamp its online presence and compete head to head with Amazon? Could traditional media outlets work with Yahoo and Microsoft to stay current in the age of mobile digital media? Ultimately yes. Partnerships of old and new business models offer incumbents opportunities to gain a competitive edge over DCs.

#### ***Response Strategy 4: Embracing DC strategies***

While acquisitions, channel initiatives, and partnerships can deliver value, DC strategies also provide transformational opportunities for incumbents that can embrace new approaches to doing business. Few, so far, have chosen to do so.

Frankfurt-based Dresdner Kleinwort (DrKW) is one that has taken bold steps in this direction. DrKW is the investment bank arm of Dresdner Bank AG. It achieved revenues of \$2.67 billion in 2005. The bank aims to double its revenue over the next three to five years. However, doing so in a market dominated by rivals like Goldman Sachs, Merrill Lynch and Deutsche Bank has forced DrKW to focus on innovation and building its expertise in capital markets.

Under the leadership of CIO JP Rangaswami the investment bank has embraced e-applications and several DC attributes as part of a strategy to enhance innovation, collaboration and consumerisation (defined as delivering e-experiences that consumers have learned to expect into the business environment). Rangaswami notes, "The drive toward 'consumerisation' affects the expectations of our customers. If a customer says they want to be able to act in a certain way on a cross-asset basis then that is defining a problem for me. Our problem is thus to find the cleverest way of doing it, one that satisfies risk needs, security needs, and regulatory needs."<sup>27</sup>

In addition to consumerisation, Rangaswami sees several lessons from the success of digital conglomerates, which he views not only as exemplars but also as future competitors. In September 2005 the company released AmazonBay, a fictional video account of what some at DrKW, including Rangaswami and Sean Park, Head of Digital Markets and creator of the video, see as the potential dominance of DCs in financial services by 2015 (Figure 5). While the threat may be hypothetical, it speaks to the company's mantra of "unexpected thinking, radical thinking, inspiration." Rangaswami notes, "Google, Amazon and eBay are setting a new agenda that is forcing the CIO to answer a new set of questions about value and technology. But understanding this new environment means knowing what's going on today, and what could be going on tomorrow."<sup>28</sup>

Figure 5: What the Future Holds for the Digital Conglomerates



Source: AmazonBay, Sean Park, Head of Digital Markets, Dresdner Kleinwort. [www.parkparadigm.com](http://www.parkparadigm.com)

Adding to the imperative for change was a structure where organizational departments operated like fiefdoms, hoarding information about clients and services. To enhance client focus, Rangaswami first aimed at breaking down information silos, a job which he claims was easy “once people worked out that by leveraging the talent and experience of their colleagues, they made more money. Then, resistance to the idea of collaboration dropped.”

DrKW’s strategy emulates the DC in several ways.

***Engineering prowess and terabytes of real time customer data help achieve supremacy in the informatics battleground***

Rangaswami notes that Google and Amazon aren’t necessarily a threat because of their size and breadth, but rather because they’ve set a new benchmark for customer expectations of technology-enabled convenience and functionality.

Our approach to the emergence of this new business model was not to look solely at the success of Google or Amazon, but rather to ask how, as a result of these successes, have customer expectations changed and how can we engage with these changes? These guys have set a particular benchmark which has a whole set of implications as to how we interact with the client.

–JP Rangaswami, CIO of DrKW

Responding to customer expectations meant a new technical architecture that lets the organization mine its data to provide customers with more value. The architecture is based on four elements:

- Publishing: The acquisition of content through a subscription mechanism (RSS, blogs) and a focus on content the customer wants to receive.
- Search: Extending content from what customers actively search for, to include the added value of collaborative filtering based on preferences and transaction approaches.

- Conversation: Client interaction tools are evolving to include telephony, blogs, instant messaging, and video chat.
- Fulfillment: DrKW's focus must be squarely set on the customer experience and will be modeled on value and convenience leaders like eBay and Amazon.

This architecture necessitates significant changes. Rangaswami notes, "This new breed of reconstruction requires engineering smarts that start at a much lower level of the enterprise architecture than was the case before."

### *Harness peer production to collaborate externally and enrich offerings*

An investment firm is probably the last place you'd expect to embrace new technologies and collaboration as part of a grand strategy, but this is exactly what Rangaswami and his colleagues have done at DrKW. Driven by customer needs and the demands of a competitive marketplace, the company has leveraged peer production by making internal developments such as releasing its "Openadoptor" messaging system to the open source community. The impetus was twofold: increasing utilization of the program beyond DrKW's doors into the mainstream, and gaining external contributions to its development. Rangaswami notes that open source is an attractive option, not because of its low cost but rather because of the flexibility, adaptability and mobility it provides. "Free as in freedom, not free as in gratis. Democratized innovation is the only option and it is the only way," he said.<sup>29</sup>

Internal collaboration at DrKW is led by an extensive internal blogosphere that now includes over 450 employees, an environment that Rangaswami describes as "a record of our organization's thoughts and conversations." Deploying the collaborative technology was based on three caveats:

- Blogging was gaining steam in mainstream circles.
- Blogging could help the company break down departmental walls and increase sharing.
- The value of giving employees a medium to express themselves and share their ideas could not be overestimated.

The company even took the concept one step further creating external, public blogs accessible beyond the firewall. The organization also uses RSS (Really Simple Syndication) to inform employees when the content of wikis or blogs changes.

We realized that these digital conglomerates were already using instant messaging, blogs, wikis, and chat channels very efficiently to deliver value to the client rather than just improve processes within the firm. So we asked ourselves what does that mean for us, in particular, as a means of pushing out our research to our client base? How can we best use collaborative filtering in order to improve customer choice? How can we build an infrastructure that actually allows us digital scaling and an ability to cope with the long term?

—JP Rangaswami, CIO of DrKW

### *Design and deliver seamless end-to-end e-experiences that engage and lock in customers: turn myriad brief encounters and transactions into long-term commitments*

In the brutally competitive investment industry, DrKW's product is not just research and services but trust. Rangaswami notes, "It's relationships first, conversations second, and transactions third." Doing so has meant reconstructing the firm's processes to ensure that the customer is seen as an asset, not a liability or a source of frustration.

The challenge of attracting customers has grown due, in part, to the transformation of expectations that has accompanied an electronic marketplace. “We have to provide a different way to attract and retain the customer. Part of this involves understanding that the marketplace is electronic. We had to find ways to learn about the importance of simplicity and convenience, the removal of device or channel lock-ins, and a movement towards the mindset that the customer’s information actually helps.”

The company’s technical architecture has therefore evolved—with the customer at its core—to meet several of these new expectations. In particular, the architecture increasingly provides a seamless experience. Enabling this experience is facilitated by three key factors:

- Platform independence: Applications must be designed as device-, location-, and platform-independent. Rangaswami notes, “The challenge is how to track the simple platform biases and work them out of the system so that they become not only platform independent but platform agnostic.”
- Open Source: Use of open source elements, with extensions to create some lock-in.
- An evolution of the presentation layer: The key is providing the customer with the right exposure, the right interaction, and the right place to escape. What is the next metaphor of client interaction? Will it be Excel, TV, Google, or Xbox?

### ***“Just do it” business practices enable agile, near-continuous innovation***

Like the DC’s use of rapid fire beta testing and iterative product development cycles, innovation at DrKW is focused on speed to market. Hosted in DrKW’s new Digital Markets department headed by Sean Park (director of the AmazonBay video), the unit focuses on the development, deployment, and use of electronic and Web-based services for trading, execution, and analysis. And like Google’s use of its beta page to pre-launch new services, DrKW hopes to try out thousands of new products in hope of finding two or three winners.

Rangaswami adds, “We probably have more people working on semantic Web concepts than could be expected of a traditional end-user IT department because we know that some of the Holy Grail lies in getting this right. We have a user-centered design team which would not normally exist unless we were in the business of creating retail end-user product. But consumerisation and the Net Generation mean that we have to prepare for a new customer-centric environment.”

This culture of “just do it” innovation has extended into the corporate culture. Rangaswami is attempting to transform a traditional command and control environment into one where employees gain greater control over decisions. He notes that once employees are armed with the proper resources, “they want you to get out of their way.”<sup>30</sup> They want to just do it. Combined with the use of collaborative technologies, this attitude is helping DrKW create a youthful, dynamic corporate culture—one that embraces sharing and client-focused innovation.

## **Conclusion and Recommendations**

The driver for the changes at DrKW has been consumerisation and the desire to satisfy an evolving set of consumer demands—an evolution that has been facilitated by the five DC differentiators that facilitate innovation, speed, convenience, and value. Rangaswami notes that the disruptive power of “the Four Horsemen”—eBay, Amazon, Google and “whomever”—will one day find its way to the core of the financial services industry. He notes, “it is only a question of time: the opportunities for these disruptive technologies will become over-fished, and financial services will stand out more and more as a giant opportunity to be taken on.”

But more than a threat, DCs present a strategic opportunity to learn from their successes. What better way to compete with the DC than to embrace and deploy the very strategies that have made them so successful. The five DC differentiators are key elements of future competitiveness and, like DrKW, provide a basis for incumbents to step up to the challenge. Doing so means adopting transformational strategies and playing by a new set of rules.

1. Focusing on engineering prowess and building a database of real time customer data helps achieve supremacy in the informatics battleground. Where finances preclude building your own, partner with those that excel at it.
2. Harness peer production to collaborate externally and enrich your offerings. Doing so, however, requires transparency and openness. Build trust with your peer community and create meaningful incentives for participants.
3. Focus on core competencies that enable organic diversification as well as effective acquisitions.
4. Design and deliver seamless end-to-end e-experiences that engage and captivate customers. Turn myriad brief encounters and transactions into long-term commitments.
5. Enact “just do it” business practices that enable you to excel at agile, near-continuous innovation.

Not every company is ready to make the dramatic jump to deploy these strategies. Progressive companies can and should begin by exploiting the opportunities and insights provided by the DC to emulate their successful acquisition strategies, and to use them as a sales channel to reach millions of new customers with specific messages and services.

## Future Implications

Digital conglomerates don't threaten every industry, let alone every incumbent. But it's now irrefutable that digital business models work. They are in their early days, and the bulk of their impact, and of others like them, is still to be fully realized. Five years from now they will have vastly more processing power, bandwidth, market data, and end-customers. Any business that is information-driven, whether risk-oriented (like moviemaking) or risk-averse (like insurance) must consider the threats and opportunities posed by digital conglomerates.

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## Endnotes

<sup>1</sup> Thanks to our friend and colleague David Kirkpatrick who first introduced the idea in "Google, Yahoo, and eBay: Next-Generation Conglomerates?" *Fortune*, September 30, 2005.

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<sup>10</sup> Stacy Cowley, "eBay Opens Its Doors To More Developer Partners," *CMP TechWeb*, August 4, 2006.

<sup>11</sup> Deepak Ramachandran and Brendan Peat, "ICICI: Innovation in the Hot House," New Paradigm Lighthouse Case Study, July 2005.

<sup>12</sup> Paul Rademacher, the creator of housingmaps.com, widely acknowledged as the first successful mashup of Google's mapping APIs, notes that one of the reasons he walked away from the application for a job at Google was the inability to monetize what was essentially others' IP. However, the value created for craigslist's classifieds was enormous.

<sup>13</sup> "The ultimate marketing machine—Internet advertising," *The Economist*, July 8, 2006.

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<sup>22</sup> Rupert Murdoch, Speech to the American Society of Newspaper Editors, April 13, 2005, [http://www.newscorp.com/news/news\\_247.html](http://www.newscorp.com/news/news_247.html).

<sup>23</sup> Ibid.

<sup>24</sup> "HP to acquire Snapfish photo service," *News.com*, [http://news.com.com/HP+to+acquire+Snapfish+photo+service/2100-1025\\_3-5628823.html](http://news.com.com/HP+to+acquire+Snapfish+photo+service/2100-1025_3-5628823.html).

<sup>25</sup> Erick Schonfeld, "Corporate America's New Outlet Mall Big Companies are Showing up at eBay," *Business 2.0*, April 1, 2004.

<sup>26</sup> Charles C. Mann, "How Click Fraud Could Swallow the Internet," *Wired Magazine*, January 14, 2006, <http://www.wired.com/wired/archive/14.01/fraud.html>.

<sup>27</sup> JP Rangaswami as quoted by Dan Barnes in "Technology: Tech Vision," *The Banker*, April 1, 2006.

<sup>28</sup> Interview with JP Rangaswami, Chief Information Officer, Dresdner Kleinwort by David Ticoll and Dan Herman, July 26, 2006.

<sup>29</sup> JP Rangaswami as quoted by Andy McCue in "CIO Jury: Businesses give open source a reality check," *Silicon.com*, September 1, 2005.

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| Strategy Domain                | Old Corporation   | Enterprise 2.0   |
|--------------------------------|---|--|
| 1. World View                  | National Engine – US, Japan, Europe<br>Protectionist              | Global Engine – China, India, Emergent<br>Free Trade   |
| 2. Corporate Boundaries        | Vertically-integrated<br>Non-porous<br>Content<br>M&A             | Focused on Core<br>Business Web<br>Context, Agency<br>+ Fasttrack Business Models                    |
| 3. Value Innovation            | Closed Innovation<br>Do It Yourself                               | + Open Innovation<br>+ Co-Creation   |
| 4. Intellectual Property       | Proprietary<br>Protected  | + Open<br>+ Shared   |
| 5. Modus Operandi              | Plan and Push<br>Hierarchical<br>Power over ...<br>Lumbering      | Engage and Collaborate<br>Self-organizing<br>Power through ...<br>Agile                              |
| 6. Business Processes          | Internal (Enterprise Integration)<br>Complex<br>Hardwired         | External (Inter-enterprise Integration)<br>Modular<br>Reconfigurable                                 |
| 7. Knowledge and Human Capital | Traditional Demographics<br>Containerized Knowledge<br>Internal   | + Global N-Generation<br>Collaboration<br>+ Across the B-web   |
| 8. Information Liquidity       | Opaque<br>Asynchronous Processing<br>Traditional BI               | + Transparent<br>Real Time<br>Networked Intelligence   |
| 9. Relationships               | Transactions<br>Product/Services                                  | + Relationship Capital<br>+ Experiences  |
| 10. Technology                 | Proprietary<br>Monolithic<br>Silos<br>Enterprise<br>Dumb Networks | + Standards-based<br>Service-oriented<br>Interoperable<br>+ Inter-enterprise<br>Intelligent Networks |

This report is an analysis of a Big Idea, presented as part of New Paradigm's Information Technology and Competitive Advantage Program (IT&CA). The program, sponsored by leading companies including yours, is investigating new business designs and strategies for competing in the networked business world.

Specifically the program examines how a new model of the corporation—The Open Networked Enterprise—(The Enterprise 2.0) is emerging as the foundation of competitiveness, growth and sustained success.

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