

# STRATEGY

## Understanding Digital Strategy

August 28, 2018

Sunil Gupta, a professor at Harvard Business School, argues that many companies are still doing digital strategy wrong. Their leaders think of “going digital” as either a way to cut costs or to attract customers with a flashy new app. Gupta says successful digital strategy is more complicated than that. He recommends emulating the multi-faceted strategies of leading digital companies. Gupta’s the author of *Driving Digital Strategy: A Guide to Reimagining Your Business*.

### TRANSCRIPT

SARAH GREEN CARMICHAEL: Welcome to the HBR IdeaCast from Harvard Business Review. I’m Sarah Green Carmichael.

By now, there are probably few companies or CEOs out there who don’t buy into the need to incorporate digital plans into the overall plan for the company.

But for too many leaders, investing in digital just means the tactical, the piecemeal, the incremental. That’s not really enough to stay competitive in today’s market, even for non-tech companies, argues Sunil Gupta.

SUNIL GUPTA: So the challenge for a legacy company is they have to strengthen the core of what they have and build for the future at the same time. The analogy I use is its like changing the engine of a plane while its flying. And many times the plane is going to go down first – and that’s a scary thought – before it goes up.

SARAH GREEN CARMICHAEL: To tackle that challenge, Gupta says leaders should integrate digital into the bigger picture strategy – to look at the ways digital companies survive and thrive, and see how that can apply to your own business.

Sunil Gupta is a professor at Harvard Business School and the author of “*Driving Digital Strategy: A Guide to Reimagining Your Business*.” Sunil thanks for being here.

SUNIL GUPTA: Thank you for having me.

SARAH GREEN CARMICHAEL: So when you say digital strategy, my impression of looking - especially at legacy businesses- is that they’ll say: “We need a digital strategy,” and that usually means a strategy for this digital world.

They don’t think about changing their own overall business strategy, it’s more like: “We need an app.”

SUNIL GUPTA: Exactly. Either a website or an app. That’s how most people started. But in all fairness, I think people have moved beyond that. Five years ago, that was the thought process: “If I have a website, if I have an app, I’m all set.”

But what I found when I asked people, what are you doing to go “digital?” And I heard three things. The first strategy that people use was “I’m going to use technology to cut cost and become more efficient.” So if I’m a bank, I can shut down some ATMs, some branches, and people can do mobile banking.

And that's fine and nice – you should always cut costs and become more efficient. But the challenge is, if that's all you're doing, you might be the most efficient but most irrelevant bank. Because Amazon will come and disrupt you. So you need to sort of think broadly, beyond just cutting cost. That should be first, but not the only focus.

The second strategy people suggested to me is: “Well, I don't know what the digital world has in store for me in the future. The world is very uncertain, so I'm going to do a bunch of experiments.” And again, great idea to do experiments. We should all do experiments.

But the reality is when I talk to a companies, they found that every brand, every business unit, every country of the multinational firm was doing some experiments, and suddenly you have hundreds of tactical experiments happening in the company. So there was a sense of activity, but there was no progress. There was no fundamental strategy shift.

The third approach I heard from companies is saying, “Well, we heard from experts like Clay Christensen that it's very hard to do innovation at a large company. So what I'm gonna do is, I'm going to start a separate unit, get a bunch of young people, send them to California, give them a couple of hundred million dollars and hopefully good things will happen.”

And every large company has an outpost in Silicon Valley. The result on that is also mixed, because what really happens is, imagine that you're trying to turn a large ship – which is what a legacy company is. And what you have done is launched a speedboat. Typically the speedboat takes off, but the ship doesn't change. And so unless the speedboat is tied tightly to the core of the business, nothing happens.

SARAH GREEN CARMICHAEL: Well, what are then some of the better ways, and what are some better ways for legacy companies in particular, to think about digital strategy?

SUNIL GUPTA: So I think the legacy companies have key assets that they should not forget. Startups have a clean slate; that's the advantage of startups. Legacy companies have key assets, so they should not ignore those key assets. They can't be like a startup.

So the challenge for a legacy company is they have to strengthen the core of what they have, and build for the future at the same time. So the analogy I use is: it's like changing the engine of a plane while it's flying. And many times, the plane is going to go down first – and that's a scary thought – before it goes up. And what I have discussed in my book is basically, you have to not only look at one aspect of your business, but every aspect.

I talk about four things: One is your business strategy; the second is about your operations and value chain; third is about how you engage with customers; and fourth is how you structure the entire organization. So it's not just one piece, all four pieces have to fit together.

SARAH GREEN CARMICHAEL: Is there an example of a company where those four things all fit together seamlessly?

SUNIL GUPTA: So let me give you example of each one of those. So, think about business strategy. When I was growing up in the MBA program, I learned competitive strategy – Michael Porter being one of them. And what I was taught was: competitive advantage comes from being better or cheaper.

Either you have a differentiation strategy or a low-cost strategy, right? And that's still fine, but I think that's not enough in this digital world. If you take an Amazon – that's how Amazon started as being better in some ways, and also cheaper because if they don't have the fixed costs of the brick-and-mortar stores. But if you look at the Amazon business, ask yourself what businesses is Amazon in?

It's all over the place. Strategy guys told us to be focused. So obviously, Jeff Bezos missed those strategy classes because he's certainly not focused. And the question is: what ties them together? And I would argue there are two key components that Amazon has that redefines the rules of strategy.

One is the complements – the razor and blade. So for example, Kindle is a “razor” for selling e-books. I don't have to make money on Kindle in order to make money on the books. Now that goes beyond the product complementarity.

So think about Amazon gets into giving loans to small and medium enterprises and competes with banks. How can Amazon compete with banks? Because as Amazon, I can give loans at a much lower rate because I don't have to make money on the loans. I make money when these small businesses do more transactions on my platform.

The moment I make the core part of the bank's business as my complement, the banks can't compete. So I don't have to be better than banks because I have this huge complementarity on the other side of the business.

The second aspect is the network effect, where even if you and I can start a better social network, nobody's gonna come to Gupta.com, because everybody's friends are on Facebook. Even if I'm better or cheaper, it doesn't matter, because the big keeps getting bigger.

Amazon has done that beautifully with marketplace. The sellers go on Amazon because all the buyers are there, all the buyers go there because all the sellers are there. And therefore, once you have that flywheel effect, it's just winner-takes-all.

So I think in this digital economy, you have these two components which are redefining the rules, and that changes the whole question of: “What business are you in?” You see Google getting into Amazon's business, Amazon getting into Google's business and Apple's business.

Take healthcare: If you ask a healthcare company, “Who's your competitor?” It's no longer just the other pharma and healthcare companies, it's Google, Apple, all the other technology companies as well.

SARAH GREEN CARMICHAEL: So I'm wondering, are these strategies – like you were speaking about with Amazon, with complementarity or network effects with Facebook – are these things that legacy businesses realistically can tap into or do they just need to find a different way to be successful now?

SUNIL GUPTA: No they can. So I'll give you two examples and in fact that's a question that I always get: “Well that's okay for Amazon, but I'm not Amazon, I'm a legacy company.” I'm on a board of a company called a US Foods and they distribute food – meat and produce – to independent restaurants.

Now, as you can imagine, that becomes a highly competitive and commoditized business. So there's always a fight for price and margins. And the question for a company like US Foods is: “How do we get out of this competition?”

So now if you think of the complements, what kind of complements can the US Foods bring up? And they looked at it from a perspective of their customers – in this case restaurants. And the question is, “What do restaurants need to become profitable?” These restaurants are usually independent mom-and-pop operations. They are passionate about food, but they don't know how to run a business.

So they have to figure it out how to manage the inventory; they have to figure out how to generate traffic; they have to figure out how to hire labor; they have to figure out how to increase the profitability of their menu, and so forth. And they don't have time for that.

So US Foods started offering these complementary services for free – this is my “razor” in order to help grow your business. The moment I help grow your business, I don't care about the prices of food as much., so that suddenly complementarity affects how I do business.

Same thing with the Peloton bike. So Peloton is an exercise bike, an expensive bike. They could have used the same strategy that we taught 20 years ago saying: “My bike is better or cheaper.” But they decided to go beyond that. They said: “Look, when you go to a gym to do exercise, nobody comes out of the gym and talks about their bike. They all talk about the exercise routine, and the instructor and so forth.”

So leveraging that thought process, they say, “Well, why don't I provide some of the exercise routines to at-home exercise bikers?” And they started producing these videos as complements, and then in order to capture the network effects and community, they started making these live biking sessions available.

So if I'm biking at home, I can actually see 500 other people biking at exactly the same time in some part of the world. And the moment I see them biking on the exercise bike, my competitive juices start flowing and I worked that much harder. Now if you and I come with a new exercise bike tomorrow, and even if we claim is better or cheaper than Peloton, we can't compete because they have these complements and network effects.

SARAH GREEN CARMICHAEL: I think one of the things that kind of freaks other business people out about Amazon is that they are in so many businesses and they seem to do such a good job in every sector. And I think relatively recently there was some news item about them getting into shipping and suddenly UPS' stock is going down because, “Ah! Amazon's getting into shipping!” You know? So I wonder are there ways that companies can go head-to-head in some of these markets where there's a real giant that's taken over? Because if you have sort of winner-take-all effects, then it is kind of like whoever gets biggest first theoretically wins.

SUNIL GUPTA: Yeah. So I think, again, nobody can be dominant in every industry and every field. So Amazon is dominant in lots of places and they're producing, for example, videos and they have the Amazon Studio. But Netflix is pretty good in that area, and it's not clear that Amazon will beat Netflix.

Now again, they have a very different strategy because Netflix makes money on the subscription, whereas the purpose of Amazon creating video is to get the Prime subscribers, who spend more money buying actual products, right? So the goal of the videos are very different, and they can live happily side-by-side.

Same thing with devices: Amazon is never going to go into the turf of Apple on high-end devices, because Apple makes most of its money on devices. That's the “blade” for it – where the blade is where you make money. Whereas for Amazon, this is a “razor” – they gave it away for free. So sometimes these can be very distinct market segments.

SARAH GREEN CARMICHAEL: Well, tell me a little bit more about kind of changing the core business. How do you do that? What's your timeline? Is this something or if you haven't started

already, is it already too late? I mean maybe it depends on the industry, but I guess I'm just wondering if that is more difficult, what advice can we give people about tackling that problem?

SUNIL GUPTA: A good example is in your area, The New York Times. So newspapers were declared dead in the age of Google because we can get all the information on Google. And The New York Times, as you know, has built a paywall, a very successful paywall. Everybody told them that information wants to be free – that's what Silicon Valley told us.

So nobody will be willing to pay. And any amount of surveys you will find what people are willing to pay is zero, because people obviously will tell you they're not willing to pay anything. So they actually designed this paywall very carefully, recognizing that once you put up the paywall, it might affect your digital advertising business, because you're stopping people to come.

But do you have to have the courage to do this and you also have to have a clear strategy as to why that is a good idea and what kind of things you are going to monitor to see where the paywall is working or not working. Now, the moment you do that, what happens typically is, imagine The New York Times goes from a fully print company, to a fully digital company 10 years down the road.

What might happen is, in the digital world, because people obviously will pay a little bit less on the digital platform, then a print platform, your revenues may go down. So you are let's say making two billion dollars in the print version. You might make 1.5 billion dollars in the digital version, because the costs of digital would be lower, the price will be lower, but your costs will also be lower because you don't have the printing presses.

You don't have all the physical assets that you need for the printing. In the digital world, costs will go down dramatically. So net-net, profit might be okay at the end of the day. But in between the time period when you are transitioning – when you have both print and digital – you're profitability will be lower. That's the plane goes down before it goes up – because in the transition time, you're running two organizations in parallel.

So that's the first major task. And I've seen this: I did a case with Adobe, where they shifted from selling boxes of software, to going to software as a subscription service. And you could see their profit went down dramatically for two or three years before they went up. And that's a challenge for a CEO, because how did they tell Wall Street? Will the board fire them in those two or three years?

And there is a bit of an uncertainty also because you see the plane going down faster than it was going before, and everybody wants to climb back up. That's where you need a conviction from the top management and a very clear roadmap that yes, this will happen, but that's okay because we will come out okay after two or three years.

SARAH GREEN CARMICHAEL: Two or three years is the kind of timeframe you've been mentioning – how do you know kind of when it's safe to pull the plug on the legacy business or that your new digital strategy is strong enough to carry the whole company? How do you kind of make that judgment call?

SUNIL GUPTA: So you never know for sure. What do you know for sure is if you don't do anything, you're dead anyway. Almost every company – I mean we've seen examples of Kodak and Blackberry and so forth. It's not a question of whether you should change or not. The key question is: how do you change?

And there's always uncertainty because the marketplace changes, technology changes. You don't know exactly what is in store for you. I think the best quote I got was from Jeff Immelt from GE, and he basically said that: "Look, I know this digital journey will be 40 steps journey, but I can't see beyond five steps because there's fog. But when I climb three or four steps, I see the next five steps. Which means that you have to be flexible and adaptable enough. You can't have a five year plan. You have to have some broad parameters of what you're going to do, and then you sort of shift around as you move forward and see the next five steps.

SARAH GREEN CARMICHAEL: To that point, one of the questions that often comes up, that people have around this is kind of, do you want to invest a lot in these new digital aspects of your business or do you take a more lean, minimum viable, experimental approach, to figuring out what customers want?

You mentioned The New York Times. My impression of them from the outside is they make big digital bets: they throw up a lot of money at their new podcast or their new video program. And it's a level of resources that, you know, most other places don't have. A place like HBR, we're much more disciplined about trying small experiments, seeing what works and then investing sort of more and more. Which approach do you think works? Do they both work?

SUNIL GUPTA: So I think you always need to have a proof of concept. So even in the case of The New York Times, they tested that idea in Canada before they launched it full-blown in the U.S. Adobe tested the idea in Australia before they launched full-blown in the U.S. HBO Now tested the idea in Nordic countries before they launched in the U.S.

So you always test it out, because there are lots of parameters or assumptions that you don't know for sure. But once you have that proof of concept, then you can't go slow, because then you have to actually – the example of the quotes that I heard from an Adobe CEO is "burn the boats" – because you can't have feet in two different boats. You'll go nowhere.

So some point in time you have to have a commitment, because otherwise people will go back to the old style of doing work. Because remember, if I shift from the traditional, analog business to digital, there's a lot of discomfort among the people themselves because they're out of their comfort zone. So if, if you give them an option, they'll always go back.

SARAH GREEN CARMICHAEL: It is interesting – a lot of your book, which is purportedly about strategy, is in fact about people and dealing with people. Why include so much of that kind of people management information?

SUNIL GUPTA: Because ultimately nothing changes unless the people change. I mean I give these examples. So think about again, go back to The New York Times. When The New York Times is running two parallel organizations – a print organization which they need to run because that's the cash cow and the digital part. You think about how do you manage those two different teams? One team will feel probably jealous of the other team because resources will go to the other one. So you need to manage those two people and bring everybody along. So I think that transition requires – no change happens and we are talking about big changes – without people getting on board.

SARAH GREEN CARMICHAEL: What are some of the biggest mistakes that companies make when they're trying to do this?

SUNIL GUPTA: So apart from thinking tactically, as we earlier said – whether it's a webpage or an app – I think the other mistake that people make is not thinking from a consumer's point of view. I always say that start with the consumer pain point. And I'll give you an example.

So I've talked with several retailers and retailers obviously are facing a big challenge with the Amazon's of the world. And I asked them: "What are you doing with the digital technology?" And the typical answer I get is: "We are putting beacons in the retail stores." These little devices which can people. And my question then is: "Why are you putting beacons in?" And the answer that I get is: "Well, we're tracking to see how many people come walk in and out of our stores because we know the traffic on the website, but we don't know the traffic in the stores."

So my next question is: "So what are you going to do with it?" And the answer is: "I don't know, I'll figure it out." And that, to me, is not the right answer. So I just turn it around to them and say, "Well, let's think from a consumer's point of view and consumer pain points." If I walk into a store like a Macy's or Home Depot or something, I can't even find the thing that I'm looking for. There are zillions of items in the store, but I can't find the thing I'm looking for. Why can't you simply put an iPad there? Where I can figure out for myself where the item is.

It's an easy solution. It doesn't require fancy technology, but from a consumer's point of view, it's an easy solution. Next pain point for consumers? I bought the stuff I'm looking for and I go to the cash register that, first of all, I can't find a cash register with a person.

If I find something, there are 20 people in front of me and there's always somebody in front of me who's returning something. So it takes me 30 minutes to get an item one I find it. Why can't I self-pay, self-checkout?

It happens in many different places. So I think if you look at it from the consumer's point of view, there are lots of easy solutions. Uber came up simply because they found the pain point of the consumer, that if you're standing in New York City, in Times Square, in the middle of rain, you can't find a taxi when you want it. That was the insight. Taxi companies had all the assets. They could easily build the app, but they never saw the world from the consumer's point of view. So to me that's the biggest mistake people make.

SARAH GREEN CARMICHAEL: I'm interested in your thoughts on Uber and taxi companies because it seems like the taxi industry, in the U.S. at least, has really fought back against Uber by focusing on regulatory issues – sort of, they can't do this. It's destroying jobs. This is illegal. And in some other parts of the world that hasn't been the reaction. What do you think of the kind of different responses to Uber and what do you think is most effective?

SUNIL GUPTA: So I think the short-term answer for any incumbent is to hide behind regulation, because I can't fight other ways, so I need the government's help. Same thing happened with banks; when I talked to the banks and I asked them: "Are you afraid of Amazon?" At the core they are, but they always hide behind regulation. They say, "Well, but we are a regulated industry." And I tell them: "Look, until yesterday you were against regulation. Suddenly you are for regulation because now Amazon is upset."

So it becomes an easy crutch for them to hide behind regulation. And that's a short-term answer. So you can never stop – I mean, people love Uber, and regulations will change. Governments actually serve the people, so ultimately regulations will evolve and change to favor the consumer welfare.

The best strategy for the taxi companies in your example is to say, "Look, what do we have that Uber doesn't?" Now, clearly taxi companies could argue that our drivers are more vetted. For example, in London, the drivers go through exams, they know exactly how to manage the traffic flow and so forth.

Uber drivers are just sort of part-timers. So why don't you leverage your strengths and build the deficiencies that you don't have – like build an app, build the whole dynamic pricing system or whatever it is. I think hiding behind the regulation is a short term thing.

SARAH GREEN CARMICHAEL: You've shared a lot of examples of companies that have succeeded or done cool stuff in this area. I'm wondering if there's any sort of cautionary tales you've seen of companies where you wouldn't necessarily recommend what they did.

SUNIL GUPTA: I don't study failures.

SARAH GREEN CARMICHAEL: But that's so digital! You know, fail fast, fail often.

SUNIL GUPTA: Yeah. So I think again, the retailers are the one example. So Walmart has struggled for a long time – I wouldn't call it a failure, but Walmart has struggled and even now is struggling to a large extent about how to compete with Amazon.

And part of that reason is Walmart has been sort of playing this dual strategy – that I have Walmart stores and I have Walmart.com, and they literally operated as independent units. So you might remember for the longest time, if I bought something from Walmart.com, I could not return it in the store, because they were different profit centers. They didn't talk to each other.

In fact, if I didn't have something that I bought online to the Walmart store, it will be reflected negatively because the company didn't change the compensation system, didn't change the metrics for the stores in this new environment. So as a result, they didn't leverage the strength of Walmart. I mean Walmart had a strength that they had a physical store that Amazon doesn't. So it should be an advantage, but because they were organized differently, because the compensation structure was sort of completely distinct, it just didn't work. And now they're sort of beginning to connect the dots.

SARAH GREEN CARMICHAEL: So many of these digital business models do rely on data and consumers seem to have become much more sensitive lately to how their data is used, how it's shared, how companies are monetizing it. Do you see any kind of risk on the horizon for companies who are really relying on data to drive their digital strategy?

SUNIL GUPTA: So I think that most of the companies that are under fire are the ones which are using consumer data for advertising – Facebook and Google, to some extent. And that's because most people don't see advertising as being useful for them. So there was some study a few years ago which asked consumers as to, are you willing to share the data or not?

And by and larger there was a three-way split. I forget the exact percentage, but roughly let's say 15 to 20 percent of the people said, "I will never share my data no matter what because I'm very controlling of my own privacy, if you will." Another 20 percent on the other side said: "People will get my data anyway, so it doesn't matter and have nothing to hide. Especially the younger people, my kids' generation, they don't care. A large majority of people in in the middle basically say: "Look, I'm willing to share my data if I get some benefit out of it."

They don't see that benefit in advertising. Now, Google may say, "I will give you a relevant ad" – but, by the way, I don't want even the relevant ad. I'll look for the information if I want it. That's why the click-through rate in most of the advertising is less than one percent.

I mean, think about it for a moment. When was the last time you failed 99 percent of the time and called it a success? That's what all these companies are doing. So even with all the technology and data and everything else, they're 99 percent of the time failing. That's because consumers are telling them, I don't care about this. Those are the ones who are struggling with it and will struggle. But in

many other places – you link my data for all the health records so that if I go from one hospital to another, they have all my information – Yes, I want that.

SARAH GREEN CARMICHAEL: I guess I would just say then, you know, if there's one message you want to leave people with today – business strategists – what would that be?

SUNIL GUPTA: Boy, it's hard to say one message because I don't think there's any silver bullet. All I will say is start with the consumers. It's an old saying; I'm not saying anything new. Find the pain points and don't do a Band-Aid solution. This is not a website and the app-building exercise. This is like fundamental looking at every aspect of your business and rethinking from scratch.