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Insights

The shift to flexible consumption

How to make an "as a service" business model work

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Deloitte Consulting LLP's Flexible Consumption Models (FCM) practice has guided a myriad of companies through the transformation to flexible consumption. We have deep knowledge of consumption-based business models and the challenges they present. We understand that modern businesses comprise a number of highly complex, interrelated organizational systems, which is why we don't view any transformational element in isolation. We have helped organizations think through the implications of the business decisions they will need to make as they transition to a pay-per-use model. Contact the authors for more information or learn more about our flexible consumption service offerings at Deloitte.com.

The move toward flexible consumption models

OVER THE LAST several years, the technology industry has seen a significant shift toward the adoption of flexible consumption business models. Flexible consumption models (FCMs), also known as "as-a-Service" or XaaS models, offer customers product delivery and payment options that allow them to purchase access to products as a service. FCMs provide compelling benefits to companies that effectively deliver them to the market: They enable predictable, renewable revenue streams, deliver greater value to the end customer by allowing them to pay for only what they consume, enable deeper insights into customer consumption patterns to help inform add-on sales, and lower operational costs by enabling a company to serve customers at scale through a common platform. According to the International Data Corporation (IDC), the market for FCM offerings will reach US$160 billion in 2018.[1]

In a move to capture these benefits, a number of traditional technology companies have attempted to implement FCMs for part or all of their business. Many, however, have met with limited success, with consequences including failed product launches, slower growth, higher costs, and greater operating complexity. Meanwhile, new entrants using FCMs have been gaining market share and are now challenging these traditional companies' marketplace dominance.

Many attempts to transition to FCMs falter because of the scope and complexity of the necessary changes. First of all, FCMs are customer-centric models, whereas traditional business models are more product-centric; this difference places different demands on a company's operating model. To effectively implement an FCM at a company that has always operated on a traditional, product-centric model, the company must radically transform its operating capabilities to support FCMs' unique characteristics (such as recurring billing, revenue recognition, and so on). Equally important, depending on how a company sells and delivers its products, it may wish to support multiple FCM-based business models to preserve each offering's value proposition. This becomes more complex if a company needs to support traditional business models in parallel with its FCM model(s).

Transforming operations to support FCMs, in fact, requires a systemic operational recalibration. Force-fitting legacy processes and practices to support an FCM model will only yield suboptimal outcomes. Thus, the key question facing traditional product companies is how to enable an operating model that can address these challenges.

One way to make the transformation to support FCMs' unique characteristics is to adopt a "services operating model"—an approach that entails treating not only the company's marketplace offerings, but also its enabling internal operations, as "services" (a self-contained, sub-organizational unit) that are delivered to internal or external stakeholders.
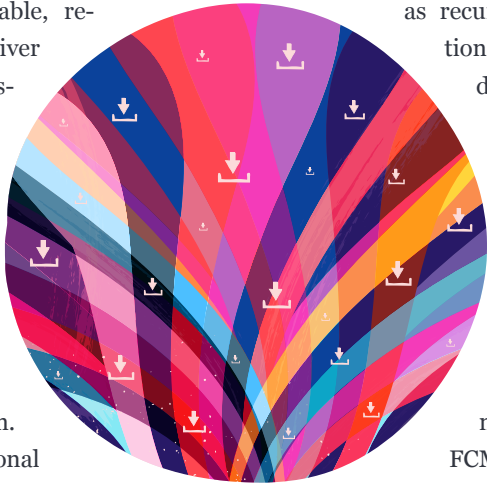
CHANGING CUSTOMER EXPECTATIONS ARE FORCING MANY TRADITIONAL TECHNOLOGY COMPANIES TO REEVALUATE THEIR BUSINESS MODELS

Technology customers today are increasingly favoring FCMs over traditional product purchases, as FCM offerings usually require less upfront cost, transfer risk of ownership away from the customer, and align payment to consumption, providing demonstrable and measurable business value. Responding to this market shift, many technology product companies have undertaken to adopt an FCM (figure 1). Broadly speaking, we have seen companies taking one of three different approaches, depending upon their market context, business objectives, and risk profile:

- **Protect and grow.** These companies aim to include complementary FCM products in their portfolio to protect and propel their legacy offerings forward. Companies can choose to either develop these products organically or obtain them through acquisitions to drive incremental revenue. SAP is one example.

- **Straddle.** These companies see value in giving customers a choice between FCM and non-FCM offerings, and want to transition to FCM with caution. They seek to maintain both FCM and legacy versions of the same product without attempting to influence customers' migration to FCM offerings.

- **Burn the boats.** These companies have decided to focus exclusively on FCM offerings and have undertaken an enterprisewide transformation to enable the FCM business. They have converted their portfolio's key strategic offerings to FCMs, and plan to develop all new products only using FCMs. Adobe is one example.

FIGURE 1

Customer expectations are driving traditional technology companies toward FCMs
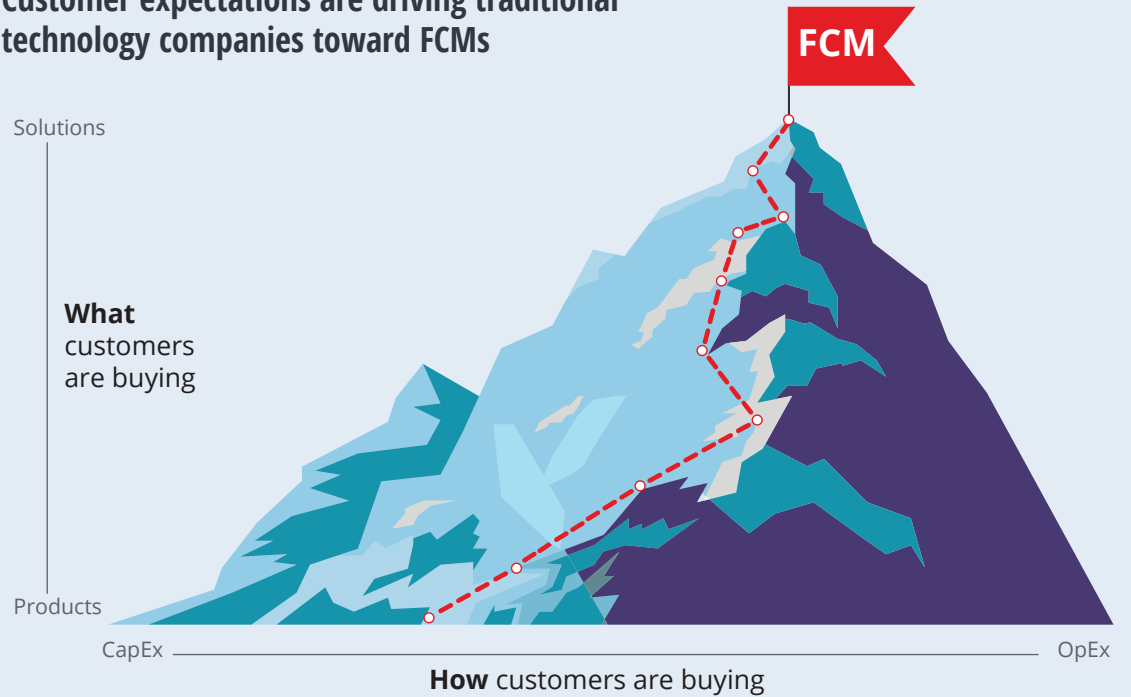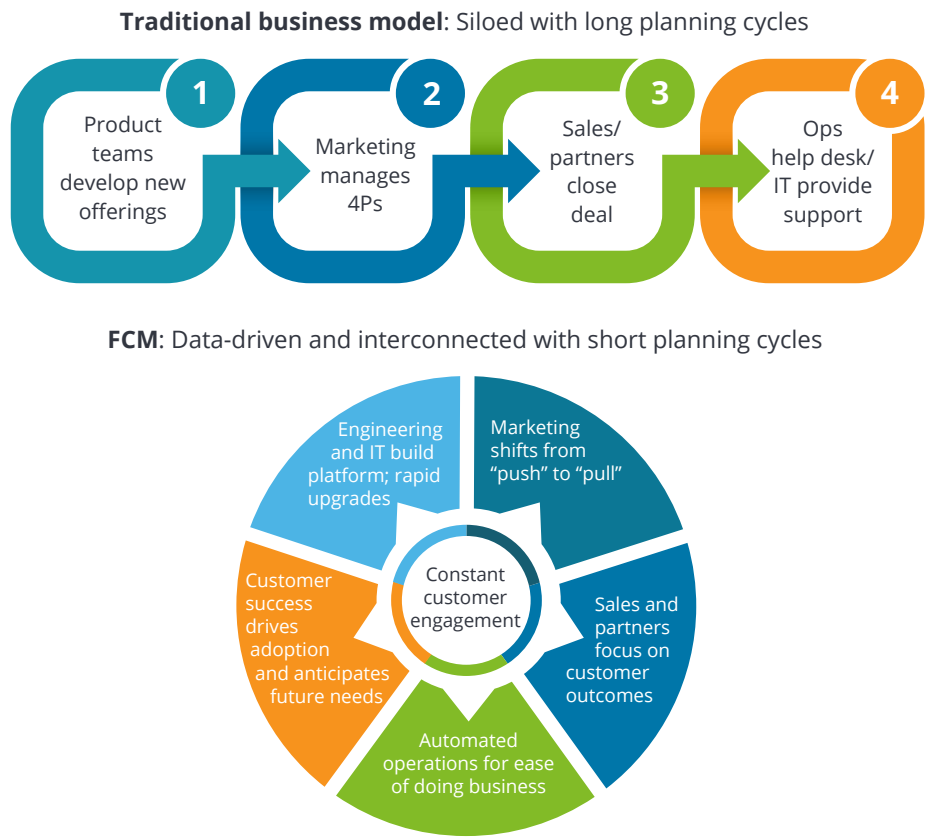

Source: Deloitte analysis.

The difference between traditional business models and FCMs

FCMS DIFFER FUNDAMENTALLY from most traditional technology business models in that FCMs organize their activities around customer needs and opportunities rather than around the product life cycle. Most traditional, product-centric companies tend to operate in a sequential fashion, moving the customer between phases in the value chain with handoffs between independently operating teams (figure 2). In contrast, FCMs' value chains are not sequential, but interconnected: The company may engage with customers at any stage at any time, which requires an operating model that

FIGURE 2

Traditional operating model (sequential) versus FCM (interconnected)

Traditional business model: Siloed with long planning cycles

FCM: Data-driven and interconnected with short planning cycles

Source: Deloitte analysis.

Given the interconnected nature of executing an FCM, it becomes clear that an effective shift to FCMs requires fundamental changes to not only a traditional product company's business model but also its operating model.

can support multiple concurrent customer interactions. For example, for a FCM business to deliver an evaluation program to a potential customer, the sales organization needs to identify the initial opportunity, the supply chain needs to extend the offer, the customer support arm must monitor service levels, and the customer success team needs to review the entire effort to determine the likeli-hood of conversion and what actions to take once the trial period expires. All of these activities must occur in tandem, and they require careful coordination among the different teams involved. Hence, the operating model must provide a mechanism for teams to work together to deliver an end-to-end outcome to the customer.

Given the interconnected nature of executing an FCM, it becomes clear that an effective shift to FCMs requires fundamental changes to not only a traditional product company's business model but also its operating model. Our experience suggests that more than 65 percent of a typical company's operational capabilities are affected by shifting to an FCM. This is a key but, in our experience, often overlooked consideration: Many major tech players seeking to implement FCMs over-rely on legacy processes, systems, and personnel to build, run, operate, and scale their FCM businesses. Indeed, some companies have invested millions of dollars to extend their existing operating models to develop and introduce new FCM offerings. In doing so, they are force-fitting legacy operations to the new business model in a vain attempt to handle FCMs' unique operating characteristics with their current people and processes.

Enabling a services operating model

REDESIGNING THE LEGACY operating model as a *services operating model* can allow a traditional product company to create and manage a structure that enables it to effectively manage a FCM business either independently or in conjunction with its legacy business.

The basic idea behind a services operating model is that it is composed of a number of self-organizing, collaborative components—"services"—that together execute the sum total of a company's business activities. Services are self-contained sub-organizational units, each of which can be managed independently or, in certain cases, outsourced from the parent organization. They differ from functions or capabilities in several important ways. Each

service has one or more clearly defined customers, who may be internal (other services or teams within the organization) or external (for instance, suppliers or end customers). A service's output is clearly identifiable by the customer, and must create business value for those who consume it. The service acts as an interface to the underlying capability that supports it, but its operation is completely transparent to the consumer. Finally, each service is headed by a "service owner" who is responsible responsible for service delivery, measuring service consumption and enhancing performance over time.

A company with multiple business units (BUs) or offerings may choose to have a separate service for a particular BU for better agility or to preserve an offering's value proposition, or it may have one service that caters to all BUs for greater cost efficiency.

We have identified five important steps in transitioning from a traditional operating model to a services operating model:

> **The basic idea behind a services operating model is that it is composed of a number of self-organizing, collaborative components—"services"—that together execute the sum total of a company's business activities.**

1. **Establish a transformation office with executive sponsorship**
2. **Disaggregate the operating model into a set of services**
3. **Determine the level of standardization within each service**
4. **Operationalize each service**
5. **Establish service life cycle management**

Step 1: Establish a transformation office with executive sponsorship

It's no surprise that some companies have struggled with transitioning to an FCM, given the many factors that can make it difficult. The complexity of establishing an FCM operating model, the frequent competition between the legacy and FCM businesses over investment priorities, and hesitation and delay in making the needed investments and mindset shift can all present obstacles. Thus, establishing a governance model that signals strong organizational commitment is imperative to success. Consider following these guiding principles:

- **Drive the change from the top down.** Identify a senior leader with direct access to the C-suite to head the transformation. This leader is responsible for ensuring that the company invests appropriately (both money and resources) in developing the services operating model, and that each service is designed and operationalized to meet its performance metrics. He or she should also be tasked with capitalizing on opportunities for organizational learning and recruiting from other teams the right talent needed to execute the transformation.
- **Deploy dedicated resources.** Create a dedicated group to carry out the transformation effort, supported by a cross-functional panel of subject-matter experts who understand the dependencies between, and the services operating model's impact on, different areas of the company (such as engineering, sales, and supply chain).

- **Define metrics to drive accountability.** Establish metrics against predefined milestones to hold the leader and the group accountable for the transformation's success.

Step 2: Disaggregate the operating model into a set of services

The next step is to decompose the company's operating model into a set of services in a way that allows each service to be managed and tracked independently. By doing this, a company can give the operating model the flexibility it needs to support a variety of FCMs. The complete set of enabling services should be identified for each of the company's traditional and FCM marketplace offerings.

Figure 3 shows an illustrative breakdown of a FCM operating model into services that can be used as a baseline reference for identifying what services may be needed to support an FCM offering. (Of course, the actual list of services for any given offering will depend on the company's target business models and current organizational model.) Figure 3 also shows the typical areas where a traditional company may experience capability gaps in various services. For services such as identity or access management, many traditional companies may already have most of the capabilities in place to enable the service. On the other hand, for services such as billing and invoices, traditional companies may need to acquire or develop capabilities such as recurring billing and payment capabilities to be able to deliver the service effectively.

> **It's no surprise that some companies have struggled with transitioning to an FCM, given the many factors that can make it difficult.**

FIGURE 3

Illustrative breakdown of an operating model into services

- Services that typically have minimal capability gaps
- Services that typically have minor capability gaps
- Services that typically have critical capability gaps

CREATE THE OFFERING

Idea to offer

Strategy & portfolio management	Design & development	New product introduction	Packaging & pricing

ACQUIRE AND GROW THE CUSTOMER

Market to demand		Lead to opportunity	Configure to quote		Quote to order	Order to fulfill		Monitor to usage	Invoice to cash		Record to report	Issue to resolution		Adoption to retention	
Product marketing	Mktg. strategy & planning	Lead and opportunity management	Digital sales	Configure, price, & quote	Order management	Prov. & deprov.	Licensing & entmt.	Usage telemetry	Billing & invoicing	Payments	Revenue & cost management	Customer & partner care	Tech support	Customer & product analytics	Customer success
Trials mgmt.	Buying program		Deal mgmt.		Subscription management	Professional services delivery	Service delivery	Mediation & rating	Trans. tax mgmt.	Collections				Renewals	CX mgmt.

MANAGE THE ENTERPRISE

Sales	Channel management	Corporate strategy	Data management	Finance & performance management	Legal & regulatory	Security	Talent & organization
GTM strategy	Partner program plan & governance	Corporate strategy	Master data management	FP&A management	Contractual & compliance management	Security, risk, & resiliency management	Talent & culture
Sales & business planning	Partner recruitment & enablement		Data governance	Management reporting	Commercial policy & rules	Identify & access management	Organization structure
Sales compensation	Partner incentives						
Sales enablement	Developer ecosystem management						

Source: Deloitte analysis.

Step 3: Determine the level of standardization for each service

Once the full set of services is clearly defined for each offering, the next step is to determine how the organization can effectively support both the company's traditional and FCM offerings in a way that enables operational efficiency while allowing for agility. Essentially, the company needs to deter-mine which set of services can be leveraged across all offerings, which services need to be developed separately to support certain groups of offerings, and which services are unique to an offering and must be maintained independently.

Here, the temptation to take a blanket approach to standardization must be resisted. In an effort to simplify the decision, many companies aim to centralize and standardize the company's so-called "back-end" capabilities while giving the individual business units more leeway in "customer-facing" capabilities to leverage their experience and re-lationships. However, FCM business models do not typically lend themselves to this superficially neat operational categorization, especially if the company also wants to continue to sell certain offer-ings under a traditional model. For one thing, FCM business models often require certain services to engage with their customers in a way that is signifi-cantly different from what would be required under a traditional business model. (For instance, a tra-ditional business model would usually not require end customers to be billed on a frequently recurring basis.) Secondly, different FCM business models themselves may differ from each other, meaning that the capabilities required for a particular service can vary significantly among different FCM offer-ings. For example, configure-price-quote (CPQ) services for a digital subscription model (such as a monthly subscription to a streaming video service)

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are usually very low-touch, whereas a club-membership subscription model, where customers expect highly personalized and customized billing and invoicing, might require high-touch CPQ services.

Because of these factors, it is imperative to consider each service separately in the context of the offerings it supports when deciding on its level of standardization. As an example, one major media conglomerate had a number of business segments supporting several FCM offerings, such as annual passes, merchant subscriptions, and digital subscriptions. Each business segment had evolved its operating model independently to meet immediate individual needs, which resulted in fragmented capabilities and an inconsistent customer experience. Realizing this, the company set out to establish the correct level of standardization across key services such as billing and payments to enable a frictionless customer experience across different offerings. Doing this would also allow the company to more easily scale the FCM offerings in the future.

A business model assessment of the FCM offerings revealed that the company had some 15 different FCM offerings, but only five distinct business models among them. "Billing" had unique requirements for only one of these models, but "payments" could be handled consistently across all five models. Consequently, the company decided to consolidate billing services for the offerings belonging to the four "non-unique" business models, but not to integrate the billing platform for the offerings belonging to the remaining business model. Payment services, on the other hand, were consolidated at the enterprise for all five business models.

Step 4: Operationalize each service

After establishing what services are required to operate the FCM business model(s), the next step is to operationalize each service. This is done by establishing ownership of the service within the organization, by defining the service components—the constituent activities—that are needed to run, manage, and track the service; by understanding the service's inputs, outputs, and resources needed to execute; and by establishing metrics.

We recommend that companies begin by appointing a service owner for each service to be operationalized. The service owner, who is responsible and accountable for overall performance and acts as the service's general manager, has several key responsibilities including deciding and adhering to service-level agreements, obtaining the resources needed to maintain service performance, managing dependencies with other services, and continually evolving the service to meet business needs. Given the importance and criticality of the service owner role, the individual who holds it should be senior enough to effect meaningful organizational change. Incentives should be devised to motivate service owners to effectively manage the service's performance without being tied to a specific business area.

Once a service owner is appointed, they will be required to work with the central transformation team to further operationalize its service that they lead:

- **Identify the service components.** The service components are the activities the service its consumers.
- **Identify the service consumer(s).** Service consumers are the stakeholders—which may be other internal services or external parties, including end customers—that make use of the outcome(s) produced by a service. Understanding who the service consumers are will help the service owner determine critical success drivers and track service performance.
- **Establish expected service outcome(s).** A service outcome is the total business value delivered to each consumer of the service.
- **Determine service performance metrics.** Service performance metrics should be defined for each expected service outcome. These metrics should measure performance on two key dimensions: efficiency (how the service uses its resources) and effectiveness (the extent to which the service delivers its intended outcome).
- **Define the inputs.** Inputs to a service come from other services or external stakeholders; the service uses these to create and deliver the expected service outcome.
- **Identify service requirements.** Service requirements are the resource and technology capability requirements that a service needs to process its inputs and make appropriate investment decisions.

Step 5: Establish service life cycle management

The journey does not end here. While the transformation establishes the foundation, equally important is the ongoing services life cycle management. Once a service is established, the service owner should periodically review its metrics to evaluate its performance and drive continuous improvement. Furthermore, he or she should work with the service's consumers to understand their new requirements, and identify and prioritize the development of any new needed capabilities. Similarly, capabilities that a service's consumers no longer need can be eventually retired.

Generally, the service owner should determine where services should "sit" within the organization. Key decisions include whether the service should be placed within the legacy organization or housed within a separate structure specifically created to contain services supporting the FCM business(es). For this, at least three distinct organizational placement options exist: segregated, parallel, and integrated (figure 4).

Where a service should reside depends on the company's organizational characteristics and busi-

The transition from traditional hardware and software sales models to an FCM can be very challenging, but it offers great potential benefits.

ness goals. A key consideration is that the service should be placed within the organization where it has, at a minimum, an equal standing with the legacy operations to ensure that it is not underinvested in due to the organization's natural propensity for maintaining the status quo. As one example, an equipment manufacturer that was losing market share decided to empower its business entities to create and launch new FCM-based software solutions derived from its traditional offerings to meet market demand. The company had aggressive targets and wanted to capture marketplace leadership in the industrial Internet of Things (IoT). In adopting a services operating model to enable these software solutions, the company decided to offer services to its business entities through a separate

organizational unit to enhance speed through increased visibility and accountability. Placing the services in a single segregated unit, as opposed to having them delivered by different teams sitting within different functions, helped to ensure their alignment with the business entities' requirements and development needs.

In contrast, a leading ERP software company that faced growing competition from cloud-based ERP service providers took an integrated approach to its services operating model. The company wanted to keep a focus on its core business, but to switch its business model to FCM to meet evolving customer demands. The company acquired a cloud-based ERP provider to integrate cloud functionality with its legacy offering for quick product enhancement. To sustain focus on its core business and maintain organizational culture, the company fully integrated the acquired business within the relevant functions to develop the centralized services. The teams consolidated the capabilities at the corporate level to support both legacy and new offerings. In this case, the integrated approach to services helped the company drive scalability and efficiency and allowed it to target larger customers with its new offerings.

FIGURE 4

**Three options for where to place a service within the organization**

■ Traditional   ■ FCM
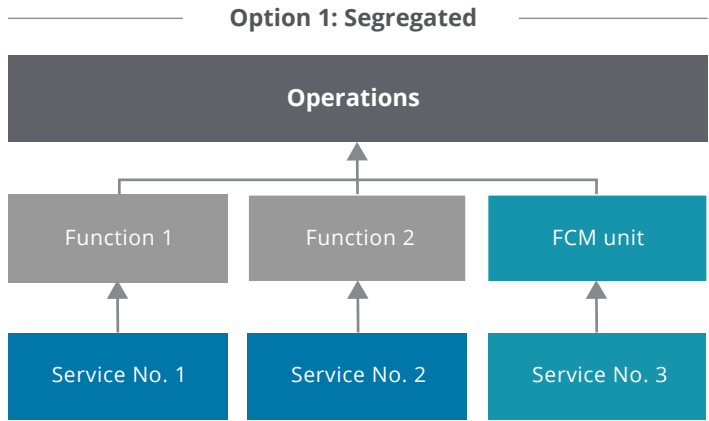
**FCM services are developed and executed under a new organization/group**

PROS
- Enables accelerated deployment and high degree of collaboration between FCM services
- Least amount of disruption to the traditional business
- Most expedient "fail fast and course correct" option

CONS
- Least opportunity for organizational learning
- Higher cost to implement
- FCM unit often has to recruit top talent from other units
- Difficult to operationally support deals that include both traditional and FCM offerings
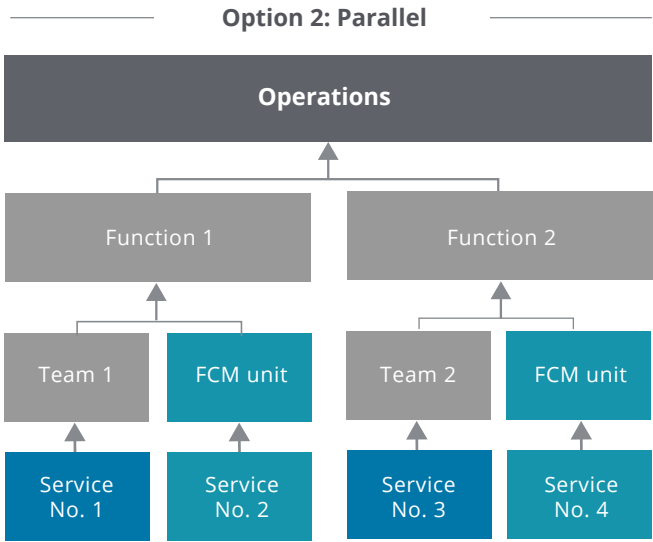
Traditional and FCM services are executed by parallel teams within the same function

PROS
- Improved opportunity for organizational learning
- Lower cost than creating a separate FCM unit
- Easier to operationally support deals that include traditional and FCM offerings

CONS
- FCM services will have to compete with traditional services for investment/development
- More difficult to collaborate across FCM services
- Requires higher focus from the governance team to ensure that the services work together
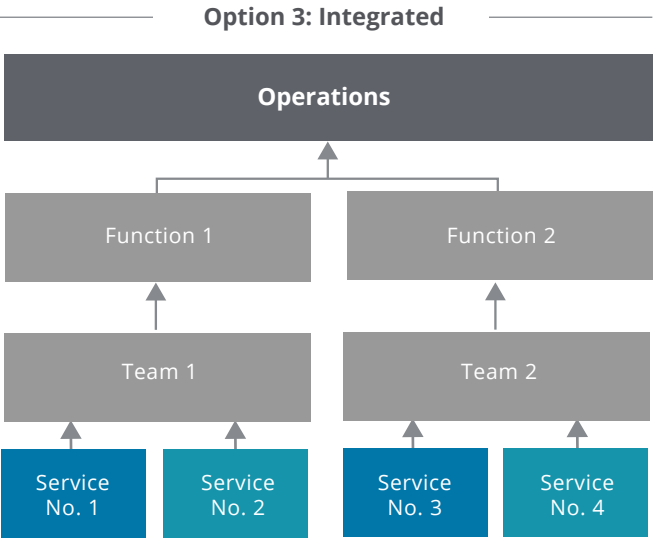
FCM and traditional services are housed within the same team within the same function

PROS
- Maximum opportunity for organizational learning
- Likely the lowest-cost option to implement
- Easier to operationally support deals that include traditional and FCM offerings

CONS
- Most diluted leadership focus on the FCM business for performance management and investment
- Requires highest focus from the governance team to ensure that the services work together

Source: Deloitte analysis.

A call to action

THE TRANSITION FROM traditional hardware and software sales models to an FCM can be very challenging, but it offers great potential benefits. To capitalize on this opportunity, leaders should understand that organizing operations to support the delivery of FCM offerings is very different from the operational needs of a traditional business model. If the strategic decision is to go forward with an FCM, applying a services operating model can enable a company to execute the FCM(s) effectively in the marketplace.

Endnotes

1. Eileen Smith, *Worldwide semiannual public cloud services spending guide*, International Data Corporation, 2018, p. 3.

About the authors

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