



## Shifting gears: How to drive your digital businesses forward with an appropriate steering approach

The digital revolution changes (almost) everything. Yes, it's true – this insight is not exactly news anymore now that we have entered the third decade of the 21st century. But that doesn't mean this digital success story has already run its course. Nor does it imply that meanwhile, every individual company has succeeded in adapting its corporate script to make the most of this thrilling and promising plot. Far from it. While the global tech giants

continue to shine with consumer-centric product innovations, platform-based businesses, and digital ecosystems, many traditional organizations in industries such as automotive, industrial products, and utilities still struggle to make their digital businesses work. This is a dangerous situation for many mature companies, as the unprecedented digital upheaval of business models all over the globe represents a serious threat. It's not only the products

and services that need to evolve. In order to grow and prosper in the digital age, organizations themselves need to evolve, transcending traditional approaches to run a business. One critical success factor that currently gets considerably less attention from the press than shiny new tech innovations is the urgent need to establish not only new processes but new steering mechanisms for these businesses. ▶



For any finance leader faced with the task of driving the setup of new digital businesses in their organization, this translates into acute pressure to develop steering mechanisms that are in sync with the company's overall strategy and business operating model. In this CFO Insight, we'll take a closer look at the various aspects of what an adequate steering approach for digital businesses entails.

#### **What's the big deal?**

As more and more leaders have come to understand, establishing new mechanisms to steer digital businesses is a very big deal indeed. The urgency cannot be overstated because for many mature businesses, the success of their digital ventures will become a matter of corporate survival in the near future. However, without a comprehensive overhaul of traditional steering mechanisms, many of these new business models are doomed to fail. Right from the start of your digital journey, it is vital to ensure that scarce capital is allocated effectively rather than being wasted on costly digital dead-ends. Yet established methods of steering do not provide the necessary information for making the right decisions at the right time. So how do finance leaders address this apparent challenge? Whether

they are tasked with integrating a newly acquired digital asset or accommodating the effective funding of in-house digital incubator initiatives, the different nature of digital business models requires them to initiate a thorough rethink of steering, such as planning, reporting, and cost accounting.

Take the example of an automotive original equipment manufacturer (OEM) deploying new business models as a mobility service provider. If the company transitions from selling large upfront cost items such as cars to providing mobility services paid for according to usage, the number of transactions will increase massively, but the individual amount will decrease. A different time frame for revenue recognition and changed cost and balance sheet ratios require new profitability structures and sets of KPIs. In consequence, these business models show a significant increase of intangible assets and diminishing variable costs compared to mature businesses. The general shift from B2B to B2C means that customer accounts multiply exponentially. Customer-centricity as a cornerstone of these new business models implies a need for non-financial KPIs, for example, daily active users, churn rate, and net promoter score. The dynamic nature of digital markets can only be navigated successfully if management meeting schedules adapt to the rapid rhythms of products and service life cycles. All of this has not gone unnoticed among industry peers. In a recent study, 80 percent of interviewed experts state that new business models require a tailor-made steering approach. Further, 60 percent of them underline the critical importance of customer-centric KPIs, while 63 percent anticipate a high impact of digital ecosystems on corporate steering. Last but not least, 95 percent note that in order to make these changes happen, companies will need to recruit talent with very different profiles in the future. These items are just a small sample of the things you need to consider for a new steering approach. In order to paint a more systematic picture, the most relevant aspects and mechanisms can be summarized in eight distinct areas.

### Setting a new course for steering: The “Why” and the “How”

The numerous implications of digital businesses for your steering approach create a scenario of challenging complexity. Let’s break down this complexity and review the main areas for practical action.

#### Consider company maturity and type

Respect the difference. The maturities of digital businesses vary as much as the individual nature of these digital ventures themselves. Accordingly, there can be no “one-size-fits-all” steering approach. It is paramount to adapt existing mechanisms according to the needs of the particular business model envisaged. You can learn a lot from how digital champions such as leading search engine providers, large e-commerce companies, and prevalent social networks are managing such challenges. Locate your business model in the following matrix<sup>1</sup>:

- **Content** – Will you mainly provide information?  
Example: newspapers/streaming portals
- **Commerce** – Will you generate value by handling transactions?  
Example: e-commerce shops/platforms
- **Context** – Will you reduce complexity?  
Example: search engines, travel/booking portals
- **Connection** – Will you connect people and services?  
Example: social/business networks
- **Coordination** – Will you improve collaboration?  
Example: messaging providers

Once you have established a new approach, it is critical to adapt the steering focus to your current maturity stage, like emphasizing the management of rising active users and fast sales growth within a typical assimilation and growth phase. It is equally important to iteratively develop this further as your maturity evolves, for example, by adapting within a typical monetization and saturation phase to focus on pricing excellence, cost efficiency, and improved asset utilization. Keep in mind that different businesses in your organi-

zation might need different approaches. Many digital ventures entail a whole host of new business models manage these efficiently by grouping them into maturity clusters and develop corresponding standardized steering mechanisms.

#### Expand the steering focus on your ecosystem

The days of the traditional supply chain are numbered. With digital businesses, it morphs into a complex multidimensional supply network and transcends the organization’s boundaries. If value is generated on platforms, the exchange of data between the players, such as platform owners and producers, is crucial. Standardized data exchange, such as via APIs<sup>2</sup>, enables you to leverage customer-specific information between the involved players (considering specific policies like the European General Data Protection Regulation [GDPR]). The distributed ownership of the value chain means that steering mechanisms have to reach as far into the ecosystem as possible. For instance, performance dialogues should be enriched with an ecosystem dimension. A global lodging platform can serve as a typical example. Here, the platform owner connects the business models of all the ecosystem players. Lodging providers optimize the utilization of accommodations and payment partners and services companies increase revenue with data-based insights. Of course, the superior digital user experience and price comparison features mean that the consumer also benefits. In order to understand the intricacies of your ecosystem, you can analyze value drivers by devising a detailed platform business model canvas. For established companies, it is useful to boost digital business through partnering, collaborations, or joint ventures.

#### Realign top-line steering

Digital businesses generate huge (additional) revenue opportunities. But at the same time, the underlying transaction characteristics fundamentally differ from traditional business models. Steering mechanisms need to reflect the fact that digital product offerings are often paid for per use or with a subscription. Performance measurement should take the vastly

increased number of transactions, often in micro- and nano-payments, into account. According to IFRS 15 rules, for example selling a bundled media package (broadband, TV, landline) forces the provider to define a fair revenue split. This revenue split can be used to determine product profitability and enhance decision-making. If you plan to introduce dynamic pricing models, you will have to introduce new KPIs as well, such as the number of used services or usage behavior. New KPIs should also focus on customer lifetime value rather than short-term profitability. In the starting phase of a digital business, pricing models like freemium might result in a negative contribution – considerably more value will be realized long-term in the monetization phase.

#### Focus on non-financials and customer-centricity

Speaking of KPIs, introducing non-financial and customer-focused KPIs is a key priority in steering digital businesses, as the digital economy revolves around the consumer. This has massive implications for almost any business today, as customer relationship management is now underpinned by digital data, and whole industries have begun to cut out the middleman and market directly to consumers. The data-driven shift to B2C and C2C allows for completely new business models, yet it also changes the interaction structure of multi-format sales channels. A more granular breakdown of accounts enables precise measurement and steering. You can use advanced analytics to boost transparency and create valuable insights into customer behavior. For example, you could tackle margin leakages by analyzing internal customer data and external data that can be purchased from specialized vendors. You can then use these insights to enhance the quality of your management reports by including KPIs such as daily active users, average revenue per user, and conversion rates. You can also include platform-related KPIs like downtime and utilization. It’s essential that KPIs are deployed in sync with the respective maturity phase of your business. Don’t stifle your digital growth by applying traditional KPIs such as EBITDA too early!

<sup>1</sup> based on the 5C net business model by Strauss (2013)

<sup>2</sup> application programming interface



### **Accommodate changing P/L and B/S structures**

A fundamental change of character. With its unprecedented scalability, digital business has a completely different cost profile when compared to traditional business models. Digital production incurs greater IT costs, which traditionally would have been considered as SG&A. While SG&A costs therefore move partly to the COGS part of the P/L equation, nevertheless, the relative importance of SG&A costs increases. Accordingly, established benchmarks must be adapted to make sense of cost trends in digital business – don't mix traditional and digital business models. The effect on the balance sheet is also significant, as intangible assets now play a much bigger role in the B/S picture. New revenue recognition rules (IFRS 15) require a chronological segmentation of revenue, for instance, when accounting for a handset as part of a telecommunication contract that has to be spread over the contract lifetime rather than being accounted upfront. All these changes should be reflected in your P/L and B/S structures. You must adjust your planning, budgeting, and forecasting to ensure integrated perspectives on actuals and plan information.

### **Plan like a venture capitalist**

One of the main characteristics of digital business is the dizzying speed the field entails. Development and product cycles shrink significantly, the market is in constant flux, and new products and competitors emerge on almost a daily basis, resulting in constant uncertainty. When embarking on a digital journey as a mature

organization, conventional long-term planning cycles are no longer appropriate. You will have to adapt your planning as if you were a venture capitalist (VC) funding a start-up. The short-term venture capital allocation methods of VC funds provide a useful template, as they rely on stage-gate definitions for their funding decisions. These are flexible enough to accommodate the needs of a business in earlier phases of its digital maturity trajectory. It is helpful to break down targets to a more granular level to optimize funding allocation, for example, from group level to business unit to department to team level. Be sure to make the most of the available analytical tools in your planning. There are many use cases for advanced analytics approaches. For instance, a global mobility service provider enhanced the quality and frequency of its sales forecasting through new predictive capabilities based on thousands of external data models.

### **Exploit a powerful digital backend**

A digital core is the heart of new businesses. For established companies, this fact poses a formidable challenge. While new market entrants can design purpose-built digital backends from scratch, established players are often burdened with entrenched legacy systems that are not nearly flexible enough to power the data-driven digital business models of the future. As the available amount of data increases exponentially, you will have to act swiftly and build an appropriate digital backbone to remain competitive. Introduce an advanced ERP system to establish end-to-end transparency and right-time

capabilities. Achieve superior insights by creating a central data lake that integrates both internal and external data as well as structured and unstructured data. Increase productivity by replacing paper-based processes with self-service functionality. Apply advanced analytics to bolster decision-making. And most importantly, take advantage of your digitally strengthened backend by increasing the frequency of management meetings and incorporating right-time business intelligence, for example, in informal daily performance stand-ups.

### **Build up digital skills and business acumen**

We've discussed many changes that flow from the new technological paradigm of digital business. But in order to make these changes happen, you still need human beings who are able to execute them. They have a very different skill set than traditional finance and controlling experts. Digital fluency and business acumen should play a prominent role in who you hire. You should also introduce new steering mechanisms into your organization by establishing trainings and leveraging existing digital know-how. For example, you could organize a digital fluency academy that spreads digital know-how across the organization. Think about hiring ambassadors of change. Such experienced individuals are capable of inspiring and mentoring your workforce – a great way to kickstart digital corporate culture in your finance department.



### Steps toward your new steering approach

While there are numerous aspects to consider when creating a new steering approach for digital businesses, it is impossible to implement everything at once. For practical purposes, you should focus on developing an individual digital steering journey roadmap that fits your company's particular situation. Start with one exemplary pilot business model, and then roll out successful mechanisms in other business areas. Do it step by step, and choose the most suitable first step according to the current maturity of your organization's finance and controlling function.

#### Step 1 – Analyze your business

Develop an insight into the impact of your digital business on your finance function in terms of revenue recognition, profit allocation, intangible assets, and other critical business items.

#### Step 2 – Define finance cornerstones

Conduct deep dives to fine-tune your understanding of the implications. Further, define finance cornerstones that are aligned with your relevant business functions.

#### Step 3 – Pilot steering mechanisms

Focus on one pilot business model and implement new steering mechanisms in an iterative process of optimization.

#### Step 4 – Scale pilot

Roll out the successful pilot template to other adjacent business models and embed the new mechanisms in your established steering.

#### Step 5 – Empower finance employees

Train your workforce to master the new steering mechanisms, and recruit talent who can fulfill the digital skill profiles your organization needs and is lacking.

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