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Flashpoint

Flexible consumption business strategies

What strategy will get you where you need to be?

Is pay as you go the way to go?

In an era of business model disruption, perhaps one of the most profound disruptions in the technology, media, and telecommunications (TMT) world is the shift away from a model based on outright purchase or licensing to one based on consumption. Flexible consumption is not new. It has long been employed by utility companies, for example, but it is now expanding to other industries, sometimes taking on new meanings. Consumption-based models are having a particularly strong impact on TMT industry.

A number of trends, including the rise in cloud, mobile, social networking, "Big Data," and the Internet of Things (IoT), are driving demand for flexible consumption arrangements. For instance, advances in cloud-based computing have increased both the feasibility and the attractiveness of hosted solutions, ranging from software-as-a-service (SaaS), security-as-a-service (SecaaS) and infrastructure-as-a-service (IaaS), to "anything" as a service (XaaS); for all of these, payment is based on actual service or solution usage. The rise in mobile devices and proliferation of broadband and Wi-Fi access points has led to an expectation that customers should be able to conduct business from anywhere, at any time, from any device. Data analytics provides customers and vendors alike with valuable insights into how, what, and when services are being used, driving expectations for real-time, contextually aware offerings.

A transition with big rewards

Flexible consumption offers substantial benefits. These range from predictable, recurring revenue streams to higher customer retention driven by stickier, long-term relationships with customers, and improved margins. Ultimately, investors may reward companies transitioning to flexible consumption models with higher valuations if communication is clear and execution is flawless.

As more and more customers demand more flexible payment models, the continued viability of many companies, and even entire industries, is being threatened.

Is pay as you go the way to go?

Yet perhaps the biggest reason for some companies to consider transitioning to a flexible consumption model is that they can't afford not to. As more and more customers demand more flexible payment models, the continued viability of many companies, and even entire industries, is being threatened. Those that fail to at least explore consumption-based offerings may end up on the path to obsolescence.

But one that is fraught with challenges

Moving to a flexible consumption model is not for the faint of heart. It calls for a fundamentally different way of doing business. For established companies that are used to the traditional sales model, the task is that much harder because their organizational capabilities may not support a consumption-based business model. There are also financial implications. First, because there is a conversion from upfront to recurring revenue, companies transitioning to consumption-based models generally experience a short-term revenue dip. In addition, the timing of cash flow and revenue recognition can often be out of alignment with incurred costs. With non-flexible models, companies will generally expense the costs to acquire customers as incurred. However, flexible models sometimes differ from their non-flexible counterparts in that companies can elect to either expense the costs to acquire customers as incurred, or defer and amortize the costs over the period during which the service is delivered. As a result, in instances where the costs are expensed as incurred, profitability tends to be reached later, once the organization has had an opportunity to scale its offerings.

Sacrificing short-term performance for the sake of long-term success is always challenging. Success with investors depends on the company's ability to communicate its business case for adopting a flexible consumption model, as well as to execute a flawless transition. But how does a company know if a flexible consumption business model is right for them? Here are the key considerations every company should keep in mind.

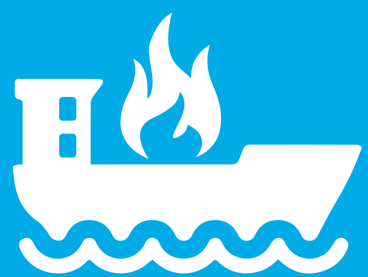
About *Flashpoints*

Every day brings new ideas and possibilities on Technology, Media, and Telecommunications sectors. *Flashpoints* is your tool for gaining the context you need to make sense of these critical development — as they emerge.

Key considerations

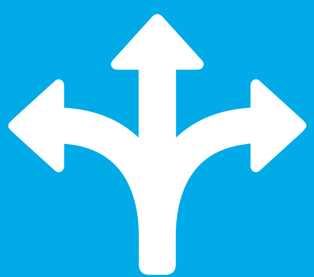
Deciding on the new model

Companies first need to decide where along the flexibility continuum their model sits with respect to three separate consumption levers: packaging, delivery, and monetization.



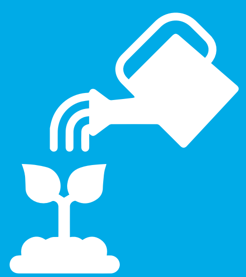
Burn the boats

Strategy of companies that determine flexible consumption is their future, committing to go through the painful process of converting most (or a strategic part) of the portfolio as soon as possible.



Straddle

Strategy of companies that see value in giving customers a choice between flexible consumption and non-flexible offerings and want to transition with caution.



Protect and grow

Strategy of companies that want to offer flexible consumption, but in a way that protects and propels their current business.

Wait and see

Strategy of companies that decide not to offer flexible consumption for the time being, particularly in markets where it is important to test whether or not customers will embrace the new model.

Choosing a path

No matter what path they choose, companies must keep in mind a number of considerations as they articulate their approach to adopting or expanding to flexible consumption.

Deciding on the new model

In order to determine which model is most appropriate, companies need to know how much flexibility is required to win new customers and retain existing ones. There is no one-size-fits-all answer to this question, and in fact, there is a significant amount of variability in what these models look like. Companies need to decide where along the flexibility continuum their model sits with respect to three separate consumption levers: packaging, delivery, and monetization.

Consumption Levers

		Low Flexibility	*High Flexibility*
Monetization	Under what model is product monetized? (e.g. transaction, subscription, pay-per-use)	**Transaction-Based** E.g. Buying a software license as a one-time transaction allows least flexibility	**Outcome-Based** E.g. Buying software and paying once business outcome is achieved provides most flexibility
Packaging	How are product/service features offered together? (e.g. standalone, bundle)	**Predefined** E.g. Cable TV provides fixed/ predefined packaging for content that can be viewed	**Configurable** E.g. On Demand TV allows customers to choose/ configure the content to view
Delivery	How is the product/service delivered? (e.g. online, on-premise, print)	**Fixed** E.g. Content available in print only offer least amount of flexibility	**Unconstrained** E.g. Content for which customers can select/alter delivery are most flexible

Deciding on the new model

To successfully transition or expand to flexible consumption, companies need to consider packaging, delivery, and monetization in addressing a few key business strategy questions:

Should we offer flexible consumption?

- Is flexible consumption essential to win in our market?
- How much flexibility is required to win?

Where do we play?

- How much of our portfolio should we transition?
- How much of our legacy portfolio should we retain?

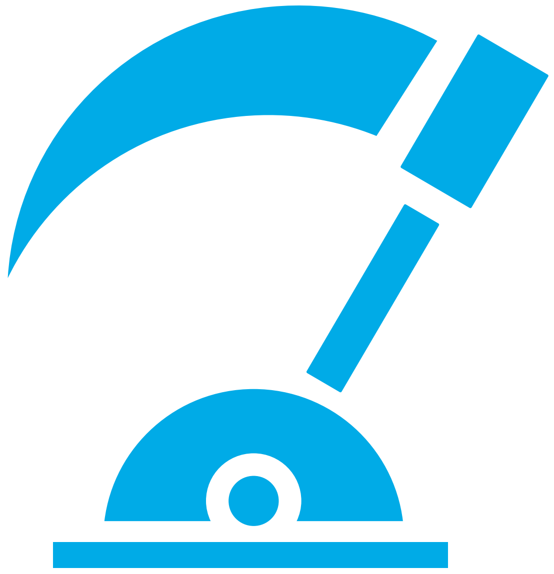
When do we transition?

- How quickly should we move?
- What should we transition first?

These questions are difficult and often spark heated discussions within companies. The issues they raise are so new that there is not always a clear path forward. Yet finding the right path may be essential to a company's very survival.

Four paths to flexible consumption

Determining which strategy is right depends on both sector and individual company conditions, as well as a company's existing capabilities and business complexities. Based on their answers to the key strategy questions, companies have typically taken four paths to transitioning or expanding to consumption-based models.



Companies first need to decide where along the flexibility continuum their model sits with respect to three separate consumption levers: packaging, delivery, and monetization.

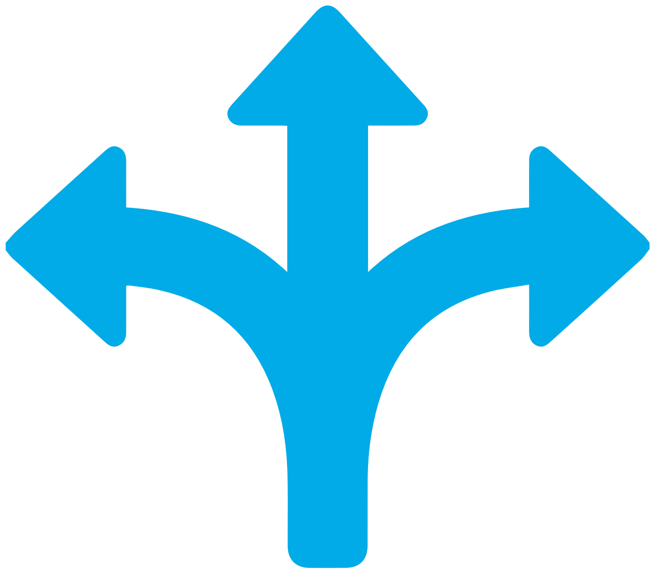
Four paths to flexible consumption
Path one: Burn the boats

This path is chosen by organizations operating in markets where there are clear signals that the existing model is running out of steam amid pressure to provide customers with maximum flexibility. Based on the belief that a move to flexible consumption is crucial to survival, these companies convert all—or at the very least their most strategic—products to the new model right away or as quickly as possible, usually over the course of one to three years. A “burn the boats” strategy poses the highest risk of the four approaches, requiring a full-blown transformation of the organization and a willingness to sacrifice short-term gains.

Strategy of companies that determine flexible consumption is their future, committing to go through the painful process of converting most (or a strategic part) of the portfolio as soon as possible.

Four paths to flexible consumption
Path two: Straddle

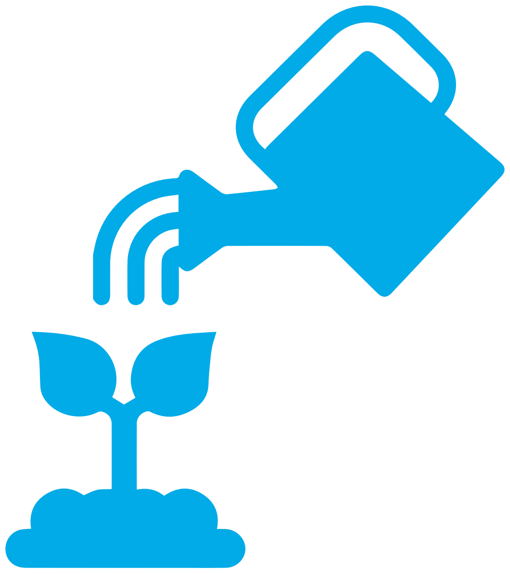
Organizations that choose this path are under slightly less pressure to make an immediate transition to a consumption-based model. They continue to see value in giving customers the option to choose between flexible and non-flexible consumption versions of same products and services, and may even be able to use offering choice as a competitive differentiator. While there is a need to innovate in the flexible consumption space, companies have the breathing room to proceed with caution and take a balanced approach to converting their portfolio, completing a full transition to the new model over a longer period of time (three to seven years). The straddle path is a lower-risk strategy than a full transition, but companies that choose it will need to maintain both flexible consumption and legacy versions of the same products. This can be costly and can result in cannibalization if there isn't a clear articulation of the value-price equation between the two options.



Strategy of companies that see value in giving customers a choice between flexible consumption and non-flexible offerings and want to transition with caution.

Four paths to flexible consumption
Path three: Protect and grow

This path is for companies that look to refresh and strengthen their core portfolio with the help of entirely new flexible consumption offerings. Companies that choose this path build or buy discrete flexible consumption offerings that are run in a fairly isolated manner, separate from legacy non-flexible consumption products. The approach poses less risk than the other two strategies, calling for less wrenching changes in cash flows and less integration of operations—and results in no cannibalization of existing products. Rather, companies use the flexible consumption offerings as add-ons to legacy products or as a means of cross-selling them. While their main objective is to protect legacy products, these companies don't want to be completely left out in the cold when it comes to flexible consumption. They will therefore participate selectively, rolling out discrete consumption-based offerings based on niche market demands.



Strategy of companies that want to offer flexible consumption, but in a way that protects and propels their current business.

Four paths to flexible consumption
Path four: Wait and see

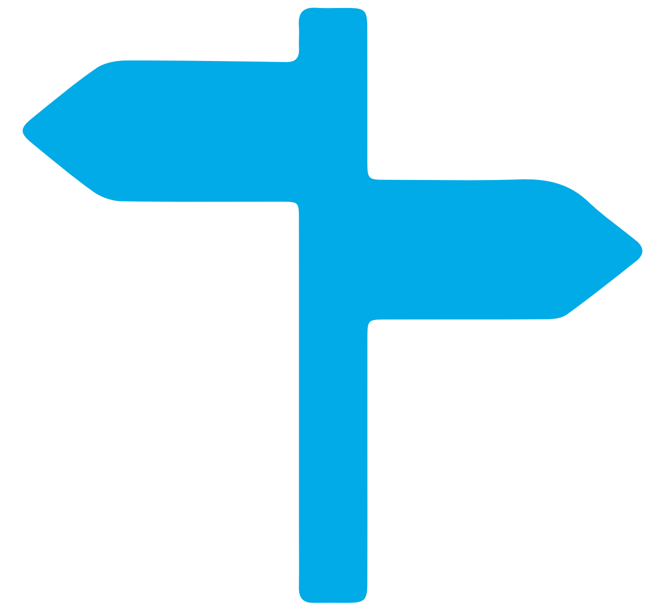
Some companies operate in markets where it is still unclear whether flexible consumption is required to win. In those situations, it does not make strategic sense to embrace a flexible consumption model in the short term without a good understanding of where flexible consumption offerings will be likely to pose a competitive threat. A wait-and-see strategy is most appropriate for companies that are well positioned to capitalize on their existing strengths. This gives them sufficient time to search for the right window of opportunity to expand to consumption-based offerings and articulate their own flexible consumption strategy. Continued market vigilance is important, because companies that wait too long to transition may run the risk of stagnating and being outpaced by competitors with newer technologies.

Strategy of companies that decide not to offer flexible consumption for the time being, particularly in markets where it is important to test whether or not customers will embrace the new model.

Choosing a path

There are a few criteria that companies should keep in mind as they articulate their approach to adopting or expanding to flexible consumption:

1. **Market growth and maturity:** It is important to assess the outlook of the markets the company plays in, as well as whether they are sufficiently mature for flexible consumption offerings.
2. **Competitive landscape:** Companies need to consider a range of factors, including the level of threat posed by their competitors' adoption of flexible consumption; their desired short-term and long-term positioning with respect to competitors; the extent to which external factors prompt a transition to flexible consumption; and whether they have the ability to sustain competitive advantage or further differentiation in their flexible consumption offerings post roll-out.
3. **Risk:** Companies will need to determine their individual risk appetite and evaluate overall risk implications (e.g., financial risk, cyber security risk, operational risk) across each of the four transition paths. This will help determine the approach that best aligns with the company's individual business, legal, regulatory and strategic objectives.
4. **Customer demand and relationships:** Important questions to address include: To what extent do customers demand the transition? To what extent will the company's customer relationships impact, or work in favor of, a transition to flexible consumption?

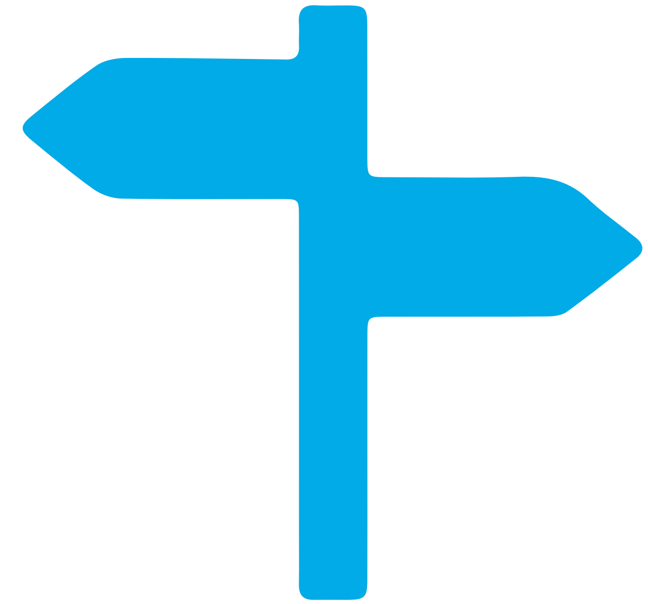


No matter what path they choose, companies must keep in mind a number of considerations as they articulate their approach to adopting or expanding to flexible consumption.

Choosing a path

5. **Product portfolio:** The nature of a company's product portfolio can influence its decision to transition to flexible consumption, as well as how it executes such a transition. Factors that may impact the decision include degree of portfolio consolidation and differentiation and the particular market for each product. Ultimately, the overall flexible consumption strategy should be informed by the individual product requirements, particularly with respect to core or flagship products.

6. **Overall company narrative:** Since the transition to flexible consumption may have a short-term impact on the business, companies should evaluate the extent to which they can defend their adoption of a flexible consumption model, including what strengths will help them successfully navigate the transition.



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Let’s talk

Finding the right answer for your company requires careful analysis of market and internal conditions. It also calls for a clear vision of how the industry is evolving and where your organization can compete most successfully. Ultimately, that answer is only relevant for a finite period of time. In the long run you may need to adopt a different flexible consumption strategy as your business, the industry, and markets evolve. Deloitte has guided numerous companies through business model transformations towards flexible consumption, and we understand the complexity of the challenge and associated risk implications. Let’s talk about what the change will mean to you.

In the meantime, be sure to check back for a monthly dose of the latest issues driving the future of technology, media, and telecommunications companies. Stay tuned for more in our Flashpoints series on flexible consumption and its impacts across the organization, from business strategy through technical enablement.

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