



THE DIGITAL TRANSFORMER'S DILEMMA

How to Energize Your Core Business
While Building Disruptive Products and Services



Karolin Frankenberger, Hannah Mayer, Andreas Reiter, and Markus Schmidt

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Table of Contents

Cover

Introduction THE DIGITIZATION OF YOUR CORE BUSINESS IS NECESSARY, BUT THE FUTURE OF YOUR COMPANY LIES IN ITS NEW, DISRUPTIVE BUSINESS

YOUR BUSINESS MUST TRANSFORM TWICE TO SURVIVE

SOFTWARE IS EATING THE WORLD - AND COMPANIES STILL DON'T KNOW HOW TO ADAPT

THE DIGITAL TRANSFORMER'S DILEMMA: ENERGIZING THE CORE BUSINESS WHILE BUILDING DISRUPTIVE NEW PRODUCTS AND SERVICES

WHAT OTHER DIGITAL TRANSFORMATION BOOKS DON'T TELL YOU

WHY AND HOW WE WROTE THIS BOOK

PANDEMIC MEETS DIGITAL TRANSFORMATION

SUCCESS IS NOT SUCCESS - THE RULES ARE DIFFERENT IN THE OLD AND NEW WORLDS

WASTE. TRASH. GARBAGE. SCRAP. RUBBISH. DEBRIS. REFUSE. JUNK.

Part 1: WHY TO ACT

Chapter 1: ACT OR DIE, PRETTY SOON

REALIZE THE "WHY" CHALLENGES YOUR COMPANY MUST TACKLE

FIGURE OUT YOUR OWN "WHY" BEFORE YOU DO ANYTHING ELSE

FAILING TO TRANSFORM IS STILL THE
NORM - BUT IT DOESN'T HAVE TO BE
TO AVOID BANKRUPTCY, “DUAL BUSINESS”
IS THE NEW BLACK

GET MOVING TO AVOID THE DINOSAUR FATE
GET INSPIRED (BY PICTURES)

Part 2: WHAT TO DO

Chapter 2: HOW TO MAKE YOUR STRATEGY,
BUSINESS MODEL, AND DIGITAL INITIATIVES
STOP FIGHTING EACH OTHER AND WORK
TOGETHER

REALIZE THE “WHAT” CHALLENGES YOUR
COMPANY MUST TACKLE

DON'T STRATEGIZE IN SILOS: CREATE A
HOLISTIC STRATEGY ACROSS BOTH
BUSINESSES

OVERARCHING DIGITAL STRATEGY

ONE THING COMPANIES FORGET WHEN
THEY MOVE FROM STRATEGY TO STRATEGIC
INITIATIVES

GAIN A COMPETITIVE EDGE THROUGH
BUSINESS MODEL INNOVATION

GET MOVING TO AVOID THE DINOSAUR FATE
GET INSPIRED (BY PRINTING PRESSES)

Part 3: HOW TO DO IT

Chapter 3: ORGANIZATION: HOW TO DEVELOP A
FLEXIBLE ORGANIZATION

REALIZE THE ORGANIZATIONAL
CHALLENGES YOUR COMPANY MUST
TACKLE

BECOME AMBIDEX-WHAT?

SAY GOODBYE TO ONE HOLY GRAIL OF
INNOVATION AND EMBRACE DISPERSED
INNOVATION EFFORTS

ANCHOR FIRST, THEN SET SAIL - THINK
ABOUT WHERE TO POSITION YOUR DIGITAL
EFFORTS NOW AND LATER

ESTABLISH CONTACT WITH OTHER DIGITAL
TRANSFORMATION BOATS IN THE BAY

MANAGE THE ORGANIZATIONAL TENSION
BETWEEN THE 1ST AND 2ND S-CURVE

GET MOVING TO AVOID THE DINOSAUR FATE

GET INSPIRED (BY ELECTRICITY)

Chapter 4: TECHNOLOGY: HOW TO USE TECHNOLOGY AS A DRIVER FOR THE TRANSFORMATION

REALIZE THE TECHNOLOGY CHALLENGES
YOUR COMPANY MUST TACKLE

LOOK BEYOND THE HYPES AND
UNDERSTAND WHAT TECH REALLY MEANS

IT DOES NOT EQUAL TECH

MANAGE THE TECHNOLOGICAL TENSION
BETWEEN THE 1ST AND 2ND S-CURVE

GET MOVING TO AVOID THE DINOSAUR FATE

GET INSPIRED (BY INDONESIA)

Chapter 5: PROCESSES: HOW TO GET STUFF DONE

REALIZE THE PROCESS CHALLENGES YOUR
COMPANY MUST TACKLE

GET YOUR HANDS DIRTY LAUNCHING YOUR
DIGITAL TRANSFORMATION

INCUBATION PHASE

GET YOUR HANDS EVEN DIRTIER RUNNING
THE DIGITAL TRANSFORMATION
MANAGE THE PROCEDURAL TENSION
BETWEEN THE 1ST AND 2ND S-CURVE
GET MOVING TO AVOID THE DINOSAUR FATE
GET INSPIRED (BY BENELUX)

Leadership

GET A GRIP ON THOSE “SOFT” FACTORS OF
YOUR DIGITAL TRANSFORMATION

Chapter 6: LEADERSHIP: WHAT TO LOOK FOR IN LEADERS AND HOW TO FIND THEM

REALIZE THE LEADERSHIP CHALLENGES
YOUR COMPANY MUST TACKLE

LEADERS MAKE OR BREAK THE DIGITAL
TRANSFORMATION DEAL

KNOW YOUR LEADERS INSIDE AND OUT

GO SHOPPING FOR YOUR PREFERRED
LEADERSHIP ATTRIBUTES

GO SHOPPING FOR YOUR PREFERRED
LEADERS

MANAGE THE LEADERSHIP TENSION
BETWEEN THE 1ST AND 2ND S-CURVE

GET MOVING TO AVOID THE DINOSAUR FATE
GET INSPIRED (BY CAR TIRES).

Chapter 7: PEOPLE: WHAT TO LOOK FOR IN TALENT AND HOW TO DEVELOP THE WORKFORCE OF THE FUTURE

REALIZE THE PEOPLE CHALLENGES YOUR
COMPANY MUST TACKLE

PEOPLE, TOO, MAKE OR BREAK THE DIGITAL
TRANSFORMATION DEAL

KNOW YOUR TALENT INSIDE AND OUT
GO SHOPPING FOR YOUR PREFERRED
PEOPLE ATTRIBUTES

GO SHOPPING FOR YOUR DIGITAL
TRANSFORMATION WORKFORCE

MANAGE THE PEOPLE TENSION BETWEEN
THE 1ST AND 2ND S-CURVE

GET MOVING TO AVOID THE DINOSAUR FATE
GET INSPIRED (BY CLOTHES)

Chapter 8: CULTURE: HOW TO GALVANIZE AN
ORGANIZATION AND HELP YOUR PEOPLE PULL
TOGETHER

REALIZE THE CULTURAL CHALLENGES
YOUR COMPANY MUST TACKLE

DROP THE PRECONCEPTIONS AND
INTERNALIZE WHAT CULTURE REALLY
MEANS

CHANGE BELIEFS BY MOVING TOWARD A
NEW MINDSET – PART I OF THE CULTURE
EQUATION

CHANGE BEHAVIORS BY ALTERING
STRUCTURE AND WAYS OF WORKING – PART
II OF THE CULTURE EQUATION

MANAGE THE CULTURAL TENSION
BETWEEN THE 1ST AND 2ND S-CURVE

GET MOVING TO AVOID THE DINOSAUR FATE
GET INSPIRED (BY POSTAL SERVICES)

Part 4: WHERE TO SEE RESULTS

Chapter 9: BECAUSE YOU'RE NOT DOING THIS
FOR FUN BUT FOR RESULTS

REALIZE THE “WHERE” CHALLENGES YOUR
COMPANY MUST TACKLE

MOVE FROM KPI LAUNDRY LISTS TO
STRATEGIC KPI SETTING

“OBJECTIVES AND BUSINESS CASES ARE
DEAD; LONG LIVE OBJECTIVES AND
BUSINESS CASES”

FAIL, FAIL AGAIN AND BETTER

TRANSPARENCY TRUMPS THE TELEPHONE
GAME

DON'T PLAY THE BLAME GAME BUT DO
HOLD PEOPLE ACCOUNTABLE

BEWARE OF THAT BOOMERANG

GET MOVING TO AVOID THE DINOSAUR FATE

GET INSPIRED (BY BANKING)

Conclusion: Reinvent Your Organization by Putting the
Pieces Together

Notes

INTRODUCTION: THE DIGITIZATION OF YOUR
CORE BUSINESS IS NECESSARY, BUT THE
FUTURE OF YOUR COMPANY LIES IN ITS NEW,
DISRUPTIVE BUSINESS

CHAPTER 1. ACT OR DIE, PRETTY SOON

CHAPTER 2. HOW TO MAKE YOUR STRATEGY,
BUSINESS MODEL, AND DIGITAL INITIATIVES
STOP FIGHTING EACH OTHER AND WORK
TOGETHER

PART 3. HOW TO DO IT

CHAPTER 3. ORGANIZATION: HOW TO DEVELOP
A FLEXIBLE ORGANIZATION

[CHAPTER 4. TECHNOLOGY: HOW TO USE
TECHNOLOGY AS A DRIVER FOR THE
TRANSFORMATION](#)

[CHAPTER 5. PROCESSES: HOW TO GET STUFF
DONE](#)

[CHAPTER 6. LEADERSHIP: WHAT TO LOOK FOR
IN LEADERS AND HOW TO FIND THEM](#)

[CHAPTER 7. PEOPLE: WHAT TO LOOK FOR IN
TALENT AND HOW TO DEVELOP THE
WORKFORCE OF THE FUTURE](#)

[CHAPTER 8. CULTURE: HOW TO GALVANIZE AN
ORGANIZATION AND HELP YOUR PEOPLE PULL
TOGETHER](#)

[CHAPTER 9. BECAUSE YOU'RE NOT DOING THIS
FOR FUN BUT FOR RESULTS](#)

[CONCLUSION: REINVENT YOUR ORGANIZATION
BY PUTTING THE PIECES TOGETHER](#)

[Resources](#)

[Acknowledgments](#)

[About the Authors](#)

[Index](#)

[End User License Agreement](#)

List of Illustrations

Introduction

[Figure 0.1 Dinosaur companies won't survive](#)

[Figure 0.2 Two S-curves](#)

[Figure 0.3 The Digital Transformer's Dilemma](#)

Chapter 1

[Figure 1.1 Key visual with focus on Why](#)

[Figure 1.2 Imbalance between 1st and 2nd S-curve](#)

[Figure 1.3 Platforms](#)

Chapter 2

[Figure 2.1 Key visual with focus on What](#)

[Figure 2.2 Business model-technology matrix](#)

[Figure 2.3 The Business Model Navigator](#)

Chapter 3

[Figure 3.1 Key visual with focus on How/Organization](#)

[Figure 3.2 Cargo ship versus drone](#)

[Figure 3.3 Matrix of origin of digital impetus](#)

[Figure 3.4 Common organizational archetypes](#)

[Figure 3.5 Baseline model \(A\)](#)

[Figure 3.6 Standalone Digital Business Unit \(B\)](#)

[Figure 3.7 Digital Competence Center \(C\)](#)

[Figure 3.8 Digital Support Center \(D\)](#)

[Figure 3.9 Digital as the new normal \(E\)](#)

Chapter 4

[Figure 4.1 Key visual with focus on How/Technology](#)

[Figure 4.2 Technology buzzwords](#)

[Figure 4.3 Application, platform, and hardware layers in an IoT platform](#)

[Figure 4.4 Incumbent versus digital native](#)

[Figure 4.5 IT architecture](#)

Chapter 5

[Figure 5.1 Key visual with focus on How/Processes](#)

[Figure 5.2 Innovation funnel](#)

[Figure 5.3 Ideation, incubation, and commercialization phases](#)

[Figure 5.4 Stage-gate approach](#)

Chapter 6

[Figure 6.1 Key visual with focus on How/Leadership](#)

[Figure 6.2 Leadership types](#)

[Figure 6.3 Leading the business, leading others, leading myself](#)

[Figure 6.4 Sources for digital transformation leaders](#)

Chapter 7

[Figure 7.1 Key visual with focus on How/People](#)

[Figure 7.2 People types](#)

[Figure 7.3 Sourcing digital transformation talent](#)

[Figure 7.4 Retraining](#)

[Figure 7.5 Recruiting](#)

[Figure 7.6 Renting](#)

[Figure 7.7 Reconfiguring](#)

[Figure 7.8 Reducing](#)

Chapter 8

[Figure 8.1 Key visual with focus on How/Culture](#)

[Figure 8.2 Higher-order versus lower-order culture](#)

[Figure 8.3 Changing beliefs – shifting toward a new mindset](#)

[Figure 8.4 Changing behaviors – altering structure and ways of working](#)

Chapter 9

[Figure 9.1 Key visual with focus on Where.](#)

[Figure 9.2 Three Horizons](#)

[Figure 9.3 KPI to-do list](#)

[Figure 9.4 KPI cheat-sheet](#)

Part 3

[Figure 3.0 Key visual with focus on How](#)

Resources

[Figure 10.1 Why tool](#)

[Figure 10.2 What tool](#)

[Figure 10.3 How tool](#)

[Figure 10.4 How dimensions](#)

[Figure 10.5 Where tool](#)

THE DIGITAL TRANSFORMER'S DILEMMA

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While Building Disruptive Products
and Services**

Karolin Frankenberger, Hannah Mayer, Andreas Reiter, and
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TO ALL DIGITAL TRANSFORMERS

Introduction

THE DIGITIZATION OF YOUR CORE BUSINESS IS NECESSARY, BUT THE FUTURE OF YOUR COMPANY LIES IN ITS NEW, DISRUPTIVE BUSINESS

YOUR BUSINESS MUST TRANSFORM TWICE TO SURVIVE

This book starts with a bit of bad news (which you already know) and some good news. The bad news, of course, is your legacy business is like a dinosaur, and threatened with the same fate—extinction. New start-ups, powerful tech companies, and other game changers are threatening the existence of every successful organization (see [Figure 0.1](#)). The good news is that firms (unlike literal dinosaurs) can prepare for drastic changes. This book is designed to help organizations prepare to meet the threat and succeed, by guiding them along the path of transformation.

The take-home message is, you actually have to transform twice: legacy firms need to transform their core, legacy-driven business while in parallel setting up new, disruptive (digital) businesses. That is, *all* firms. Irrespective of their industry, geography, or size, companies will need to strike that balance between two very different worlds. Large, well-known companies – like Michelin, Volkswagen, AB InBev, Nestlé, Novartis, and BNP Paribas – are just as much affected as smaller, hidden champions – such as Ohio-based manufacturer of precision instruments Mettler-Toledo, Swiss-based diversified tech conglomerate Bühler, or BTPN of Indonesia. We interviewed all of these – and many more –

only to find that there is no safe haven for any particular kind of organization. Our apologies.

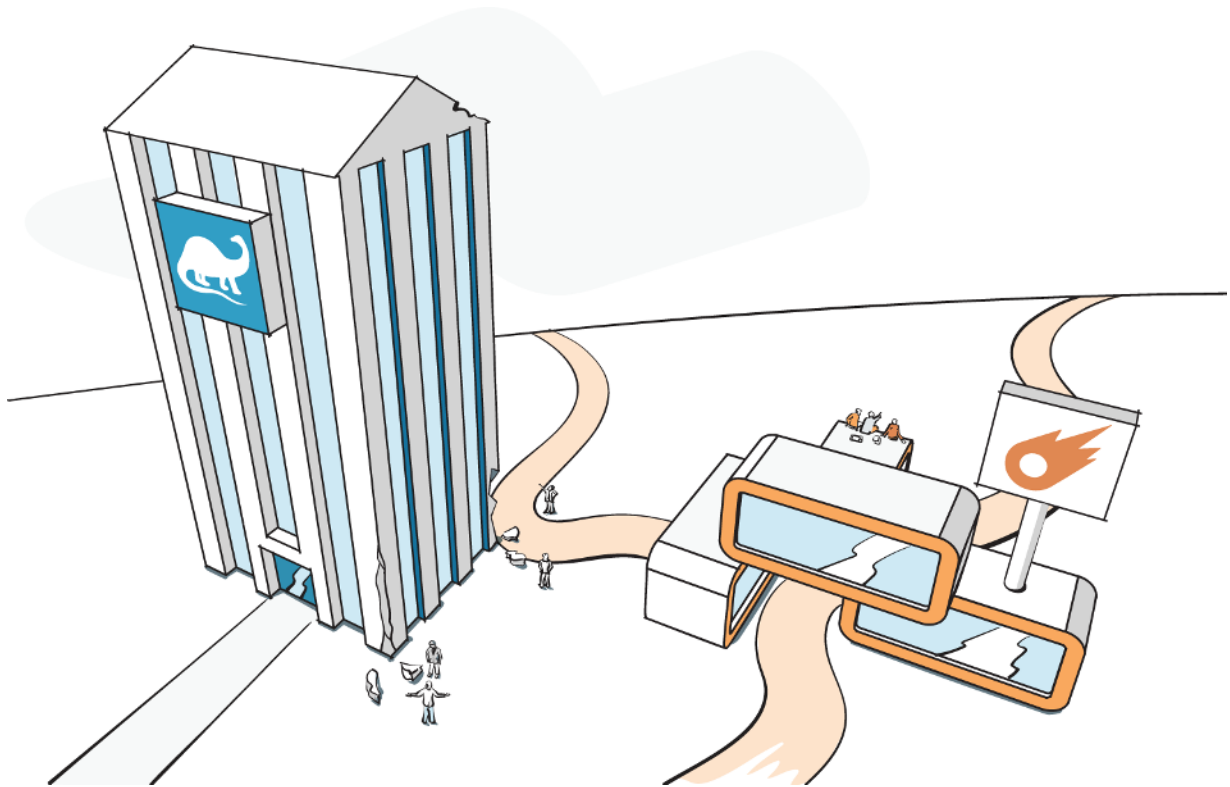


Figure 0.1 Dinosaur companies won't survive

Why is that, though? In essence, it's wrong to distinguish based on size or geography when it comes to digital transformation. Though some differentiation based on industry is possible due to differing sector maturity and the resulting differences in urgency to transform, the most relevant distinguishing factor is the age of the organization in question, making this a “start-up versus legacy firm” competition. Start-ups can launch disruptive innovations more easily than legacy firms because they are not bogged down by past (infra-) structural or mindset baggage. Legacy firms, on the other hand, cannot act as quickly because the organizational realities they face are more complex and harder to overcome. For them to continue to be successful in the old world while at the same time succeeding in a new world is a challenge no holistic

consultant model captures – so far. We are trying to tackle the problem in this book.

The good news is, the digital world order that organizations need to brave is not as dystopian as one might think. On the contrary – it bears great potential that firms can tap into when they open their minds to disruptive innovations, including business model innovation paired with or based on the use of artificial intelligence, platform-based businesses, product-as-a-service, digitized customer journeys, and many more of those all-too-well-known buzzwords. We go beyond the buzzword hype, though, to illustrate how organizations not only can understand but can master the challenge of creating a radically new business which will rely on fundamentally different success factors than the core business.

Avid management literature readers will know that some books and concepts have addressed the necessity for disruptive innovations already. Think Blue Ocean Strategy, which talks about how companies can create new demand in previously untapped market spaces rather than fight over a shrinking profit pool with fierce competitors. Or think Three Horizons, which depicts innovation as occurring on three time horizons, with these time horizons gradually shortening, thus disadvantaging bureaucratic incumbents and advantaging nimble attackers well positioned to act swiftly. Yet one thing is missing: a concrete guide to the differing success factors in the core business versus those in the new disruptive business, particularly as relates to the implementation of such a transformation, and to how the tension inherent in the coexistence of these two businesses can best be managed. This is where we come in – the book at hand guides digital transformation practitioners from all sorts of organizations and across all career levels along the implementation of a holistic, two-tier digital transformation.

SOFTWARE IS EATING THE WORLD - AND COMPANIES STILL DON'T KNOW HOW TO ADAPT

Digitization is complicated and exciting and perilous. The possibility of autonomous cars has led automotive players to make huge investments in radically rethinking mobility – like Daimler and BMW, which have formed a joint venture covering new-generation services.¹ Now you can schedule a doctor's appointment via your phone while riding the subway to work. And don't we all value being able to search property listings online instead of having to drive to dozens of properties? On the more negative, perilous side of digitization, besides the much covered collapse of Nokia² and Kodak,³ you may remember Nike halving the size of its digital unit, Lego defunding its Digital Designer virtual building program, and P&G not being able to achieve its ambition of becoming “the most digital company on the planet.”⁴ And, if nothing else, you have surely wondered how jobs, including your own, will be affected by digitization – especially given that 60% of occupations have at least 30% of constituent work activities that could be “automated away” and because significant skill shifts are expected as a result of automation and digitization.⁵ It's understandable then that individuals and sometimes entire occupational groups fear digitization.

Digitization affects how we live, work, communicate, and consume products and services. It has enormous effects on how organizations operate – because established rules and best practices of doing business now have a rapidly approaching expiration date.⁶ Also, established firms are being threatened by emerging start-ups and diversifying tech players, at the same time that traditional industry boundaries are falling. (Think about Google entering the

healthcare and biosciences field by venturing into cancer detection and diabetes diagnosis.) Digitization also brings with it challenges like increased competition from China (Alibaba's possible expansion into North America and Europe), drastic shifts in customer preferences (TV's shift to streaming on demand), and new digital phenomena like ecosystems and platforms (can you think of a mobile operating system that is not a platform for thousands of third-party software developers?).

All these trends have gained momentum over the last few years. Nevertheless, we find that surprisingly few established firms have a clear view on how to best navigate the change brought about by digitization. All of them will, however, need to rethink their business if they want to ensure sustainable success. The bad news: sprinkling a bit of “digital glitter” over incumbents' core businesses does not suffice. Instead a fundamental overhaul of the business is necessary – a *digital transformation*.

It feels intimidating but transformation at this scale is actually nothing new. Think about the fundamental changes to ways of working as part of the industrial revolution in the 18th century. Digital transformation will have similarly wide-ranging effects. Arguably, transformations happen all the time across many organizations. But digital transformation is unprecedented in pace and impact, and thus drives profound changes in our economy and society.

From a fundamental economic and business perspective, the beauty and power of digitization comes from the fact that any digital representation can be perfectly replicated and transmitted at almost no marginal cost to a practically infinite number of globally dispersed customers.⁷ Savor this slowly: virtually no marginal cost. This basic fact means that when a digital technology replaces an analog technology, the change it brings with it will be

comprehensive, to say the least, thus fundamentally affecting the organizations and industries the technology touches. The organizations that can reap the most benefits from this are the digital pure players who lose any limit to scale and whose costs to scale are decimated. Meanwhile, some companies will continue to be bound by constraints rooted in the non-digital nature of their assets (for instance, physical constraints to cloud computing), though they may still be able to take advantage of the power of digitization (see the surge in demand for cloud computing).

It is this re-architecting of the nature of business that enables digital transformation to give rise to a wave of new opportunities for firms to take advantage of. And, generally speaking, it is exactly this fundamental disruption that makes a digital transformation structurally different from your typical plain-Jane business transformation, like cost-cutting transformations that have become commonplace for managers and employees alike.

In other words, a real digital transformation is not simply the deployment of information technology to aid traditional business models. Instead, a two-tier transformation is necessary: (a) careful thought needs to be given to how the traditional core of your organization can benefit from digitization and, at the same time, (b) you need to explore and capture new (digital) ways of creating value for your customers. This implies a fundamental re-architecture of an organization's business, which, post-digital transformation, needs to follow a dual business approach.

Historically, digitization has had an important, yet somewhat restrained impact on firms because it was introduced almost as a kind of “window dressing” on top of existing organizational systems, still reflecting typical processes. Most organizations did not drastically rethink their business model. By contrast, a business whose

operations are founded on digital assets, structured around the ubiquity of data and information flows, would have profoundly different processes and constraints (this is a fundamentally new, digital business). While the former – the digitization of the core business – is vital for any digital transformation, the future of the business lies in the latter – the digital business. For instance, think of the extreme case of online pure players that operate solely in the digital space: there is no required human involvement when a price is changed at Amazon. Similarly, no human checks whether a new user should be allowed to join Facebook. The result: the absence of an organizational growth bottleneck and virtually no traditional limit to the scalability of these organizations. While we will not focus on such digital native companies or start-ups in this book, their business models and strategy certainly bear learnings and provide ample food for thought for established businesses, especially for how they may think about establishing their own digital business, thus venturing onto uncharted digital territory.

THE DIGITAL TRANSFORMER'S DILEMMA: ENERGIZING THE CORE BUSINESS WHILE BUILDING DISRUPTIVE NEW PRODUCTS AND SERVICES

Being the attentive reader that you are, you may wonder: none of this explains anything about a digital transformer's dilemma. Correct, the dilemma only arises once companies have understood there is a necessity to act across two businesses. Once they have embarked on their digital transformation journey, the dilemma they are all bound to face is: How can they maintain profitability in their legacy-

based, core business activities (which we call the 1st S-curve) while reaping the full potential in a radically new, disruptive (digital) business (which we refer to as the 2nd S-curve)? In other words, how can the pursuit of the digitized 1st S-curve and the development of the innovative, digital 2nd S-curve best be reconciled in one organization, ensuring adequate links between the two? Put even more simply, how can firms digitize their core while reinventing their future (not just at the senior strategy-setting level but on the operational level as well)? That is the essence of the digital transformer's dilemma (see [Figure 0.2](#)).

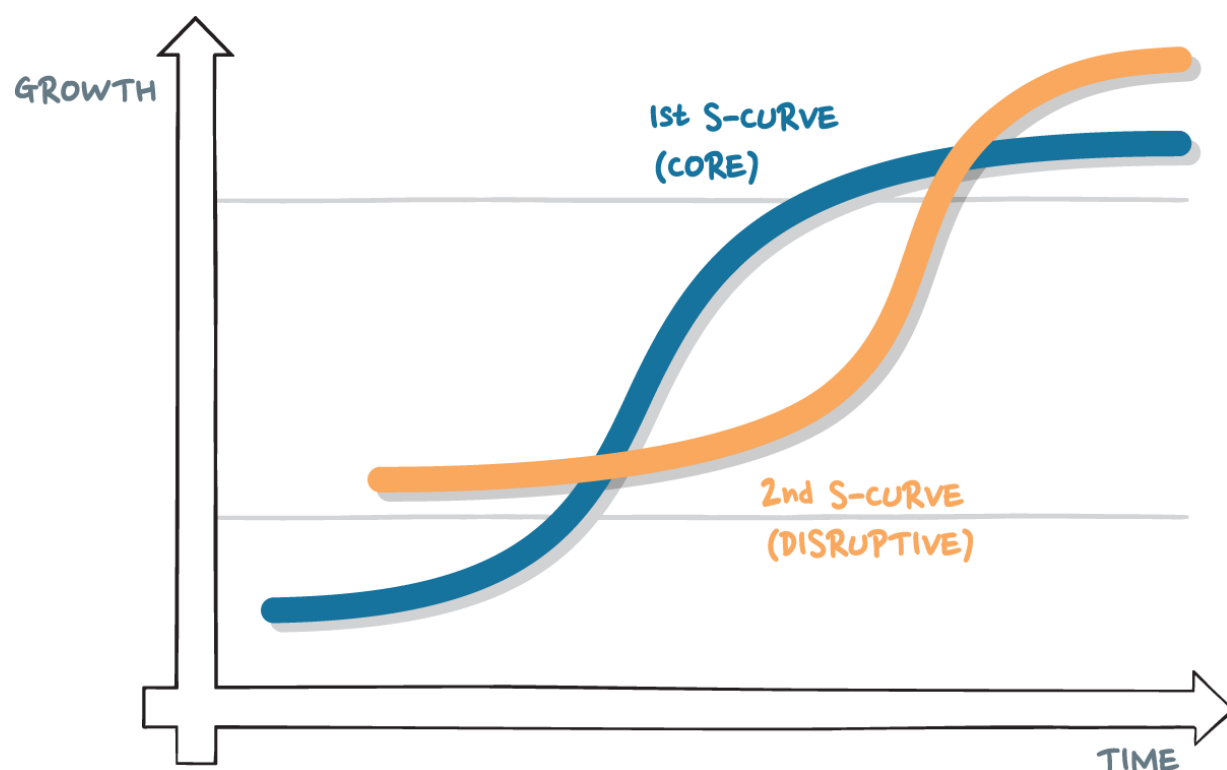


Figure 0.2 Two S-curves

Source: Adapted from Gabriel Tarde. *The Laws of Imitation*. New York: Henry Holt and Company, 1903.

The reality is that companies often struggle with striking that balance between 1st and 2nd S-curve efforts, often leading to animosities between the two. Think about it: the

1st S-curve will continue to generate the majority of the top line revenue for the time being and now also has to cover for the 2nd S-curve, which is bound to break even only later in the process. (It's a kind of sisterly rivalry, with a tendency of the 1st S-curve to be portrayed as the ugly stepchild.) Still, however, the 2nd S-curve will often be marketed both to the outside world and internally as a showpiece and token for visionary innovation. No wonder the 1st S-curve might feel undervalued and unjustly treated; similarly, no wonder that the 2nd S-curve might feel superior (many siblings would probably be able to attest to that). Managing the tensions between the two siblings ... umm ... S-curves is indispensable for the success of the digital transformation as a whole. The key to achieving that is for management and staff to internalize that the success factors on both S-curves differ significantly and that only through a well-orchestrated interplay between the two can the maximum digital transformation potential be realized.

If “The Digital Transformer's Dilemma” sounds familiar to you, you may have heard of Clayton Christensen's work. In his 1997 bestseller, *The Innovator's Dilemma*, he argued that successful companies can do everything right and still lose their market leadership position in the face of newly emerging competitors that pioneer disruptive technologies. Although his book dates from the 1990s, we believe a lot of the premises from *The Innovator's Dilemma* are experiencing a resurgence in importance today, including (and especially) in the digital transformation context. Decades of widely accepted principles of good management have become only situationally appropriate if not obsolete. Meanwhile a new set of rules and practices needs to be established to guide innovative (as Christensen argues) or transformational (as we argue) efforts.

WHAT OTHER DIGITAL TRANSFORMATION BOOKS DON'T TELL YOU

Many publications center around the “why” of digital transformation, convincing C-level executives of the role a digital overhaul plays for the continued success of a company and evangelizing there is a need to act to begin with. The “why” certainly is important because, arguably, knowledge is the first step to improvement – and admittedly it is also what we just dedicated the first few pages to and what we will dive into more in the next chapter as well. But we aspire to something more. To date there has been very limited guidance on the “how” of running a digital transformation. This book is the first practitioner-oriented roadmap on how to execute a digital transformation in real life. We present a set of actionable steps, highlighting how to avoid common pitfalls and address and overcome barriers along the way. This book is for all those who encounter digital transformation in their daily lives, not just the select few at the top but mid-level managers and staff as well. For the former, Parts 1 and 2 – where we describe the reasons for embarking on a digital transformation and how to go about strategy setting – will be particularly insightful. For the latter, the essence of our book – Part 3 describes in detail how to go about running a digital transformation and Part 4 is dedicated to success measurement – will be most relevant.

We want to entertain you, inspire you, and, most importantly, set you up for success when running *your* digital transformation with the tools you need to launch a digital transformation yourself. We introduce you to all facets of the dilemma, tell you how to manage the tension between the 1st and 2nd S-curves, and outline action plans

for how to best address these challenges. To do that, we use an innovative format, showing a host of brand-new, in-depth case studies based on over 100 interviews with executives from a broad set of industries and geographies.

While the Alibabas and Amazons of the world may be prime examples for navigating the digital world, they never had to deal with the requirements of transforming a legacy business. Instead, we focus on those companies with a long legacy to showcase how they can transition into the digital age while keeping their core intact – maintaining their traditional business activities on the 1st S-curve while reaping the full digital potential on the 2nd S-curve. We explore how to best tackle the interaction between the two S-curves while making sure to strike a balance between maintaining profitability in the core and at the same time establishing the new, disruptive (digital) business. This holistic look at the two S-curves instead of just zeroing in on 2nd S-curve champions is a departure from what others have written. It would be grossly negligent to disregard growth opportunities in the core business that can be taken advantage of when digitization is introduced. In many industries and business lines, it is imaginable that the 2nd S-curve eventually becomes the 1st S-curve and the original 1st S-curve ceases to be a considerable top-line revenue contributor. But these are natural, longer-term developments. Even when that happens, though, a new 2nd S-curve will be waiting around the corner. Striking a balance between two very different worlds will remain a central topic for organizations even in the future.

To set you up for success, we also provide you with a load of practical tips and all the tools you need to succeed in real life. In the “Resources” section you will find interactive tools for guiding the strategizing and implementation of your own digital transformation alongside a set of actionable steps. On our website

(www.thedigitaltransformersdilemma.com) you will find an even bigger repository of materials to make use of.

WHY AND HOW WE WROTE THIS BOOK

We hold ourselves to the same standards that we suggest companies follow, in keeping with the motto: You want to talk about transformation? You have to live transformation!

First, we saw the need to fill a gap: despite much literature on the “why,” there's a lack of “how”-oriented digital transformation guides. We devised an initial experimentation phase: inspired by some of the textbook ways of working utilized in digital transformation, we first established a minimum viable product (MVP) of the book. We used that to test our vision with leading digital transformation minds (C-level executives, company owners, thought leaders, and scholars) and digital transformation practitioners (project managers, business unit heads, individual contributors). We incorporated their feedback, making frequent iterations before establishing a prototype of the book as early on as possible (following the motto “fail fast, fail cheap”).

Eventually we needed some meat on the bone. A vision and an MVP are good and all, but you can't make something out of nothing. So, we assembled 100+ different corporate case studies based on interviews with leading executives and operational managers leading digital transformation initiatives in companies that managed to Uber themselves before they got Kodak'ed.⁸ This informed our digital transformation how-to framework. We kept iterating this framework with various test audiences and made sure to incorporate their input.

Finally came the finishing touches, which, in author lingo, means writing up the whole thing. Well, as you can see, we did that, too.

But then something happened.

PANDEMIC MEETS DIGITAL TRANSFORMATION

Life – regular and business – around the globe changed abruptly and unexpectedly in spring 2020 with the outbreak of a novel Coronavirus, introducing new norms related to social distancing, reduced mobility, remote work, home-schooling, the (near-)shut-down of entire industries (and the sudden surge of others), expansive lay-offs, and haphazard stock markets. Companies found themselves in the field of fire, torn between the demands of radically new realities imposed by the virus and the deep-rooted necessity (and oftentimes, long-prepared ambition) to digitally transform. As COVID-19 brought with it a transformational impact on the nature of work, the structure of firms, and the economic realities of people, businesses, and countries, many questions emerged, some of which related to digital transformation: What does Coronavirus mean for digital transformation and how can the two be reconciled? Specifically, what are repercussions of the virus for the 1st S-curve, the 2nd S-curve, and their interplay? Who ends up a winner, and who ends up losing in this nexus of transformations?

We have no crystal ball to answer these questions and predict long-term effects of COVID-19 on digital transformation with certainty. This includes whether post-pandemic effects will reshape life fundamentally in the long run and alter the rules of the game completely, or whether it is only select parameters that will change and we'll

largely be able to go back to business as usual. In the absence of such certainty, we would caution everyone to take our views with a grain of salt, as they reflect our latest thinking as of April 2020 based on the information available at the time and our own opinions. But one thing is undisputed: Coronavirus and digital transformation are intimately linked. Here's what this means.

One, the pandemic is like a benchmark to past digital transformation efforts and bears learnings on how well companies have digitally transformed

The COVID-19 pandemic is not unlike a stress test to a firm's digital transformation to date, able to unveil any flaws inherent in (digital) business models quicker than they would have otherwise surfaced. Those firms whose digital transformation across both S-curves was well underway before the COVID-19 outbreak are at an advantage in times of Coronavirus, as are firms that managed to swiftly rally digitization efforts at the onset of the crisis to rapidly bring about digital value propositions. Organizations that missed their ticket onto MS Digital Transformation (before and at the beginning of the crisis) are poised to be left behind. This means that companies whose value-add is generated and rendered through digital means (or that have managed to morph into this profile quickly) will, on average, weather the Corona storm better than those whose value generation lies purely offline. Though in a global recession, which economists agree we are headed into,⁹ none are real but only relative winners. The question is not so much who ends up a winner but rather who will lose the least.

Naturally, digital pure players are well positioned to reap the benefits of a virtually powered economy, particularly

when they don't rely on human involvement to complete transactions. Think, for instance, of ZOOM, which has managed to grab a large share of the delicious and oh-so-topical virtual conferencing pie, with shares surging 63% in three months.^{[10](#)}

Foot traffic, unfortunately, is equal to a Corona-infested death bed: when there's no feet, there's no business. Companies that have adamantly focused only on their 1st S-curve operations hence are at a disadvantage. They will find themselves cash-strapped after the crisis. Traditional firms relying on in-person interaction to render services are thus hit the hardest, though if they manage to entertain or quickly set up a digital channel, they may be able to dampen negative effects.

One such example is Domino's, where delivery makes up 55% of total orders. Domino's is thus well positioned to thrive during Corona, as proven by its call to hire 10,000 workers due to increased demand^{[11](#)} while millions of US workers file for unemployment.^{[12](#)} It is one of the only big chains that refuses to work with outside delivery apps such as DoorDash or Grubhub, which promise to boost restaurant sales but take a cut of that money. Having its own delivery app, drivers, and pickup infrastructure – and thus full control over value chain and customer service – is a winning strategy for Domino's in times of social distancing. A focus on the Corona-minded customer who cares about contactless delivery^{[13](#)} paired with increased profits thanks to cutting out middlemen proves a viable strategy to accelerate digital (2nd S-curve) as opposed to dining-in (1st S-curve) business.

Even among those entities that are system-critical, the digitally transformed ones will do best. One example is governments, which are center stage amidst the crisis, alongside select essential firms. Countries like South Korea