LIVING NETWORKS

ANNIVERSARY EDITION

LEADING YOUR COMPANY, CUSTOMERS, AND PARTNERS IN THE HYPERCONNECTED ECONOMY

ROSS DAWSON

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Leading Your Company, Customers, and Partners
in the Hyper-Connected Economy

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What Business Leaders Say About *Living Networks*

"I'm not sure that even Ross Dawson realizes how radical—and how likely—his vision of the future is. Ideas that spread win, and organizations that spawn them will be in charge."
- **Seth Godin,** author, *Unleashing the Ideavirus*, the #1 selling e-book in history

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“The author has demonstrated that the success of his first book was no mere flash in the pan. His book is the one I would choose as a guide to understanding and action for the practical business person.”
- Bill Godfrey, Editor, Change Management Monitor

About *Living Networks*: Anniversary Edition

Living Networks is being relaunched in its Anniversary Edition five years after its original publication by Financial Times/ Prentice Hall in November 2002, to revisit the foundations of our networked age.

Free chapter downloads of *Living Networks*:
www.livingnetworksbook.com

Ross Dawson's *Trends in the Living Networks* blog:
www.rossdawsonblog.com

About Ross Dawson

Ross Dawson is globally recognized as a leading authority on business strategy. He is CEO of international consulting firm Advanced Human Technologies, and Chairman of Future Exploration Network, a global strategy and events company. Ross is author of the Amazon.com bestseller *Developing Knowledge-Based Client Relationships*, and over 100 articles and white papers. Strong demand for Ross's expertise has seen him deliver keynote speeches on six continents and consult to leading organizations worldwide such as Ernst & Young, Microsoft, Macquarie Bank, Morgan Stanley, News Corporation, and Procter & Gamble. Ross's frequent media appearances include CNN, Bloomberg TV, SkyNews, ABC TV, Washington Post and many others.

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CHAPTER 7
The Flow Economy

Opportunities and Risks in the New Convergence

Devices, communications, and industries are all converging into one vast space for doing business. This is the flow economy, in which almost all value is based on the flow of information and ideas. Companies must continually reposition themselves in this flow economy, both to meet new competitive challenges from unexpected quarters, and to take advantage of the massive emerging opportunities.

For a few years there in the mid 1990s Japan seemed to be lagging in the uptake of mobile communications. Then suddenly it exploded, and everywhere you looked there were mobile phones, from the giggling girls sporting tiny toy-like devices on wrist straps to the dark-suited office workers muttering earnestly into their phones as they bustled by. At the heart of the phenomenon was NTT DoCoMo, which launched its i-mode service in February 1999, to see almost 20 million paid subscribers snatch it up within two years.

What has made NTT DoCoMo such an enormous success, and its glitzy showcase offices in Tokyo a Mecca for pilgrimage by telecom executives from around the world, is simply its business model. It wanted to make the service fun, easy, and inexpensive, and to do that it had to create the conditions for excellent content providers to want to participate. It passes on to providers an amazing 91% of what it bills its customers for content usage, but in return it has strict quality control standards, first in vetting the up to 100 proposals a week it receives from content providers, and then in monitoring the content, usability, and pricing on an ongoing basis.[1] As a result, it boasts over 50,000 high quality content sites, ranging across news, horoscopes, karaoke, multiuser games, and far more.

DoCoMo gives access to this vast array of content and services by providing its customers with mobile always-on connectivity and the required interfaces. The firm doesn't manufacture the i-mode handsets—these are made by the likes of NEC, Panasonic, and Sony—but it works with them to define the device specifications, and sells the handsets directly to its customers, all clearly emblazoned with the NTT DoCoMo logo and no other. DoCoMo has announced plans to publish the technical standards for the i-mode service and to open the network to other providers, after initially keeping the standards closed. However DoCoMo's powerful relationships with its close to 30 million customers place it in an extremely solid position moving forward.

What Japan's leading mobile telephony firm has done is positioned itself to provide each of the elements that enable far richer and easier flows of information and ideas. Back not so long ago, a large proportion of the value in industrial economies was in tangible flows, like transport, water, and electricity. In the early 19th century canals dominated global stockmarkets, with railroads taking their turn a little later. These new, efficient modes of transport enabled the flow of goods on which the rest of economy depended. In the first half of the 20th century many of the largest companies were those that provided the infrastructure and distribution for flows of water, electricity, and oil and gas, again providing a foundation for other economic activity.

Today, economic flows consist overwhelmingly of information and ideas. However, now these flows provide far more than just an underlying infrastructure for other industries. They are intrinsic to almost every aspect of the economy. We now all work and do business in the emerging *flow economy*. Business strategy must be reinvented in this new world. In this chapter you will discover the shape of this converging economic landscape, and steps to position your organization effectively within the flows.

The convergence of convergence

It's hard to read a business or technology magazine these days without seeing the 'c' word splattered around like the victim in a Quentin Tarantino movie. However "convergence" has many different meanings. The term is primarily applied to how devices, communications, and industries are each becoming unified. These three major convergences are themselves coming together to create a new convergence that is giving birth to today's flow economy.

Device convergence

Humanity is just beginning to emerge from a strange phase in its technological evolution, in which people have carried a multitude of separate digital and communications devices for different purposes. Over the last years it has not been at all unusual for people to carry a cell phone, personal digital assistant (PDA), and pager. Many have also been squeezing into their bulging pockets or handbags a mobile e-mail device like the RIM Blackberry. It seemed like the more technology progressed, the more devices we had. So will our glorious techno-future give us yet more things to carry around?

For years now, PR and media hype have promised better, but only now are we finally getting there. In the spring of 2002 several players, including Motorola, Handspring, and start-up Danger Inc., launched what were billed as the ultimate in handheld devices. These lightweight devices combine mobile phone, e-mail, Internet browser, and a calendar, all literally in the palm of your hand.[2] It is becoming increasingly difficult to sell portable digital devices that do not cover the spectrum of functionality.

Devices are converging, not just in our palms and pockets, but also in our homes. The convergence of PCs and TVs has been far slower than the evangelists of the 1990s proclaimed, but each is gradually taking on some of the functionality of the other. People watch DVDs or news broadcasts on their PCs, and interactive TV is offering Internet-style services. Game consoles are emerging as powerful multimedia platforms that have the potential to play a central role in home entertainment. A battle royal is under way, and the winners in this space will win big.

Communications convergence

When you pick up the telephone and dial a friend's number, you are quite possibly using technology that dates back to the 19th century. The public switched telephone network (PSTN) establishes a circuit directly between two people, tying up bandwidth for their conversation. Through much of the 20th century telephone companies gradually upgraded their networks to cope with growth in voice communication, a business that still earns more than the US national defense budget. Then in the 1980s and 1990s telecommunications companies built new kinds of networks to carry the massive explosion of data communications. Different networks again were deployed for the boom in cable television. Some large telecom firms found themselves running over a dozen distinct networks, each based on different infrastructures and technical protocols.

Now this multitude of voice, data, and video communication networks is converging to a single network. Internet Protocol—usually called IP—is the clear winner as the most effective and versatile communications framework. It needs to be adapted for some uses, like voice, but in essence a single communications protocol and network can be used for all telecommunications. The major telecom companies are still in the process of phasing out old networks and replacing them with IP-based systems, and it will take many years for the transition to be complete, but the shift is by now inevitable. The implication is that telephone, television, Internet, and all other digital flows can be carried through the same pipes, potentially merging these businesses.

Industry convergence

In Tampa, Florida, a single building houses Media General's three operations: the *Tampa Tribune* newspaper, NBC affiliate WFLA-TV, and the Tampa Bay Online website. Newspaper reporters become talking heads in front of the TV cameras, television staff write stories for the paper, and material from both media is adapted to become online content. Across the nation, over 50 companies and partnerships are merging what were traditionally distinct media into single operations.

In companies representing almost every sector of the economy, boardrooms are hot with talk of "industry convergence". Each industry is experiencing convergence in a different form, but in each case it is driven by similar issues of deregulation, the increasing information component of business, the desire to maximize customer value, and companies seeking to leveraging their strengths into new domains.

Take a look at the financial services sector—including the banking, securities, insurance, and funds management industries—which has been the scene of a mating frenzy since the early 1990s. When financial firms' appetite was unleashed by the abolition of Depression-era regulations, they sought desperately to gain economies of scale on their massive investments in technology, cross-sell products to their customer base, and globalize their businesses. These powerful drivers were exemplified by the birth of colossus Citigroup, formed by the merger of Citibank and the Travelers Group, which itself had recently digested investment bank Salomon Smith Barney and insurer Primerica, among others.

Now the financial services sector is itself converging with other industries. Every major British retailer offers a broad range of financial services, while in Germany Volkswagen Bank has diversified from providing auto finance to now offer credit cards and mortgages. Banks too are extending their tentacles. Spanish bank BBVA joined with the country's leading telecoms firm, Telefónica Móviles, to form Móvilpago, that provides mobile payment facilities in Spain and 30 other countries. Barclays Bank and investment bank Nomura jointly own Shopsmart, Britain's largest online shopping site. The shift to defined-contribution health plans in the US is resulting in a convergence of health care, insurance, and other financial services. Accenture's relationships with health care firms are managed by its financial services group.

Other examples of industry convergence include pharmaceuticals, biotechnology, and medical devices, which have seen a flurry of mergers as the distinctions between their industries blur. In energy, the synergies between different sectors have became apparent, resulting in 17 mergers between gas and electricity firms in the US in the four years up to 2000. Even automakers are seeing their offerings overlapping with other industries. The Mazda MP3 is a sound system on wheels, while General Motors and Fidelity Investments have allied to provide real-time trading and financial information through GM's OnStar communications service. Later in this chapter you will discover new approaches to business strategy that cut through traditional industry boundaries.

The new convergence

Today, these three powerful convergent trends are themselves converging. As the economy becomes increasingly dominated by the flow of information and ideas, all boundaries between sectors are dissolving. Business now exists within a single convergent space, and the very concept of an "industry" is losing meaning.

It is not just the more obviously information-based sectors such as telecommunications, technology, entertainment, media, and financial and professional services that are participating in this new convergence. Many manufacturing, mining, energy, utility, transport, and retailing firms are also finding that much of the value they create is in the flow of information and ideas. Their strategies must become increasingly similar to those of more typical information-centered companies. As you saw in Chapter 4, companies selling manufacturing inputs such as Dow Chemical, Buckman Laboratories, and FMC Corporation are making information flows the heart of how they differentiate themselves from their competitors. FedEx, American Airlines, and Cemex are just a few of the firms that would appear to be firmly rooted in the physical economy, yet have been lauded as paragons of information-based businesses.

There are two key implications of this emerging convergent space. The first is that all companies are experiencing many new threats to their established businesses. The melting of traditional industry boundaries means that competitors can—and do— emerge from what not long ago seemed like totally different fields. In Europe, banks have seen new competitors spring up from department stores, supermarkets, car manufacturers, airlines, a furniture retailer, a semiconductor firm, and an oil company, among others.[3]

The second implication is that massive new opportunities are emerging as firms suddenly find that they can parlay their existing strengths into new and profitable domains. Gas and electricity utilities are piggybacking their existing relationships and infrastructure to provide communications services. Banks are jumping into retailing, online exchanges, media, software sales, and many other pursuits. Transport firms are becoming telecom providers, consultants, and logistics outsourcing firms. Every company must think of itself as no longer belonging to any particular industry, but simply a participant in the flow economy.

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The six elements of the flow economy

In 1958 Tokyo Tsushin Kogyo, unheeding of advice from its bankers and partners that it shouldn't throw away an established and well-recognized brand, changed its name to Sony Corporation. At that time its product line consisted primarily of transistor radios and audio tape recorders. Over the following three decades Sony created, or was first to market with, many of the devices that have become an intrinsic part of our lives: color television, the video-cassette recorder, the Walkman personal cassette player, the CD player, and 8mm video.

Then, in 1988, Sony dramatically shifted its strategy, buying CBS Records, and the following year Columbia Pictures. It had moved from selling physical products that provided an interface to entertainment, to owning the entertainment itself. When you bought a CD Walkman, you might also pay Sony for the music that you played on it, and the videos you played on your VCR might be from Sony's extensive movie catalog. At the time, the business world was sceptical, casting doubt on the ability of a Japanese product manufacturer to manage creative businesses, and questioning that there really were any synergies between entertainment content and electronic goods.

Sony has in fact been biding its time, running its consumer electronics and content largely as separate businesses. Now is when broadband connectivity and the true birth of the networks is enabling its long-held vision to come to fruition. Howard Stringer, the CEO of Sony Corporation America, notes that until now Sony's millions of electronic devices have been bought without Sony ever having any knowledge or connection with its end-customers. Now it will be able to reach, identify, and connect those customers, providing them with not just interfaces to the networks, but also the content they access.[4] In Japan, Sony has an alliance with NTT to provide broadband access to users of its Playstation2 game console. Sony generates more revenue from online games than anyone else in the world, boasting 300,000 subscribers paying $10 per month to play its *EverQuest* multi-player game. In Japan, Sony offers stock trading and auto insurance through its website.

Sony's positioning illustrates many of the key principles of business in the emerging flow economy. Rather than thinking about traditional industry definitions, firms must position themselves relative to the flow of information and ideas. There are six elements of the flow economy, as shown in Figure 7-1:

- Standards
- Interfaces
- Connectivity
- Relationships
- Content
- Services

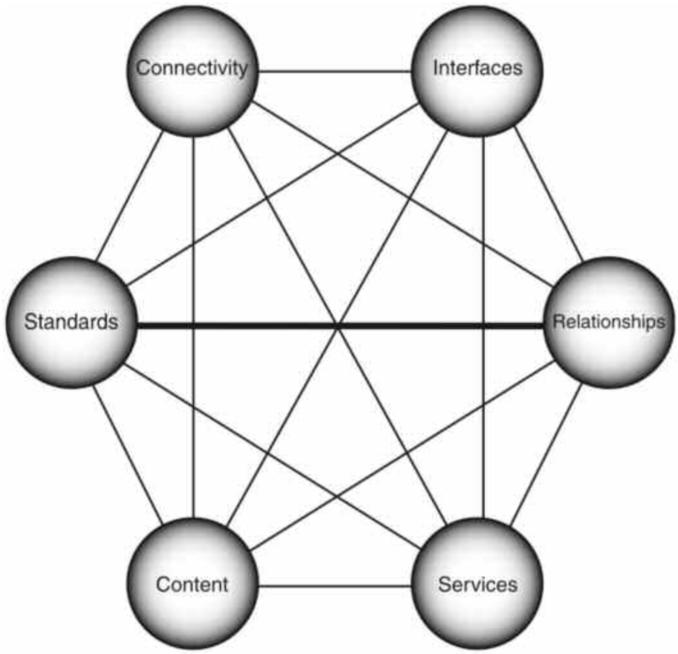


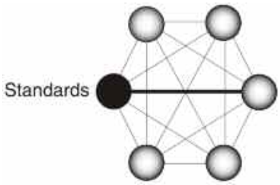
Figure 7-1: The six elements of the flow economy

The primary axis in the flow economy is that of standards and relationships. In Chapter 2 we introduced the basic drivers and strategies of a world increasingly built on standards. In Chapters 3, 4, and 6 we explored the role of relationships in the connected economy, and how this is intertwined with that of standards. However there are four more “flow elements” that combine with standards and relationships to form the landscape of the flow economy. These are connectivity; interfaces; content; and services.

Each of the six flow elements can act as a stand-alone business. However the greatest value is unlocked in how they are combined. Only a handful of firms—most obviously Microsoft, AOL Time Warner, and Sony—have the wherewithal to attempt to play in all six elements of the flow economy. Even then they must rely heavily on alliances. Companies must understand what flow elements they currently provide, and how they are positioned relative to other providers. This allows them to build on their existing strengths.

In this section we will look briefly at each of the six primary flow elements. We want to understand how each can be a business in its own right, and the fundamentals of how it can be combined with the other elements of the flow economy. In the following section we will present the key steps to reposition your company in the emerging flow economy.

The power of standards



Whenever you click on a website to listen to audio or watch video, you are using streaming media, the technology that is enabling the Internet to begin to compete with radio and television. The streaming media market is a true David and Goliath battle, pitting RealNetworks against Microsoft. At the time of writing, the market is relatively balanced, with similar numbers of users for each system.

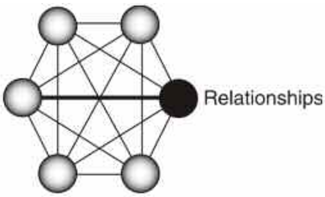
Streaming media is a classic standards battle, as discussed in Chapter 2, driven by the preferences of both consumers and distributors. As in every standards war, success breeds success. If one clearly dominates, then content providers will offer streaming in only that format, resulting in less interest by consumers in other choices, and thus a reinforcing feedback loop leaving just one winner. Given the current even-handed battle, most media sites must offer streaming in both formats. As befits a winner-take-all struggle, the two companies are waging a bitter war. Microsoft takes advantage of its operating system domination by bundling Windows Media with Windows XP, while RealNetworks has cut deals such as paying Major League Baseball $20 million for three years of exclusive Web radio broadcast rights.[5]

Standards are at the heart of the connected economy, as you saw in Chapter 2. Because of the forces driving towards open, accepted standards, it is increasingly difficult for a single company to run a standard as a stand-alone business. It is more viable for a consortium of powerful firms to establish and license a standard, but it is still challenging to run a standard purely as a business. If the owners try to make too much money from the use of a standard, more open—and less expensive—standards stand a good chance of attracting users. The MPEG-4 video compression technology—which is owned by 18 patent holders—is attempting to become a widely accepted standard, however it is jeopardizing that effort by charging steep licensing fees, as we will explore in more detail in Chapter 8.

In the case of streaming media, Microsoft and RealNetworks are battling over establishing a technological standard. However they don't make their money from the standard as such, but how it enables them to control the customer's interface to the networks, and thus form powerful relationships.

Most companies are in the situation of requiring standards in order to participate effectively in the flow economy. The value they provide is in the other five flow elements. As such, they would prefer to see open standards that enable greater flow that they can exploit in other ways. Wireless Application Protocol (WAP)—a kind of wireless version of the Internet—was developed by a broad range of companies in the wireless industry, because they could all benefit from the business opportunities enabled by an open standard. In all cases, companies must understand the current state of play in the standards that underlie their participation in the flow economy, and follow the action steps proposed in Chapter 2.

Relationships rule



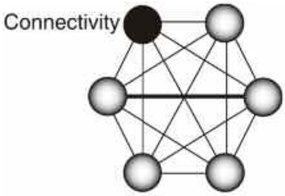
In 2001 Virgin Mobile was rated #1 in customer service for mobile telephones in the United Kingdom, despite not operating any telecommunications capacity.[6] It set up shop in August 1999, selling wireless services supplied by One 2 One, and became the fastest growing operator in the market, chalking up a million subscribers in less than one year. Virgin Mobile is in the business of relationships alone—all the other flow elements that comprise the total offering to the customer are provided outside the company.

As standards and networks rapidly become more open—and thus it becomes ever-easier for customers to change affiliations—relationships are becoming the primary source of value. In just about every case, whoever controls the relationship, controls the value. If you provide other flow elements, without the relationship, your business is very likely to become commoditized. However, the other flow elements can be used as tools in order to establish and build relationships, as you will discover later in this section. For example, the use of a network interface like a web browser or cell phone can be used to build relationships.

As you saw in Chapter 4, relationships can be thought of as habits or patterns of behavior by customers. These will include both digital and real components. Yahoo! gets more Internet visitors than any other company in the world, yet its audience is always literally just a click away from going to a competitor. Much of its efforts have gone into developing services such as Mail, Chat, Finance, and Photos that promote "sticky" relationships, that is require a significant effort to switch to other providers.

In the vast chain of video production and distribution, it is Blockbuster Video and its peers that control the final customer relationship. Blockbuster's relationships with its customers are less virtual than Yahoo's, as they usually physically visit its stores, and are offered various schemes and incentives—financial and otherwise—to come back regularly. However as a result, they know who is hiring videos, can learn their habits and profile, and regularly initiate direct, personalized communication.

Connecting the world



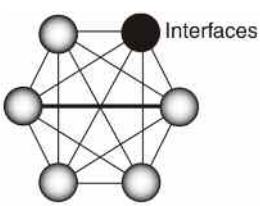
Communications bandwidth is a commodity. Global Crossing, founded in 1997, raised over $20 billion and ploughed it into fiber-optic cables providing digital connectivity around the world before filing for bankruptcy protection in early 2002. What it hadn't counted on was the rapid drop in prices for global bandwidth, meaning it couldn't reap a decent return on its massive investment. Global Crossing tried to build direct relationships with corporations by providing value-added services, but this market was dominated by AT&T and WorldCom, and Global Crossing found it could only sell its bandwidth wholesale.

As standards and networks rapidly become more open—and thus it becomes ever-easier for customers to change affiliations—relationships are becoming the primary source of value.

The commoditization of pure connectivity is amply demonstrated by the emergence over the last years of Band-X and a number of other bandwidth trading exchanges. Bandwidth trading is like the stockmarket. You can buy or sell, make money by day-trading, and not care who you're dealing with. However one big difference is that over the long-term equities prices will always go up, while Band-X's pretty colored charts show how the price of bandwidth seems to be heading just one way: down.

Despite the challenges of providing connectivity at a wholesale level, it can be very powerful when used to create relationships with consumers. Those firms that provide their customers with the famous "last mile" that connects their home to the global networks or cell phone to the local transmission tower are potentially in a very powerful position. Cable providers are clearly in the core business of providing bandwidth. However the real value in this business is in the relationships, and tapping the resultant business opportunities effectively.

Our interfaces to the networks



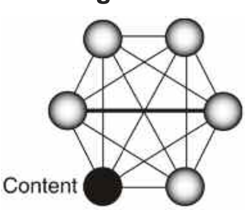
Buy a Logitech keyboard for your PC, and you will find it studded with a series of buttons that give you access to a range of Internet sites and services. Logitech, the world's largest maker of computer interface devices such as mice and keyboards, is leveraging its position to become part of the relationships that are at the foundation of the flow economy. Its alliance with Google means that the

Search button on its keyboards takes users to the Google Web site, going via its own Web site so that the two firms can keep track of the value of the well-positioned button. Other buttons on Logitech's keyboards—in their default configuration—lead users to Amazon.com, Citibank, and other service providers.

Interfaces are the bridge between people and the networks. Many of these are the digital devices discussed earlier in this chapter, including cell phone, PDA, PC, TV, game consoles, music players, video recorders, and so on. Web browsers too can be considered as interfaces to the networks. Microsoft's aggressive bundling of its Internet Explorer Web browser into the Windows operating system—which is at the heart of the Department of Justice's antitrust concerns about the company—demonstrates the very high value that Microsoft places on mediating people's access to the Internet. Web browsers can be set up so that users find it easier to access some services than others, thus channeling their attention and potentially spending. This illustrates how controlling people's interfaces to the networks can be used to create massive value.

Every aspect of the flow economy is ultimately accessed through an interface of some kind. Many businesses don't need to care about this—as long as their customers have PCs and Web browsers they are happy. However especially now that information flow is shifting to wireless channels, businesses need to understand how they can effectively deliver value through an entirely new set of emerging interfaces. For those firms that are playing in the interface space, the issue remains how to gain a solid user base, and leverage that hold into other flow elements, especially in helping to create or develop relationships.

The magic of content



On October 9, 2001, Disney released its classic *Snow White* on DVD, selling over one million copies on the first day. This provided a tidy addition to the more than $1 billion the film has earned Disney since it was first released in 1937. This is the kind of tale that has led to the constant refrain heard at every bar and party in Los Angeles: "content is king".

Content creation can certainly be run as an independent business, as long as it can generate sufficiently strong demand. If it does, then the providers of other flow elements will be eager to use the content to attract customers. Cable television companies attract subscribers on the basis of their quality of content, even though their core business is actually connectivity and relationships. By becoming increasingly involved in broadcasting and distribution, Disney has chosen to more directly exploit some of the opportunities created by the strength of its content. However content is not always the magic bullet. UK digital television firm ITV Digital collapsed in early 2002, largely as a result of having committed to pay £315 million over 3 years for soccer broadcast rights. Content providers on the one hand, and those providing the connectivity, interfaces, and relationships that channel content to customers, are involved in a complex dance to appropriate value for themselves.

People talk about "content" very loosely, but it important to understand that there are many different kinds of content, and that the appropriate strategies for each can vary widely. There are two key variables in content: *shelf-life*—that is how long the content remains valuable—and *audience focus*—which is how narrow or broad is the range of intended viewers. Figure 7-2 shows how these dimensions can be used to classify content. Entertainment tends to access broad audiences, and almost always attempts to have a long shelf-life. Disney has a clear policy of not overexploiting its most valuable content, in order to extend its shelf-life. In contrast, high-value information such as customized investment strategies, industry analysis, or strategy recommendations, gains its value specifically by being directly relevant to a very narrow group, or even an individual client, and its value usually falls rapidly over time. News is by its nature fleeting, but can become more valuable by being tailored for a particular group, or compiled into archives. In Chapter 8 we will discuss detailed strategies for content providers in the flow economy.

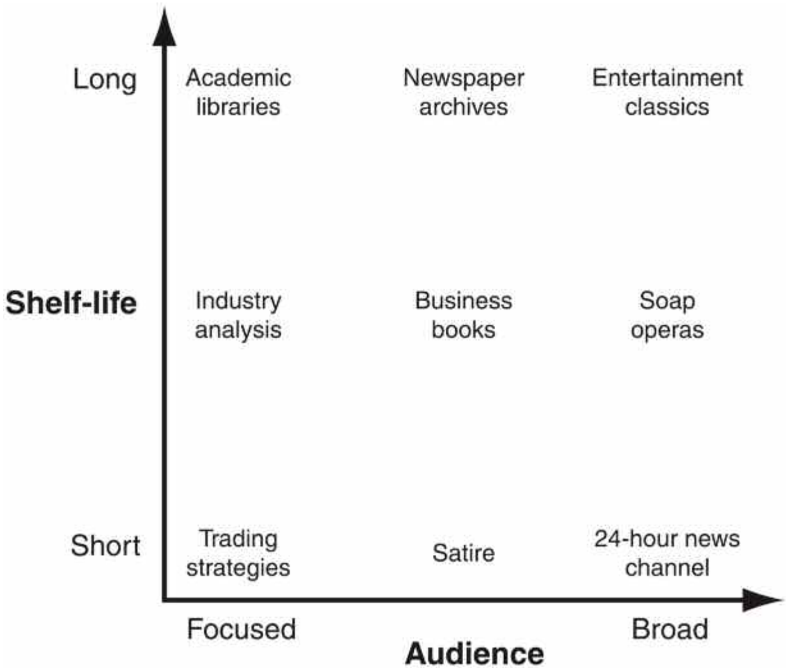
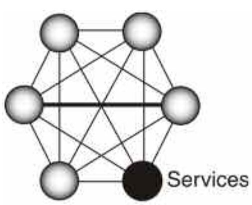


Figure 7-2: Classifying content by shelf-life and audience focus

The services that surround us



Unless you pull a crisp bill out of your pocket and hand it to someone, you have no way of making a payment without in some way using the banking system. Our entire economy is based on a set of networks that enable banks to transfer funds between accounts. You may have the best products or services in the world, but to make any money from them you are completely dependent on the banking system. In a networked world, financial services—not just payments but also credit, investment, insurance, and more—are fundamental to the flow economy.

Services—which are things that are done for you—are fundamental to the flow economy. They underpin much of the value of the other flow elements. As you have seen, financial services are necessary for all flows of value. We still live in a physical world, so the logistics of moving goods is a key part of the flow economy. In addition, increased connectivity allows a far broader range of services to be delivered online. Services are now often provided by software. In other cases, people still provide services such as consulting or even mowing the lawn, but we are connecting to those service providers by purely digital means.

Services can usually be run effectively as an independent business, and simply rely on the other flow elements being in place to deliver these effectively. In some cases, providing services can allow firms to leverage themselves into new types of business. Some financial services firms have done this effectively, as we'll see later in this chapter. UPS, Fedex, and their competitors, have all sought to move into entirely digital businesses such as secure document delivery, based on their existing positioning. However, as always, relationships are what enable services to be customized rather than become commoditized. In Chapter 9 we will explore in more detail the new world of services, focusing on digital services including software, and the evolution of professional services.

Strategic positioning in the flow economy

Walk into a youth hostel or budget hotel in any exotic country around the world, and you're more than likely to see someone reading a guidebook from Lonely Planet, the dominant global brand in budget travel. From its birth in the early 1970s, when Tony and Maureen Wheeler found so many people asking how they'd travelled overland from London to Melbourne that they decided to publish a book about it, the company has grown and repositioned itself neatly in the flow economy. The core of Lonely Planet's business remains the publication of over 500 regularly-updated travel titles, however that is now complemented by a broad range of other business initiatives. The firm's website attracts over two million unique visitors a month, providing free downloads of book updates that enhance the attractiveness of the guides, direct book sales sent from distributors worldwide, a highly popular discussion forum where readers share travel experiences, and access to Lonely Planet's other services.

Lonely Planet launched CitySync in January 2000, providing in-depth guides to four US cities plus Sydney for mobile devices running the PalmOS operating system. The software and content, including interactive maps, can be downloaded on the Internet or purchased on CD-ROM or preinstalled modules. In addition to integrating city maps with reviews of hotels, restaurants, and nightlife, it integrates with other Palm functionality and enables users to add their own comments. As with Lonely Planet's guidebooks, updates can be downloaded for free. Lonely Planet's customers are by their nature on the move, so it seemed a natural fit to offer telecommunications services. Its eKno service provides not just low-cost international calls, but also global voicemail, faxmail, and voice notification of emails. In addition, Lonely Planet licenses its brand for a television travel series that is screened worldwide, and now it even publishes world music CDs. From publishing books, Lonely Planet has successfully diversified into providing telecommunications services and software in addition to a very wide range of content, and in the process built powerful direct relationships with its end-customers, which it never had before.

New approaches to business strategy are required as the economy begins to reshape itself. Almost every strategic tool in use over the last couple of decades is based on the increasingly dated concept of industries. Tools such as Michael Porter's five forces model of competition are still applicable, but their value is fading because they are based on the concept of an industry as something static and defined.[7] You must now consider your firm as a participant in the multi-dimensional space of the flow economy, rather than belonging to a particular industry. As you saw in Chapter 3, the issue is now how to extract value from your participation in a deeply integrated economic lattice made up of many players.

Earlier in this chapter we described how in the new convergence of the flow economy every organization will face new competition—often from unexpected quarters—and immense opportunities will unfold for those that recognize them. Firms must go through a constant process of strategic repositioning, founded on opening their thinking to dramatically new possibilities. Far more than at any time before, companies can participate in shaping the evolving structure of the economy. There is now immense scope for creative thinking—and leadership—in conceiving and forging entirely new forms of business. There are three core steps to this process of strategic positioning in the flow economy. We will study these steps, and then examine how to bring the strategic process itself to life.

STRATEGIC POSITIONING IN THE FLOW ECONOMY
1. Define your space
2. Redefine your space
3. Reposition

Table 7-1: Action steps to strategic positioning in the flow economy

1. Define your space

To know where to go, first know where you are. Every company and industry will face different challenges and opportunities. Each firm must ask a number of strategic questions that will enable it to establish and implement a clear strategy. The key strategic questions for defining your current space in the flow economy are shown in Table 7-2.

STRATEGIC QUESTIONS FOR POSITIONING IN THE FLOW ECONOMY – I

Define your space

- What is the "total customer offering" in which you participate, and what is the value created for the customer?
- Who provides each of the flow elements that comprise the total customer offering, and what is the competitive landscape within each flow element?
- Which flow elements do you provide, and how are they combined?
- Are there any non-information elements to the offering, and who provides these?
- What alliances do you have with providers of other flow elements?
- What are your organization's distinctive competences and strengths?

Table 7-2: Strategic questions for defining your space in the flow economy

The starting point is to define the "total customer offering" in which you participate. Since at this stage of the process we are examining the current strategic space, this should be the most obvious articulation of what customers receive. Only rarely do firms provide the entire customer offering. For example, newspaper publishers may frame their businesses as providing news to end-customers, and selling access to end-customers' attention to advertisers. The other participants in this offering include newsagents, delivery services, and newswires; and if the newspaper has online services, a far more complex array of providers. Digitally-based customer offerings will always draw on every flow element in some form.

Let's illustrate the strategic positioning process by taking a brief look at one major player in the flow economy, addressing the key strategic questions by examining each of the flow elements in turn. Nokia—and its peer mobile handset makers—at first view is a participant in providing the customer offering of mobile connectivity and services. Standards are the very basis of this mobile connectivity. Some standards—such as GSM (Global Standard for Mobiles)—are set by non-aligned industry bodies, and as such are essentially in the public domain. Nokia participates actively in the standard-setting process, both in order to have input to the technology, and to be fully informed on developments. It has made a strong public commitment to open standards, and has often worked closely with competitors and partners to initiate and develop other standards such as Wireless Application Protocol (WAP), that have promised to expand the use of mobile services. It is also a strong proponent of RosettaNet, described in Chapter 3. In most cases Nokia doesn't provide connectivity; this is the role of its close partners, the telecom firms. Relationships with the end-customers are usually controlled by telecom providers, since they usually sell the handsets, and while Nokia has a powerful brand, it often has little or no information on the end-users of its handsets. Nokia, as many of its peers, outsources the actual manufacturing of its products.

The heart of Nokia's participation in the total customer offering is the interfaces, in the form of mobile handsets. Both content and services are important parts of the total customer offering, and it works hard to make it easier for its partners to deliver these. It understands that the better the total offering, the bigger the space will become, and it will benefit along with all of its partners in providing the total customer offering. Nokia has also established "Club Nokia" in 26 countries, in which it provides services such as customer support, games, and ring tones exclusively to Nokia handset owners. The strategic benefit of this initiative is in fact at least as much in establishing direct relationships with the owners of its handset as in service provision.

The idea of a firm's distinctive competences and strengths of course has been central to business strategy for over a decade now.[8] In defining a company's current strategic space, in most cases the existing understanding of the firm's competences will be adequate, though this may be reframed in the process of redefining the space. Nokia's core competences and strengths can be considered to be telecommunications expertise, brand and market presence, global presence and scale, and its relationships with telecoms firms.

2. Redefine your space

Having defined the strategic space in which you are currently participating, you can now begin to redefine that space. Selected strategic questions to reconceive your space, and your position within it, are shown in Table 7-3. The creative scope and active challenging of assumptions required by this phase means that highly participative—and provocative—approaches are often useful.

STRATEGIC QUESTIONS FOR POSITIONING IN THE FLOW ECONOMY – II
Redefine your space
• How is the flow of all information and value changing in relation to your current and potential customers, suppliers, and competitors? • How can you reframe the total customer offering? • How are market dynamics changing within each of the flow elements? • Are there flow elements in which you do not participate that influence your ability to extract value? • How can you leverage your existing strengths in the flow economy into new sources of revenue or value?

Table 7-3: Strategic questions for redefining your space in the flow economy

A very valuable early exercise is simply mapping the current flows of information and value within your strategic space. This can help to uncover new ways to participate in existing flows, and elucidate how they are changing, particularly from the perspective of your current and potential customers. Formal processes, such as Verna Allee's approaches and tools for mapping value networks, can be very useful.[9] Understanding the current status of each of the flow elements provides a foundation for identifying potential strategic moves for your company.

American Airlines was a very early leader in redefining its participation in the emerging information flows in the economy. Starting in 1959, working with IBM, it established the Sabre airline information and reservations system, which at one stage was the largest private real-time computer network in the world. In the 1990s Sabre generated more profits than its parent, playing a dominant role in one of the most information-intensive industries in the world. Now one of six global computer reservation systems, Sabre is continuing to reposition itself, having taken a 70% stake in Internet travel agency Travelocity and providing software to other airlines on an applications service provider (ASP) model.

Another example is provided by how corporate banking is redefining its scope. The family tree of JP Morgan Chase is long and distinguished one, bringing together a multitude of firms such as Manufacturer's Hanover, Chemical Bank, and of course John Pierpont Morgan's eponymous institution, all of which have provided financial services to the corporations of America and the world since the 19th century. JP Morgan Chase no longer provides just financial services to its traditional client base, but is now seeking to take a commanding position in the information and value flows between corporations.

Electronic Invoice Presentment and Processing (EIPP) is a digitally-based process by which firms present invoices and make payments in business-to-business transactions. At its most basic, the field is about providing electronic notifications to suppliers and clients of order status, and making the related payments. However to implement these systems effectively when there are a multitude of complex processes including internal approvals, partial shipments, returns, insurance, and far more, ultimately requires integrating the accounts payable and accounts receivable systems of the firms involved. For consumer goods companies, these systems can extend as far as providing accounting systems and payment options to retailers, while for other large firms, they can cover all aspects of procurement, including integration into online marketplaces. This emerging space is attracting competitors from all fronts, including software vendors such as SAP, start-ups such as Billpoint, and banks like JP Morgan Chase. The only part of the EIPP suite of services traditionally provided by banks is payments—a very low-margin and commoditized business. However JP Morgan Chase has redefined the scope of its business to encompass a far larger proportion of customer value.

3. Reposition

Once you have determined your new strategic space, you need to decide how you will reposition your company. You have the usual range of strategic options available, as illustrated in Figure 7-2. You can:

- **Build.** Create the capabilities you require, by internal development and hiring.
- **Acquire.** Identify and merge with a firm with complementary capabilities and positioning.
- **License.** Implement technologies or processes others have developed.
- **Form Alliances.** Create shared business models with other organizations.
- **Virtualize.** Outsource business processes and functions.

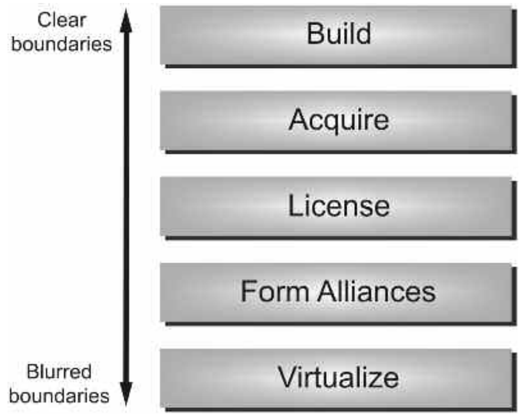


Figure 7-3: Strategic options for repositioning

Traditional approaches to corporate strategy remain useful in assessing this range of options. Depending on the specific situation, some of the issues to be taken into account include the degree of integration required, financing costs, the importance of market dominance, intellectual property, cultural fit, industry barriers to entry, and so on.

At the same time, it's important to understand how the rapidly shifting dynamics of the flow economy change repositioning decisions. As you saw earlier in this book, companies can now easily integrate their processes and operations to a far deeper degree. This means that it is increasingly possible and relevant to shift towards options that require blurring the boundaries of the organization. You are severely limited in what you can achieve if you simply buy or build capabilities internally. Those firms that actively engage in the more challenging approaches of drawing on external intellectual property, forming alliances, and allocating business processes inside and outside the organization, will have immensely greater flexibility in their strategic positioning. In Chapter 3 you saw that companies today participate in a broad network of value creation, and position themselves to extract value from that. The greater your versatility in fine-tuning your positioning relative to other firms, the more accurately you can conceive and implement your strategic vision.

Those firms that actively engage in the more challenging approaches of drawing on external intellectual property, forming alliances, and allocating business processes inside and outside the organization, will have immensely greater flexibility in their strategic positioning.

Lonely Planet, discussed at the beginning of this section, clearly started with its primary strength in content creation, combined with a strong brand. In seeking to develop direct relationships with its end-customers—which most book publishers don't have—it chose to develop its own capabilities for the Internet and online community development. However for its other new ventures it has formed alliances with a telecommunication provider, television program producer, software developer, and personal organizer makers to leverage its content and brand. In all cases it ensures that it controls the customer relationships—and thus the majority of the value creation.

Microsoft has never hidden the fact that its Xbox game console is in part the first step of a strategy to be at the heart of all home entertainment. As such it needed to create a standard. It could have done that through alliances with established players, but it decided that it wanted to completely control this business. Despite being historically a software firm rather than hardware vendor, it was easy for it to outsource manufacturing of the console. However for a game console to be massively successful it needs a large range of quality games to be available, so in addition to providing its own games, it allies with third-party game developers.

Strategy in the flow economy is also about positioning relative to your competitors. Microsoft is a powerful player in many of the flow elements, however one of the elements at which it is currently weakest is connectivity. It's happy if the market is open and competitive, but if there is a dominant player, especially combined with relationships with end-players, it could throw a wrench into its plans. So, when AT&T's cable television business was auctioned in late 2001, Microsoft was desperate for it not to fall into the hands of its arch-rival AOL Time Warner, as it would have doubled the firm's broadband reach to 26 million subscribers. Accordingly, Microsoft chose to bankroll Comcast's bid for the cable networks, thus averting the powerful hold its competitor may have gained on customers' access to digital broadband services.[10]

In this chapter we have looked at strategic positioning at a very high level. In Chapter 9 we will look briefly at the implications of web services in creating modular organizations. This allows firms to define what they choose to locate inside and outside at the level of specific business processes. We will conclude this chapter by examining how firms can bring the strategic process to life inside their organizations.

Creating participative strategy

The Work-Out process is one of General Electric's standard practices. This brings together 40 to 100 people in a "town meeting" to discuss specific issues, and make firm recommendations. Once the issues that need to be addressed have been identified, these are clearly defined by a team, and attendees for the meeting are selected from a range of functions and managerial levels. The team meet in an offsite location for usually three days, commencing with a briefing by the relevant executive, who then leaves. The participants break into a number of teams, and in a structured process come up with clear recommendations. At the end these are presented to the senior manager, who must make a decision on the spot whether to proceed. Work-Out sessions are routinely run across General Electric's divisions, and often include customers and suppliers.[11]

This participative approach to strategy—which permeates General Electric's culture and practices—has become imperative in the flow economy. Most importantly, strategy development must happen in real-time, rather than at the traditional annual off-site strategy review. In the same way as any form of innovation, it must draw on the broadest possible spectrum of experience and perspective available in the organization. This is required by the increasing complexity of technology and the economy. In addition, strategy must be communicated meaningfully to all employees and even partners, as it affects day-to-day business decisions. In short, strategy must draw in the participation of people across and sometimes even beyond the firm, rather than be set by senior management behind closed doors.

Clearly there are limits to the ability to distribute strategy formation through the organization. Leaders must assess rapidly-changing situations and make quick decisions. Confidentiality is often an important issue, especially regarding acquisitions and major strategic moves. Most employees cannot afford the time for deep consideration of strategic issues. However firms that use these issues as excuses to keep strategy an isolated exercise will be severely disadvantaged. There are three key steps companies can take to rapidly and effectively build participative strategy.

BUILDING PARTICIPATIVE STRATEGY

1. Develop an iterative strategy process
2. Link to innovation processes
3. Use scenarios

Table 7-4: Action steps to building participative strategy

1. Develop an iterative strategy process

Most company employees will be all too familiar with the strategy roll-out session. A roll of drums, death by Powerpoint, and perhaps an appearance by the CEO, then everyone files back to their desks, deeply inspired by the bold vision they have just been presented, and already forgotten. People cannot have a sense of ownership when they are presented with a finished product.

An effective iterative strategy process cycles back and forth between the strategic planning group—that can put in the effort required to research key issues and develop strategic frameworks—and the broader employee community, that can take on early stage frameworks and be given an opportunity to provide input and perspectives. In most cases these sessions will result in valuable input to the strategy development process, and they will always generate a far greater sense of participation and involvement. Perhaps the most important success factor is presenting a strategic framework that is both readily understood, and has clear dimensions for input and discussion. For one global financial services firm, I designed a process that included framing the organization's strategy in a format suitable for employees to provide input, and applying the output from these discussions into high-level strategy and innovation sessions. In this way an iterative strategy development cycle could be begun.

2. Link to innovation processes

Over the last few years many organizations have implemented formal innovation processes. In their simplest form, these enable employees to submit ideas to an assessment panel that selects the most promising for allocation of funds or other resources to develop the innovation to fruition. During the dot-com era, innovation processes often focused on ideas for ebusiness start-ups, functioning much like venture capital firms, however the focus for these initiatives is increasingly applied to issues such as product development and process enhancement. It can be very valuable to link innovation processes with participative strategy initiatives. Most companies that have implemented innovation programs have found that after an initial flurry of ideas, submissions dry up. People need to be challenged in structured ways to provoke new ideas. For example workshops that work through how value flows within and across industries are shifting often stimulate new thinking in those that have extensive experience in the field.

Royal Dutch/ Shell's Exploration & Production division has been running an innovation process called GameChanger since 1996. It is essentially an internal venture group, reviewing proposals for new technologies and strategic visions that can come in from anyone, anywhere, anytime. It typically approves initial funding for successful ideas within one month, but if ideas are proven worthwhile they are then passed on to operating units within the Shell group for full commercialization. At the end of the last decade, four of the top five growth initiatives in Shell had emerged from the GameChanger process. While the GameChanger team is open to all ideas, most stem from innovation workshops that are run both within Shell, and at universities and institutes worldwide. These focus on stimulating different perspectives on where new revenue streams can be exploited in what appears to many to be a mature industry.[12]

3. Use scenarios

I have consistently found that scenario planning is the single most powerful tool for developing participative strategy processes within an organization. The process of scenario planning develops a small number of realistic, complementary, and relevant future scenarios for the organization's environment, that are used to establish a robust yet flexible strategy. One of the key advantages is that the scenario development process is inherently iterative, and so can very easily be adapted to running broad participation sessions, interspersed by focused development and research by a specialized team. By their nature, scenarios are easy to communicate, and the development process generates frameworks that provide a solid foundation for rich discussion.

Since 1995 Morgan Stanley has used framework scenarios as a foundation for strategic thinking across its businesses, involved more than 3,000 executives worldwide. The strategic fields to which it has applied scenario planning include technology, international expansion, and the changing nature of its institutional and retail clients. The scenario development processes are specifically designed to gain useful input from a diverse range of internal and external thinkers, and to give key stakeholders a sense of ownership and participation. To do so, initial scenarios are created that provide valuable perspectives on the future of the business in question, while still clearly being not in final form. This enables participants in the process to contribute effectively, gain a deeper understanding of the issues underlying the resultant strategies, and be clear on their role in successfully implementing the strategies.

Vital Connections: Chapter 7

In this chapter we have looked at the development of the flow economy, in which almost all value is based on the flow of information and ideas, and traditional industry boundaries are dissolving. Companies must understand the six flow elements that comprise this emerging flow economy, and take the necessary steps to position themselves effectively as competitive dynamics change.

In Chapter 8 we will explore in-depth strategies for content providers, while Chapter 9 covers the pressing issues in the new world of services, including online services and professional services. Chapter 10 will go on to examine strategy in a networked world from the perspective of individuals.