



USER FRIENDLY

Flexible Consumption

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Mark Litwin

Mark: We really see no sector that hasn’t been touched by the flexible consumption revolution. Within the next couple of years I don’t think you’re going to be able to find a sector or product category that hasn’t somehow been affected, whether it’s a disruptor or traditional businesses now offering their services in a much more flexibly consumed manner.

Heidi: Almost every form of consumable product or service is now being offered in new and different ways; where we can buy anything, anywhere, in any manner we like. I’m Heidi Rataj and joining me today on User-Friendly is Mark Litwin and Faruk Muratovic. Welcome gentlemen. I’d like to give the listeners a quick overview of flexible consumption, Mark.

Mark: Flexible consumption is really affecting most industries and a real broad range of product offerings within those industries. We’ve seen a lot of shift with very capital-intensive products being offered on a services basis. That lets companies avoid having to make very large capital investments; instead they pay for services as they actually use them. For example, the healthcare industry, with large MRI machines, now offers them to clinics on a pay-per-use basis for the actual clinic provider. Or, instead of an airline having to buy a jet engine, they can now lease it based on the hours of usage.

Heidi: Where do you think the business is headed?

Mark: We see this moving across both businesses supporting enterprises as well as a number of different use cases in the consumer space. Within the next couple of years, I don't think you're going to be able to find a sector or product category that hasn't somehow been affected.

Heidi: So, Mark, what kind of transformation will companies need to make to compete in this market?

Mark: We see transformation at a number of different levels as a result of flexible consumption, all the way from the strategy companies are pursuing to the business models and the actual operations and technology that support flexible consumption products. We like to use the example from an operation and sales perspective of the transition from big game hunting to farming. It used to be that sales forces would sell large capital items, collect large commissions, and then move on to their next client prospect trying to repeat the same process. What we see now is a much more direct correlation between the customer's actual usage of products and the value that they're obtaining, in the way that they actually pay for those products. It's much more important that companies are actually working with their customers and monitoring customers' usage of that product.

Heidi: Let's talk about the examples of some of the companies that are disrupting their industries, and why they've been so successful.

Faruk: They're the born flexible consumption companies, the likes of Netflix and Salesforce. Netflix, as an example, gives you an unlimited subscription to as much of their content as you can consume from the cloud, whereas if you think about Salesforce they were the pioneers of being an anti-software company. Rather than buying a software package and activating it on premises they said we're going to provide you Salesforce, a service, with which you can better manage your opportunities and be more effective at selling products.

Adobe is another great example of a company that has really taken a burn-the-boats approach and very systematically shifted their customer base from being perpetual to being a subscription-based software company; and there are many other [companies] that are well underway.

Heidi: Adobe did something that was quite sophisticated, which was to really think about how they delivered this information not only to their stakeholders, but to their partners, contributors, and content developers. Could you illuminate a little bit more about how Adobe did this so successfully?

Faruk: Typically, when a software company shifts from a perpetual to a service business model there is a noticeable short-term or midterm revenue impact because, as a result of selling a one year or monthly subscriptions, the amount of up-front recognized revenue is significantly smaller than in a perpetual world. At the same time, there's a significant amount of investment required to deliver the capabilities required for this. So, what they've done really well is educate their financial and analyst community to the fact that, while the revenues are going to rise, the revenue profile is going to change and revenues are going to decline upfront. The recovery and the margin and the amount of opportunity ahead of delivery as a new business model is immense. So, while their revenue and margins declined in short-term the stock price continued to skyrocket during this transition.

Heidi: We've also seen the auto industry experience some huge changes, what are the ways that the automotive industry has changed, Mark?

Mark: It really started when automotive companies started offering services that are probably best exemplified by OnStar, which gave auto companies their first opportunity to interact directly with their end consumers. As soon as automotive companies started offering connected vehicle services, it gave them a direct link to their consumers and the ability



to provide a lot of different services and to create subscription-based business operations. How we now think about transportation is fundamentally changed. Think about Uber or about Lyft and other types of services that give you the ability to get from one place to another without car ownership. The automotive companies have very direct relationships with those types of ride sharing services, and now they're getting into those types of services on their own. I think in some cases there are examples of automotive companies that will now offer you fractional ownership type opportunities where you can use a car on a per-day basis and no longer have to worry about parking your car, buying insurance for your car, or maintaining your car. We're really seeing a revolution in the way that consumers think about transportation and the automotive companies are really having to make a lot of transformational changes to be able to compete with a number of these disruptors that have really sort of blown up how we think about getting from one place to another.

Heidi: That's an excellent point Mark. Faruk, how else has flexible consumption changed this area, and what can we expect in the future of mobility?

Faruk: Another thing that's happening is that in terms of infotainment in the car there's more and more paid services and advanced services that are available on a subscription or usage basis. Interestingly, offers are emerging already in the market. There are examples from Porsche, soon, and I believe from Toyota where you can now buy a subscription or call it an advanced lease and use several types of vehicle during the course of a year or a month rather than just being committed to buying a single-vehicle. If I'm taking a weekend trip with my extended family I can drive a large SUV or minivan and I can drive a Prius if I'm going to work on Monday. I think the maturing of autonomous vehicles is going to completely revolutionize this and introduce a limitless number of new subscription and usage-based services, be it autonomous parking of your vehicle,

autonomous delivery of your food or a package, and many other services that will introduce additional efficiencies and conveniences to the consumers.

Heidi: Mark what are some of the challenges legacy companies might face within a flexible consumption business model?

Mark: For companies that have grown up in the model that you produce a service, you sell your service and your connection to the customer is then disconnected, changing that relationship creates a number of challenges for how these types of companies operate. That's because you now have a constant connection to your customer. As consumer expectations rise and the need to be able to support that customer becomes omnipresent there are a lot of technical capabilities that relate to being able to interact directly: the ability to develop mobile applications; the ability to work in some cases in larger ecosystems where you are participating in a marketplace; or, in the example that we used before about connected cars. In that case, cities are getting a lot smarter, and car companies, as an example, are now having to deal directly with a number of municipalities. The various technologies that they're putting in place mean the connected car is now connected to the city to help with things like congestion, for things like optimizing parking, and for things like giving consumers new seamless ways of using city services that are based upon being in a mode of transportation.

Heidi: I would imagine that there are a number of clients that really don't even know where to start with this new model. Faruk, why is it more difficult than just charging a per-use, versus yearly fee.

Faruk: Well, I think it's counterintuitive, and that's part of the reason why some other companies have taken so long to start their transformations. The traditional transactional business model is basically tailored to a very linear supply chain. You spend two to three years in R&D and engineering to develop a great new

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product, marketing does their magic to attract the customer and ship them the new version, and sales sells large upfront contracts with support in any way the customer wants. The customer can call them once the product is delivered and support is there on their toes waiting to provide support as needed. Well that's all different. You have constant feedback from customers about the new features that they want. You need a product platform and your solutions need to live on that product platform and iterate quickly on that platform. Sales has to start getting compensated on smaller sized deals and not only on upfront contracts, but also on acquisition and on consumption of additional services. Then there's this whole notion of customer success, to continuously collect data, and from the data derive whether customers are healthy. Are they're realizing the value that was promised and if they're not, engaging the right services, the right training, the right other pieces of organization to help them realize their value—because if they don't their cost of walking away is very small and they can go to the next vendor.

Mark: And I think one of the themes that underlies what Faruk described is this concept of experimentation. Just as the concept of agile has really taken hold in the technology development world that same concept applies here, where it's incumbent upon organizations to be able to launch new products and new iterations of products very quickly, at a much lower cost and in a much more flexible manner. But, that experimentation necessarily should have a lower cost of failure.

Heidi: With all of these changes in the way the consumer is requesting flexibility, what's the silver lining?

Mark: The silver lining is that offering products in a flexible consumption manner provides a lot more opportunities to reach consumers that may not have otherwise used your product or of providing new means of creating product variance. I use the example in the media sector for a product like HBO GO®, where you no longer need to have a cable subscription.

If I'm a big fan of "Game of Thrones" or "Curb Your Enthusiasm" I can pay nine dollars a month for HBO GO watch it on any device and consume exactly what I want to consume at a price point that I think is more fair. That provides an entirely new market and a new revenue stream for HBO that didn't exist five years ago.

Heidi: Faruk, final thoughts on this program, why is it important for companies to not overlook these types of models?

Faruk: When I was in college my roommates and I used to go to Blockbuster, the closest one down the street. Maybe we'd have to hit a couple of them because if you came there too late all the movies that were worth watching we're already rented out. Then, Netflix showed up and for a simple subscription you didn't need all that brick and mortar, though you still needed to get the DVD to watch a movie. Not so many months after that Blockbuster was out of business, a completely disrupted company hundreds of times larger than Netflix. The simple truth is that flexible consumption is the new economy of consuming, both in the enterprise and for consumers, and unless companies listen and transform, their existence is limited.

Heidi: This is an area that will probably leave no product untouched, companies not considering how to move to these types of models, may be left in the dust. This is simply the way of business. I want to thank my guests today on User-Friendly, Mark Litwin and Faruk Miratovic. Thank you.

Faruk: Thank you.

Mark: Thank you.

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