

DIGITAL OEM #3

DIGITAL BUSINESS MODELS FOR AUTOMAKERS

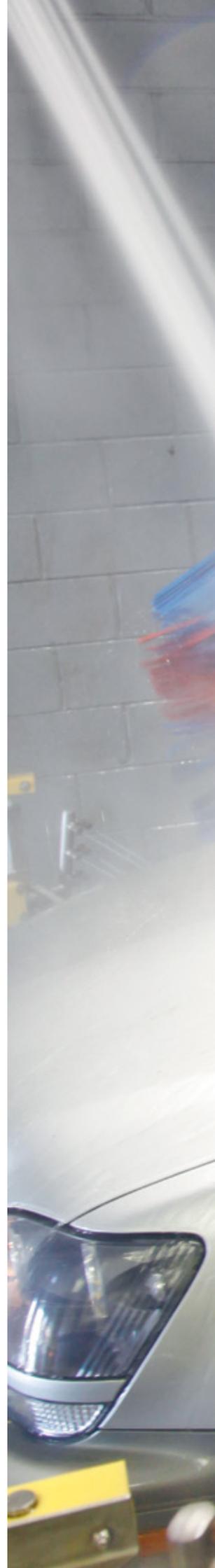


DRIVING DIGITAL BUSINESS MODELS IN AUTOMOTIVE

MAKING A SPLASH IN THIS EMERGING REVENUE POOL TAKES A FLEXIBLE STRATEGY, OPERATIONAL RESILIENCE AND EFFECTIVE COLLABORATION

The disruptive changes facing the automotive industry today, as well as certain solutions to legacy product challenges, have one thing in common: their digital roots. Connected cars, autonomous driving, and the Internet of Things all demand a digital proficiency that few industry players currently possess. Adding to this challenge is the fact that most automakers still lack comprehensive digital strategies for addressing the “connected life” needs of their customers, even as a range of tech-savvy newcomers encroach on car manufacturers’ traditional territory. These newcomers tend to focus on areas like vehicle electrification, city mobility, and autonomous driving, though some are targeting tangential but potentially lucrative plays, such as content provisioning, online commerce, and home automation.

Capturing business opportunities in the digital space will require automakers to fundamentally change their approach. In the past, they might have pursued a solitary, self-sufficient path, rarely turning to suppliers to meet their innovation needs. To thrive in the digital world, however, innovative, interconnected business models are necessary. Companies must develop ecosystems of partners, establish multi-speed capabilities, and completely rewire their product development processes. While none of this will be easy, there are no alternatives: Those automakers who are slow to adapt will quickly find themselves outmatched by players who are willing to make the substantial investments needed to transform their businesses. And once the company has formulated its coherent digital strategy, it should concentrate on establishing optimal organizational foundations early, to avoid major implementation hurdles later on.





CRAFTING A DIGITAL STRATEGY

For all its scale and global reach, the automotive industry is a relative latecomer to the ongoing digital battle. For example, Ford expects traditional automotive revenue of \$2.3 trillion to compete against \$5.4 trillion of other transportation services revenues. Now is the time to make the digital switch. The first step towards this necessary transformation involves crafting a coherent digital strategy.

From the digital business models that have emerged across industries, car companies can identify distinct patterns and factors for success, allowing them to develop strategies rapidly. A number of business models have shown promise in attracting customers by serving them differently from traditional models, such as Uber or Airbnb. Data aggregation, a prominent digital business model, monopolizes the data required for a business, with Google the most prominent example.

While success stories offer valuable lessons, there is much that companies can learn from their industry's digital failures. Indeed, the auto industry already has a sizable record of trial-and-error digital efforts, from telematics-based concierge services, to app-guided car-sharing schemes. Most important, companies must be cognizant of the key set of dynamics specific to the digital industry: the "winner-takes-it-all" pattern of competition and the need to scale up rapidly and capture the customer interface. Auto incumbents' reflexive focus on proprietary solutions and unilateral action cannot compete in this type of environment. Nevertheless, evidence suggests that simply cloning successful digital models is not the answer, either: In many business areas, it is often the case that only one or two players dominate, making it difficult for new players to try the same approach. Moreover, the typical automotive business case logic may not apply on the surface to digital, where the emphasis on growth often outweighs profit.

The following success factors reflect the insights of a wide variety of recent digital strategy initiatives Oliver Wyman has conducted for clients in the automotive, mobility, media, and online marketing industries. These factors are also applicable to other areas, such as home automation, healthcare products, financial services, and the Internet of Things.

DIGITALLY RESOLVING CUSTOMER PAIN POINTS

The most successful digital companies address their customers' "pain points" better than their competitors, handling existing customer needs such as reducing the time it takes to get to places and in-car connectivity. This frequently requires more than a one-off initiative from companies. Instead, successive trial-and-error improvements will be necessary, as players iteratively design efficient roll-out models and scale them up, learning as they go.

Building a substantial digital network is a critical first step that calls for outspending the competition, a stage requiring access to capital. Successful digital players accelerate this process by taking advantage of network effects: Having achieved scale leadership, they translate that into sustainable competitive advantage.

A good digital business model will carefully consider other dynamics, as well. For example, players must proactively roll out to the market scale-sensitive elements such as recommendations and reviews, exploit data to match their users with content, and optimize their value-creation efforts and reach.

But automakers must be cognizant of regulatory developments in the area of data privacy, which may affect their digital model. One critical data-related issue involves Europe's General Data Protection Regulation (GDPR), set to take effect in May 2018. The GDPR unifies information privacy rules across the EU, giving customers greater control over the data that companies collect on them. It stipulates severe financial penalties, in some cases up to 4 percent of global revenues, for businesses that fail to adhere to its regulations.

CREATING LOCK-IN OPPORTUNITIES

The most successful digital business models create ecosystems to capture and lock in customers, orchestrate partners to support brand positioning, and align offers to address customer needs. Those companies control the key parameters of their ecosystems, which may be open- or closed-source, and feature a variety of monetization options. These factors become apparent as companies contemplate the digitized experience, in which automakers interact with their customers along the lifecycle of the vehicle. The customer journey, which formerly was a linear path with clear starting and ending points, is transformed in the digital ecosystem into a circle characterized by continuous involvement, going far beyond traditional parameters.

CONNECTED LIFE – COMPETING IN THE BROADER DIGITAL WORLD

Digital business models typically focus on B2B or B2C markets (and sometimes both), although companies must take care to separate the two from a commercial perspective. Beyond choosing the optimal market, automakers need to decide where to play in the technology stack. (See Exhibit 1.) In simplified terms, should they launch a digital business with customer-facing services or provide an enabling platform to include other industry players and support rapid scaling-up efforts?

Across the immense variety of digital businesses in operation, there exist a number of patterns and success factors with broad applications. Consequently, it makes sense to incorporate these key strengths as competitive advantages. For automakers, that means focusing on the customer relationship. There is one notable caveat: if digital business models rely on lower-quality brands or products and services, companies will have more difficulty entering, scaling up, and defending their value propositions.

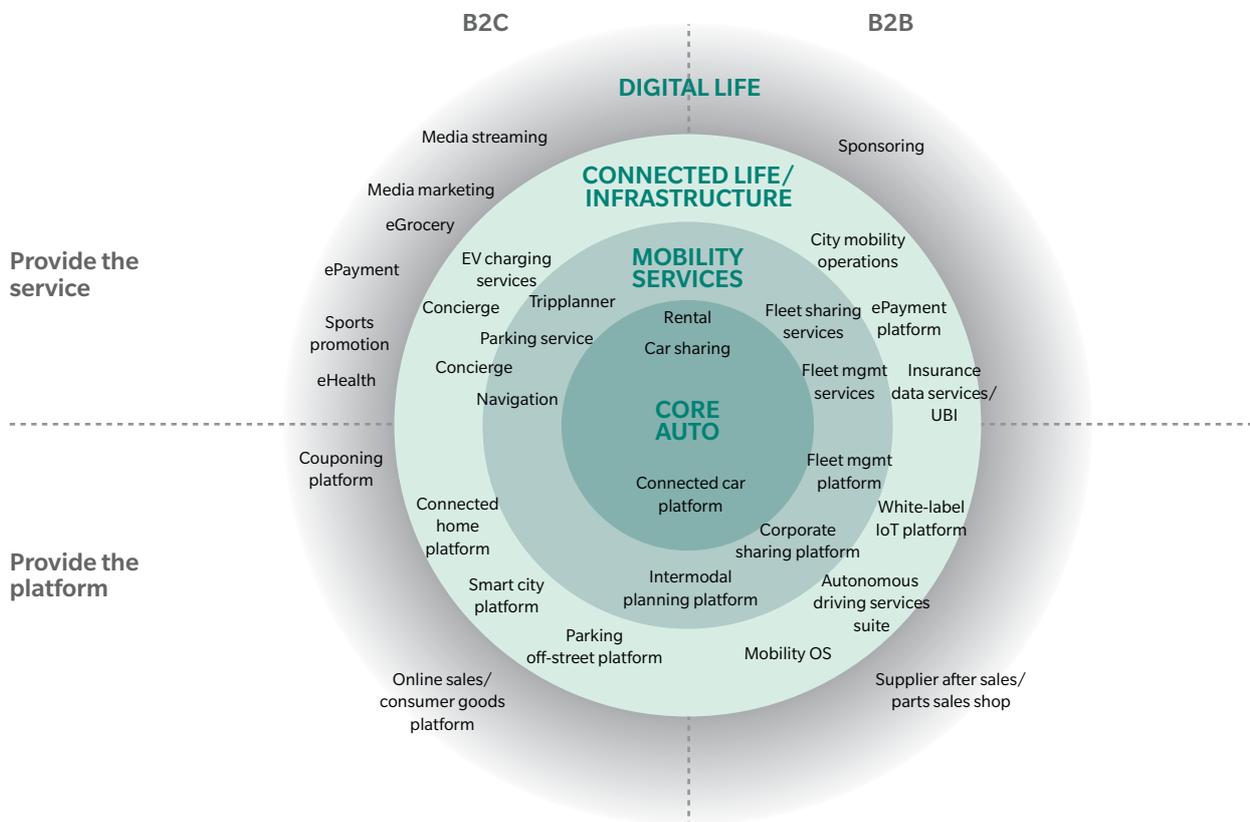
Carmakers can take advantage of their traditionally strong positions in terms of “owning the driver relationship.” (See Exhibit

1.) For example, the vehicle manufacturer has the best opportunity to tailor the connected-car platform to specific customer segment requirements and secure their loyalty. Other advantages include their control of parts, services, and the data associated with the car itself, such as financing, after-sales parts, new car sales, connected services, navigation, and mobility services. Players can choose to focus on their customers and brands directly, or alternately aspire to create a cross-industry platform for greater scale and a broader customer base.

In today’s automotive industry, certain digital paths are no longer optional: most automakers have already waded into the new mobility services value pool, competing against asset-light startups and so-called unicorns (privately held startups valued at over \$1 billion) such as Uber.

The market for mobility services is expected to grow at different rates, depending on segment, through 2025. Electric-vehicle charging is projected to expand the fastest at 33 percent annually, followed by car sharing (26 percent), and safety and remote services (19 percent); slower-growing segments are likely to be intermodal services (4 percent), rentals (3 percent), and passenger car driving services (2 percent). This expansion should lead to an

EXHIBIT 1: DIGITAL FRAMEWORK TO PRIORITIZE PROMISING BUSINESS MODELS



Source: Oliver Wyman

expected €370 billion market in digital mobility services by 2025, as innovative players with disruptive digital business models replace many of today's incumbent companies. (See Exhibit 2.)

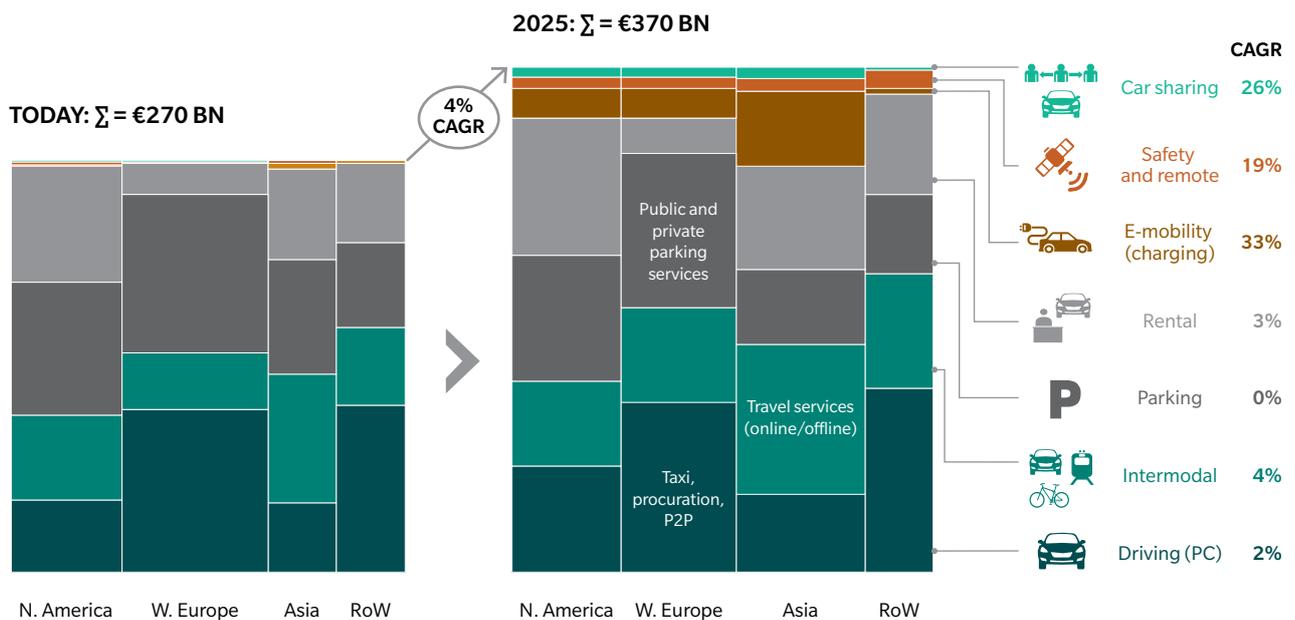
But focusing on the growth rates of individual segments is not sufficient. Certain industries will see, or already are seeing, fundamental changes, with huge revenue potential for new, disruptive players. For instance, while the overall parking segment exhibits little growth, smart parking solutions could soon drive new expansion in the sector, effecting shifts in value pools.

To focus on one of the most disruptive areas in the automotive segment, the shift to online sales channels for new and used cars, as well as car parts and services, could soon capture up to one-third of revenues (and related profits) from established dealer networks. The primary reason: Online channels and potential cooperating partners such as Amazon, Shift, and Carvana continue to gain momentum. For example, Amazon is already experimenting with

Fiat regarding online new car sales in Italy. The carmaker is selling three models via Amazon's platform, although franchised dealers will remain in the retail loop, as buyers will receive their deliveries and complete purchase transactions on-site.

Looking beyond the car and mobility circles, connected-life digital business models also seek to address use cases involving home and work situations. (See Exhibit 1.) Because substantial numbers of players with different business models find this market attractive, analysts have trouble estimating overall value pools; nonetheless, these are expected to exceed hundreds of billions of euros. Viewed in its totality, including digital businesses with only remote connections to automotive, the connected-life market also features sectors such as financial technology, energy, eHealth, and online commerce – businesses that could support enhanced automotive activities as connectivity improves and innovative automotive apps tailored to such business models emerge.

EXHIBIT 2: PROJECTED CUSTOMER SPENDING ON MOBILITY SERVICES THROUGH 2025



Source: Oliver Wyman



CHOOSING WHERE TO PLAY

Automakers have better chances of success in mobility-related digital business areas than in spaces more distantly related to the industry, such as home ecosystems. They are at a distinct disadvantage when they venture beyond their core strengths and try to take on powerhouses of the digital world, such as Apple or Google, which can approach a market from a variety of perspectives and entry points. And they are further handicapped when competing with asset-light capital-intensive venture capitalists, industry asset owners, cross-industry integrators, platform providers and technology experts. Many of them address the cross-industry digital business plays. (See Exhibit 3.)

Companies interested in rapidly developing successful digital models need to make use of unique assets like their pre-existing customer relationships and trusted physical products. Lacking these, the alternative involves investing massive amounts of capital to scale up rapidly.

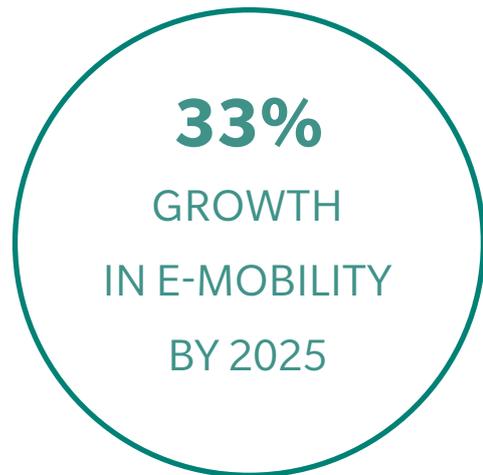
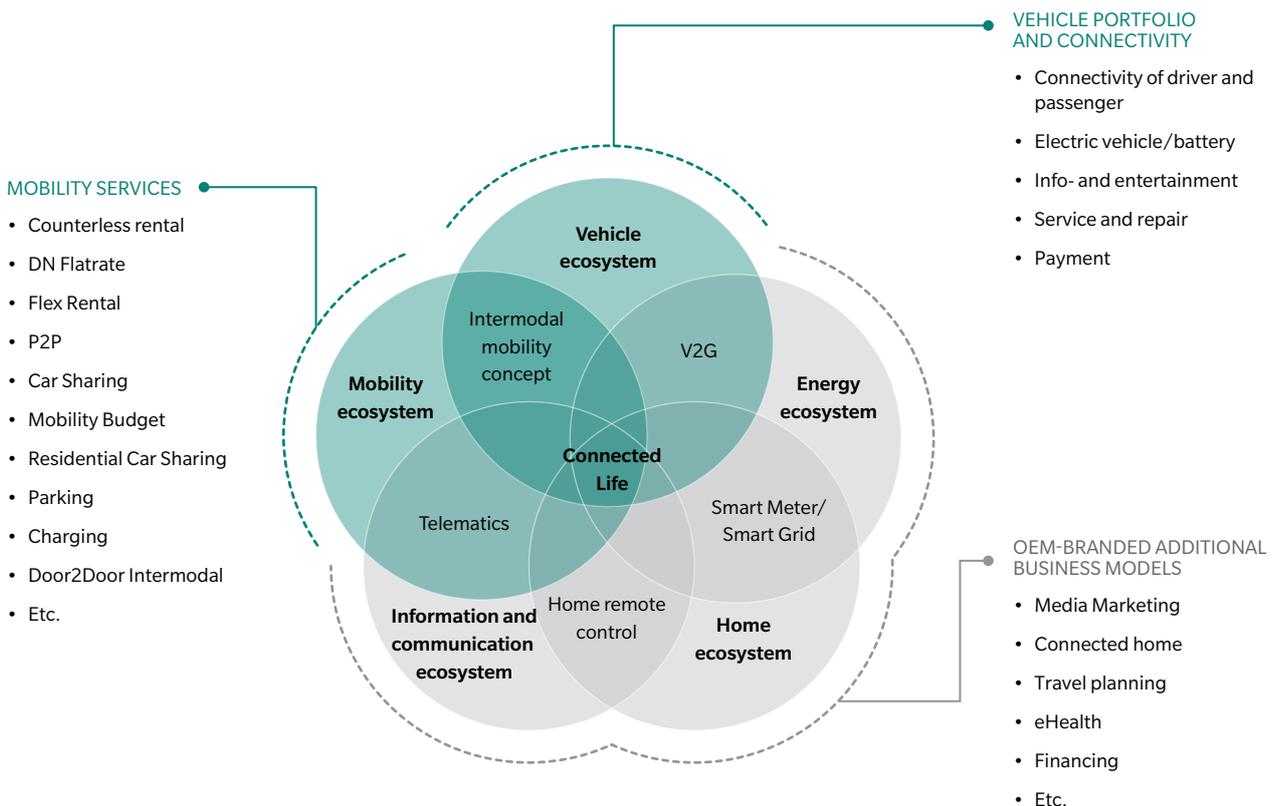


EXHIBIT 3: CONVERGING ECOSYSTEMS – AUTOMOTIVE DIGITAL BUSINESS MODELS ACROSS INDUSTRIES



Source: Oliver Wyman



SUCCESS REQUIRES COMPANY-WIDE COMMITMENT

Even the best digital business model will fail to gain traction if automakers underestimate the necessity of “taking the organization along.” Successful digital business models require distinct approaches to the IT stack, and rely on key partnerships to scale initiatives quickly.

Implementing digital strategy effectively requires that organizations develop new capabilities and agile work methods – and fast. This typically means transformative action. However, standard corporate approaches – usually conducted top-down, inside the perimeters of the current governance system – often fall short of reaching digital targets quickly.

Instead, our experience suggests that adopting an approach with three horizons will increase a company’s likelihood of success. The first horizon consists in a rapid pilot implementation. The second horizon sets up funding and staffing governance that enables the company to establish an agile organization; teams can then scale pilot business models, ramp up further initiatives, and take steps to enable infrastructure and methodologies. Finally, the third horizon involves the full scaling up of the digital business.

Reaching the first horizon is particularly critical for digital businesses. Oliver Wyman has identified some key success factors for implementing pilot initiatives that players ought to consider: First, the platform architecture should feature a modular structure, enable the use of micro services, and remain agnostic with regards to front-end systems. Second, product and vehicle technology integration efforts should incorporate in-car data and existing customer information as much as possible. Third, agile development should always begin from the customer’s perspective, not from a data or technology standpoint. And finally issues involving organization, governance, and steering should focus on digital products, underlying platforms, and supporting capabilities such as analytics.

To reach and lock in customers, companies need to scale their digital business rapidly, which will require substantial investments. Automakers must understand that trying to excel in new fields will require abandoning the certainty of volume planning. New markets with continuous shifts in competition, size, and customer segments will exhibit elevated levels of ambiguity despite the heavy investments necessary for ensuring lasting success.





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