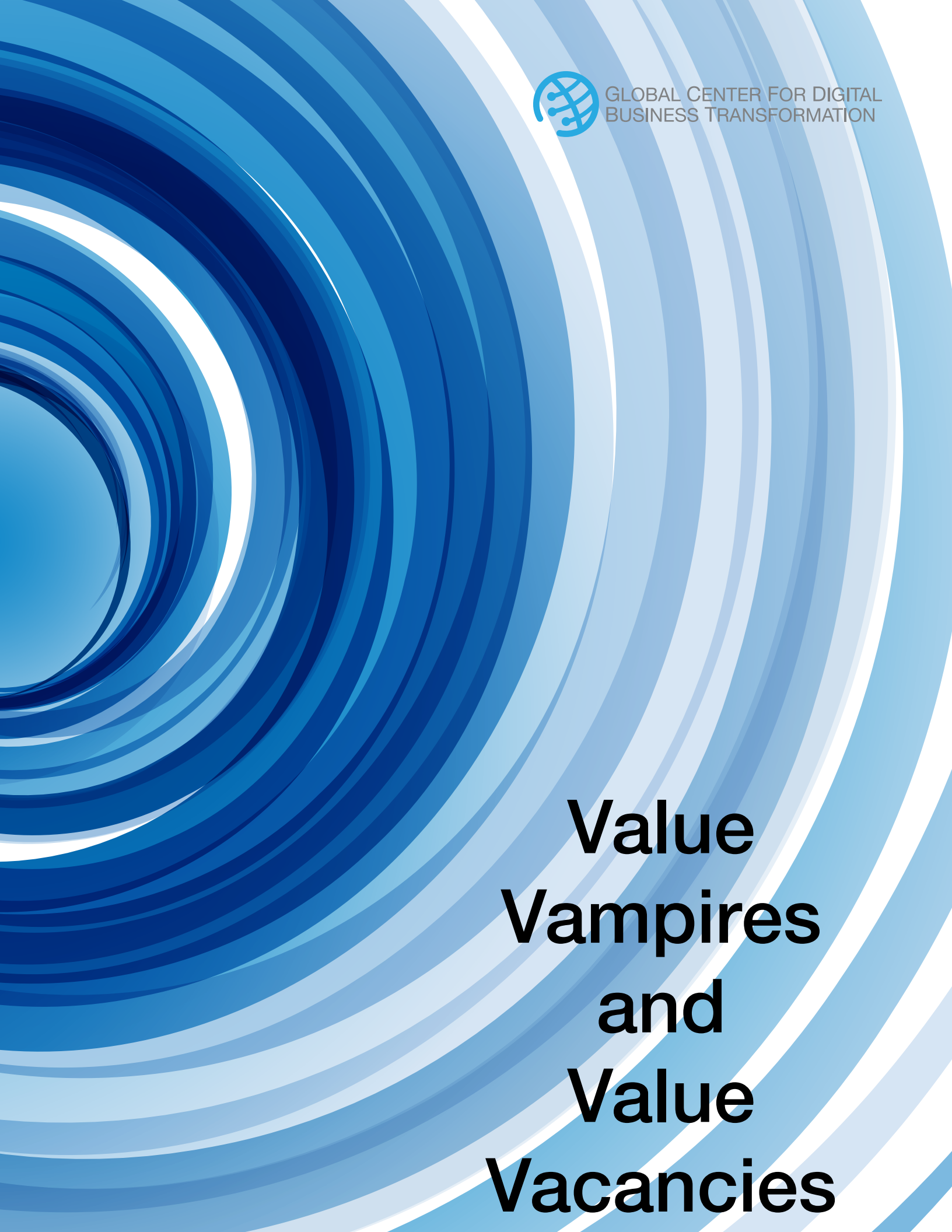


Value Vampires and Value Vacancies

Introduction

In recent studies from the Global Center for Digital Business Transformation (the DBT Center),we showed that digital disruptors threaten to displace some 40 percent of market leaders within the next three years, and drive many companies out of business altogether. We then examined the three types of value that digital dis-ruptors deliver—cost value, experience value, and platform value—and the digital business models behind each of them. We noted digital dis-ruptors are most successful when they use these business models to practice "combinatorial disruption,"—that is, blend these three forms of value to create offerings that are different from and better than those of incumbents.

In what we call the "Digital Vortex," the competitive landscape driven by digital disruption, we see the unbundling of industries and exponential market change. In this paper, we introduce two competitive realities confronting firms today: the value vampire and the value vacancy. Value vampires combine compelling forms of cost value—low cost or even free – with experience value and platform value to undercut incumbents and quickly win significant market share. Value vampires render higher cost offerings irrevocably obsolete. Most disturbing is the effect value vampires have on the markets they attack: overall revenue and profit margins are sucked dry, and do not return. The threat of digital disruption in general, and value vampires in particular, forces incumbents to seek new markets continually. Otherwise, they risk suffering revenue stalls, from which few re-emerge.

In the past, markets have presented instances of "white space"—those situations where competition lags opportunity, either where a given firm can get a leg up on rivals, or where a new market can be created. Markets were neatly defined in a kind of mosaic of competition—this is what we do, this is how our market creates value for customers; that is what you do, that is how your market creates value for customers. The playbook for success in this environment was straightforward: companies competed fiercely within contested markets, but could create growth and increase profit margins by "seizing the white space,"[1] the gaps in the mosaic.

In the Digital Vortex, however, industries collide and recombine in new ways, yielding new competitive forms. And the rate of change increases exponentially as industries converge toward the digital center. The resulting competitive landscape is less like a mosaic of clearly demarcated players and more like an ever-shifting kaleidoscope of forces. More (and more diverse) companies can therefore vie for a given market opportunity. It is, therefore, dramatically harder to a) maintain one's position as an incumbent upon seizing white space, and b) "see around corners"—that is, to predict what will happen and catch resulting market transitions. In this environment, certainty is scarce.

In the chaotic swirling of the Digital Vortex, opportunities for savvy firms emerge, but can close quickly as fast-moving rivals join the pursuit and options for customers proliferate. This is why we call such opportunities "value vacancies." Companies can enjoy a period of fast growth, high margins, and a privileged market position, but they generally are not long-lasting. Established competitors from other industries, start-ups, and value vampires soon intrude. To maintain growth, companies must find and exploit a succession of value vacancies.

Welcome to life in the Digital Vortex. Don't get too comfortable.

Value Vampires

A subset of digital disruptors are what we refer to as "value vampires" (see Figure 1). A value vampire is a company whose competitive advantage shrinks the overall market size. They are not simply companies that produce better mousetraps, supplanting market leaders along the way—that is the natural course of capitalism and a feature of competitive dynamics since the dawn of industry. Many digital disruptors are not value vampires at all—they are just exceptionally good at doing more or less what everyone else does, while exploiting digital technologies and business models in the process. What is fundamentally new about the emergence of value vampires is that their success implies not just a smaller market share for incumbents, but also a smaller market *size* (i.e., the market—its total revenues, profits, or both—diminishes). Despite creating enormous value for end customers, value vampires actually make markets sick.

The "value vampire" concept is useful for strategy not because value vampires are especially commonplace today, but rather because they are extreme versions of digital disruption, and therefore present a learning opportunity. Value vampires may actually be relatively rare but furnish the template for customer value creation followed by a legion of digital

Figure 1
Value Vampires Defined

A disruptive player whose competitive advantage shrinks overall market size.

- Places incumbents on the defensive
- Uses cost value to shrink margins of incumbents
- May also use experience value (renders incumbents obsolete) or platform value (acquires market share rapidly)
- Most dangerous value vampires practice "combinatorial disruption" (all three sources of value at once)

Source: Global Center for Digital Business Transformation, 2015

disruptors, any one of which can wreak havoc for an incumbent. Value vampires may, however, increase in number as more industries converge toward the center of the Digital Vortex and disruption intensifies.

Value vampires are dangerous for incumbents because they are ruthlessly efficient at creating customer value. First, value vampires always introduce a form of cost value, employing business models like Free Lunch, Hard Bargain, and Share the Wealth (these were described in a previous paper) that provide products or services for free; create price transparency and lower switching costs; virtualize or create variable costs, and so forth. Accordingly, these business models drain margin from incumbents.

Second, value vampires also have a nasty habit of creating innovations that yield new experience value for customers: Power to the People, Nonfriction, and Robo-Tasking business models put customers in control; deliver products and services faster; and eliminate inconveniences. As noted in "Digital Vortex," these disruptors are focused on "the value, not the value chain." That is, they tend to create experiences that circumvent the *modus operandi* of what we termed the "encumbered incumbent." These experiences can render the most venerable of companies obsolete. Value vampires do not merely drink up profit pools, they may disintermediate market leaders completely.

Finally, value vampires benefit from (and contribute to) exponential change in markets. Disruptive technologies, and the behaviors they support, have led to a proliferation of platforms—venues to connect, and buy and sell, in a peer-to-peer (P2P) setting. Because platforms depend upon network effects, where the utility of the network (platform) increases exponentially as users are added, there are built-in

The New Paranormal

The term "value vampire" is meant to be descriptive rather than pejorative. Whether value vampires are good for the economy overall is a fascinating question that should be taken up by economists. One school of thought is that they may help keep a lid on inflation (economic growth of the past two decades has been uncharacteristically inflation-free, at least by historical standards). They do so by creating cost value (i.e., they make stuff cheaper to buy). The low-interest-rate environment that has coincided with this period has resulted in two massive asset bubbles, wealth effects from appreciating stocks and real estate, and an upswing in consumer and business spending. These developments are arguably evidence of value vampires unlocking potential in the economy as a whole. As noted in "Digital Vortex," whether one accepts the proposition that digital technologies are driving productivity or not, customers are undeniably realizing a lot of value from digital disruption, especially in the form of lower costs. Whether correlated or causal, it is probably reasonable to attribute at least some of the low levels of inflation we have seen to the cost value created by digital disruptors, some of which exhibit "vampirish" tendencies.

Another school of thought is that value vampires are a bad thing—their margin-compressing effects can lead not just to healthy low levels of inflation, but also to debilitating deflation, especially in individual sectors beset by value vampires. This deflation constrains investment, compresses wages, slows economic growth, and results in structural unemployment, especially where market incumbents (who employ a lot of people) are displaced.

While we contend value vampires are unquestionably real (leaders discount their existence at their own peril), it is possible they are a transitory phenomenon fueled by "easy money." When access to capital dries up, the thinking goes, the ability of digital disruptors to create new cost value, experience value, and platform value will diminish.

In "Digital Vortex," we discuss how many advantages of incumbents flow from size—their balance sheets, number of customers, brand strength, and more. We pointed out, though, that disruptors can easily acquire these advantages of scale (citing examples of MyFitnessPal and SnapChat). Value vampires, on the other hand, are particularly pernicious for incumbents because they benefit from diseconomies of scale—meaning it is better to be small.

Remember, the value vampire, by definition, possesses a competitive advantage that shrinks the overall pie. Value vampires do not need to capture all of the existing profits in a market. They need only enough margin (or equity proceeds) to make their owners and investors rich. Many start-ups would not think twice about wiping out a multibillion dollar industry segment if it meant they themselves could make a few million dollars, either from cash flows or an initial public offering (in fact, many would argue this is the *raison d'être* of today's entrepreneur). Value vampires can wring costs from products and services by eliminating layers of physical production, distribution, and overhead. In doing so, they also reduce the size of the industry ecosystem, and the number of companies that can profitably subsist on it.

The question of whether these competitive dynamics can be sustained is, therefore, very different in this light. Today's digital disruptors could be simply a new incarnation of the famously unsound business models of the dot-com epoch. And, as noted in "Digital Vortex," shrewd incumbents can and do defeat digital disruptors. But the revenue stalls, margin compression, and customer flight that value vampires bring about make even survival a challenge for many big players. Indeed, most incumbents who have the misfortune of confronting a value vampire in their core business tend to take on an unhealthy pallor, and either die quickly or become the stumbling undead, never to regain their vitality. Customers also are unwilling to relinquish new forms of value, making it hard to put the vampire back in the coffin.

growth drivers for disruptive players who can exploit these platforms. These growth drivers are intrinsically different from the marginal customer acquisition paradigm to which most incumbents are accustomed. Platforms present risks to incumbents quite simply because they can cause markets to change very rapidly. While cost value creation is a necessary but insufficient condition for being a value vampire, platform value creation is often its handmaiden.

Value vampires can affect any industry, but they are probably most apt to alight on markets where there has not been a lot of innovation (i.e., new forms of cost value, experience value, or platform value); where customers are by and large dissatisfied with services levels, or worse, feel abused; where incumbents dictate processes and circumscribe choice; and where established players have enjoyed high margins for a long stretch. Going forward, value vampires may lead to more frequent and more catastrophic revenue stalls for companies in the Digital Vortex. The most lethal value vampires, however, practice combinatorial disruption—creating cost value, experience value, and platform value simultaneously. One is bad enough, but when a value vampire kills your margin, makes your value proposition superfluous, and acquires your customers *en masse*, you have a major problem.

The Original Value Vampire: Napster

Determining which companies are value vampires and which are merely "digital disruptors" inevitably involves a measure of subjectivity. What's more, it is usually not possible to judge a company to be a value vampire until a considerable period of time has passed to determine empirically whether the overall size of the market decreased.[2]

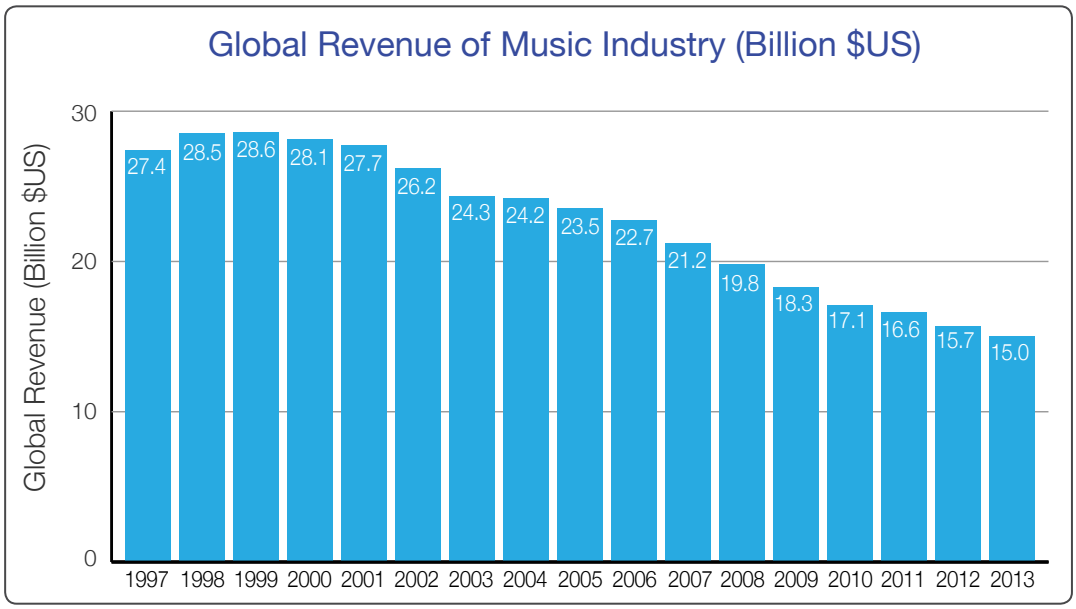
Perhaps the starkest example of the value vampire phenomenon has occurred in the recorded music industry. After experiencing more than a decade of digital disruption, this sector represents an object lesson in the impacts of value vampires. The music industry is also an example in which the value vampire was undoubtedly responsible for the overall market decline; waning industry revenues and profits could not be attributed to economic cycles or other sources.

In 1999, the music industry was riding high, as global revenues reached $28.6 billion (see Figure 2, next page). The average price for a compact disc (CD) was $14—the same as it had been in the early 1990s, despite a major drop in the cost of production.[3] Everyone in the value chain benefited from CD high prices. When a CD was sold in 1995, for example, 35 percent of the retail price went to the store, 27 percent to the record company, 16 percent to the artist, 13 percent to the manufacturer, and 9 percent to the distributor. Retailers alone made a 35 percent margin on the sale of a CD.[4] Consumers, however, went from feeling puzzled about the persistence of high prices as CD technology matured, to feeling exploited as compact discs sometimes retailed for over $20. Nevertheless, they kept buying CDs, owing to their superior sound quality when compared with cassettes, and because they were more portable than records. CD sales peaked in 2000, reaching nearly 2.5 billion units.[5]

Few music industry executives had any inkling that their industry would be thrust into the middle of the Digital Vortex, but the seeds of that disruption had been sown. CDs put studio-quality digital files in the hands of everyday consumers. All that was missing to catalyze the reaction was a

file format that could take that digital file, replicate it, and make it easy to distribute. This came with the MP3 format, standardized in the mid-1990s, which took the large amount of data from the CD, compressed it, and made it transferable. Either via "burned" CDs or over the Internet, consumers could finally duplicate and share reasonably high-quality digital music files with ease.

Figure 2
How Value Vampires Impacted the Music Industry



Source: IFPI, Recording Industry in Numbers, 2014

This digital disruption had a colossal impact, cutting industry revenue in half globally (again, see Figure 2). Only 46 percent of this reduced revenue came from physical music sales in 2014.[6] In addition, piracy costs the music industry an estimated $12.5 billion in revenues and $5 billion in profits each year.[7] Thirty billion songs were illegally downloaded on file-sharing networks and torrent sites from 2004 to 2009 alone.[8] The effects on several players in the value chain were swift and merciless, and the reverberations are still felt by incumbents that have managed to survive.

Let's examine what many consider to be the key player in the disruption that ensued, and what many deem the archetypal value vampire: Napster. We will view this example through the lens of cost value, experience value, and platform value to see how value vampires attack, and how they benefit end customers while concurrently weakening the market itself.

Napster was a file-sharing service launched in 1999 that enabled consumers to download music for free, and to share their music collections with others. By "ripping" digital files from CDs and converting them to the MP3 format, music lovers unshackled their favorite albums and songs from their physical bonds, and enabled others to acquire them at will over the Internet. Napster provided the platform that connected music fans with one another so they could swap files, or just download the files others had posted. Suddenly, instead of being forced to purchase

what many felt was an overpriced CD, consumers could get the songs or albums they wanted at no cost. Napster's business model is highlighted in Table 1, which details the complementary forms of cost value, experience value, and platform value that flowed to consumers.

Napster's business model (it was a "business" only in the loosest sense, of course) placed immense cost pressure on other players in the value chain—notably record labels and retailers—because a product that was sold at a huge markup was suddenly available for free. Cost and consumption were decoupled: Napster users could acquire the exact songs and albums they wanted without paying for them.[10]

At their most disruptive, value vampires fill a significant market need and scale their offerings quickly. In Napster's case, the unmet needs were 1) the ability to acquire the music customers wanted, while avoiding what they did not want, and 2) to acquire it immediately.

As noted above, in the world of CDs, music fans needed to make a sizable investment—$14 to $20—even if all they wanted was a single song. There was no option to buy low-cost singles for the vast majority of titles. Moreover, consumers had to travel to a retail store, which may not have had their desired CD in stock. With Napster, they could pick songs or albums, and get them right away. Users could also use Napster to

Table 1
A Free Lunch with Millions of Dishes

	Cost Value	Experience Value	Platform Value
Business Model	**Free Lunch:** Providing something for free, rather than requiring customers to pay for it.	**Power to the People:** Enabling self-service, disintermediation of middlemen, sharing of content and experiences **Right Here, Right Now:** Delivering goods, services, or value-added experiences in real time, or via new device form factors (e.g., mobile), dematerialization **Just 4 You:** Personalization of products, services, and experiences	**Connect the Dots:** Dissemination of information through a network or community of recipients; creation of marketplace capability **Chain Gang:** Ability to scale quickly; acquire and disseminate content through peer-to-peer dynamics; viral content
Customer Value	Full decoupling: customers could own a huge volume and variety of music without paying for it. Users shared their own music files (which they may or may not have paid for originally) and downloaded the music others owned for free.[9]	Users could pick the artists, albums, and songs they wanted and download them directly, and immediately. In addition, they no longer had to pay up to $20 for a CD, when all they wanted was an individual song—which they could not buy as a single in the existing music distribution model.	Connected millions of music fans who distributed content from their own machines using P2P sharing. P2P allowed Napster to quickly scale the number of songs and albums, and enabled a very low-cost structure.

Source: Global Center for Digital Business Transformation, 2015

discover new music beyond the limited selection offered by most FM radio stations, music video programming, or retail outlets.

Most important, Napster's P2P file sharing allowed it to scale incredibly quickly (at one point, Napster was the fastest-growing application in the history of the Internet, rising from 1 million to 50 million users in just seven months).[11] At its peak, the service boasted some 80 million customers, or nearly one in five Internet users at the time.[12] Users shared their music libraries, attracting others who did the same. This created what, for Napster, was a virtuous cycle in which the platform acquired both customers and content exponentially. In short, it was combinatorial disruption—a combination of cost value, experience value, and platform value—that made Napster so supremely disruptive.

The New Blood: ClassPass and Jet.com

Some might argue that the margin-compression effects of rampant cost-value creation are overblown, especially in the face of record corporate profits for incumbents. Plus, digital disruption over the last decade has tended to be most severe where the core product or service is highly "digitizable," as was the case with music and other information-centric offerings. We often hear this at the DBT Center in conversations with executives from companies that have "physical" offerings, such as pharmaceuticals, apparel, fossil fuels, and transportation. It is true that in "Digital Vortex" we found that the technology and media/entertainment sectors were closest to the middle of the Digital Vortex, meaning they are the most vulnerable to digital disruption over the coming five years. To be sure, a significant factor in that vulnerability is the "digitiz-ability" of the products and services in those industries. We also found, however, that digital disruption was accelerating for all industries, irrespective of the level of digitization of offerings. This means that disruptors are using digitally enabled business models to upend the status quo (Uber is one oft-cited example where the product—rides in an automobile—is physical).

Was Napster a compelling but singular example from a bygone era? Can value vampires create cost value, experience value, and platform value when offerings are less conducive to digitization? In the Digital Vortex, everything that can be digitized is digitized. So in the value chain of industries where products are inherently physical, "what can be digitized" may often be the channel or one step in the customer lifecycle, rather than the product itself.

To understand the wider applicability of the value vampire beyond so-called "information industries," we will examine two comparatively new companies—ClassPass and Jet.com—that, despite their relative youth, betray telltale signs of value vampirism. They are particularly interesting precisely because their offerings—fitness classes and household consumer goods—are inherently physical.

With a valuation reportedly topping $400 million,[13] ClassPass bills itself as a new kind of fitness membership: "Thousands of classes. One pass." Rather than paying to join an individual gym, ClassPass members pay a flat monthly fee to access all gyms in the ClassPass network on an unlimited basis (with a maximum of three classes at any one gym). This creates cost value for customers: the flat fee ($79 in most cities where the service is offered) is cheaper for anyone who

even occasionally takes exercise classes (say, three "drop-ins" per month).[14] As with online travel-booking sites, which are not actually providers of flights or hotel rooms, ClassPass is not itself a gym, but rather has reintermediated a well-established commercial relationship between gym and member. Gyms depend upon low levels of utilization for profitability (fewer customers using their facilities translate into lower variable costs to operate), so this places gyms in a tough competitive position when ClassPass members fill up workout sessions, increase utilization, and prevent other higher-paying clientele from taking a class.

ClassPass provides experience value because users enjoy dramatically more choice in where they exercise, the times classes are offered, and which types of classes they take, including yoga, pilates, cardio kickboxing, dance, indoor "spin" cycling, and many more that would not be feasible to offer under one roof. Platform value is generated via the network effect of its more than 4,000 participating gyms and fitness studios. ClassPass creates competitive pressure for gyms and fitness studios to sell their classes through the ClassPass platform, lest they be sidelined by the evolving market expectations of gym-goers. In fact, consumers can "recommend" to ClassPass that their gym be added to the network, too. In a classic pathology of value vampirism, this can lead to a downward spiral in margins for incumbent providers of these services as the network grows.[15]

The company has reportedly booked more than 4.5 million exercise sessions since launching in 2013, claims it is growing its user base 20 percent per month, and is now offered in more than 30 cities around the world. While the company has said it will pay out more than $100 million to participating gyms in 2015 alone, it will be intriguing to see how overall gym and fitness studio revenues change in the years ahead.[16]

Jet.com provides a striking example of another digital disruptor that may have the effect of a value vampire—not in a narrowly defined market such as exercise studios, but in a multisegment market that cuts across many different retail categories. Jet describes itself as "the shopping membership that gets you club price savings on just about anything you buy." It uses a mix of Free Lunch (substantially lower prices, rewards) and Hard Bargain (price transparency) approaches to offer significant discounts to consumers on a vast array of products ranging from groceries to appliances to jewelry.

Its strategy has been to promise consumers the lowest prices on the Internet (generally 10-15 percent lower than elsewhere online[17]), charge no margin on goods (in fact, it frequently incurs negative margin), and make revenue through annual club membership fees of $49.99, reminiscent of the fees charged by the incumbents the company is targeting: Costco and Amazon Prime. In October 2015, the company announced it was doing away with the annual membership fee and would instead charge retailers "commissions." Jet buys goods—at no markup for itself—from merchants who then fulfill the items directly to the consumer. When reporters from The Wall Street Journal recently tested out Jet, buying a basket of 12 items, they found "Jet's prices for the 12 items added up to $275.55, an average discount of about 11 percent from the prices Jet paid for those items on other retailers' websites. Jet's total cost, which also includes estimated shipping and taxes, was $518.46. As a result, Jet had an overall loss of $242.91 on the 12 items."[18]

Jet also creates impressive experience value for customers, particularly Just 4 You (greater choice) and Nonfriction (eliminating process inefficiencies). An explicit component of its business model is "Unbundled costs to give you choice. We took apart the traditional retail model, letting you avoid costs normally baked into prices. For example, if you don't need free returns on an item, we give you the choice to waive returns, so you save more."[19] This unbundling is a perfect illustration of the notion of "the value, not the value chain," explained in "Digital Vortex": consumers do not care about how incumbents have always done things or the operational constraints they face—they just like lower prices. Jet uses algorithms to create information advantages, such as by grouping products to create efficiencies in shipping that can translate into lower costs, and also more choice and flexibility in getting what the consumer wants. Jet's ability to yoke customer value and experience value together shows how long-standing competitive strategy constructs such as "cost leadership" versus "differentiation," for example, go out the window when firms practice combinatorial disruption. It also underscores why this customer value is so disruptive (i.e., because a consumer is not forced to prioritize low cost or quality of experience at the expense of the other).[20]

Jet's model is especially interesting because retailers are not themselves losing margin directly to Jet (although they are now are reportedly paying Jet referral fees, as noted above). On the contrary, Jet pays retailers their full online price, and the company's algorithms can actually translate into larger basket sizes as well (customers get more savings when they add more items to their cart). As a result, on the surface, this relationship is quite symbiotic—Jet amounts to another channel for other retailers, and a platform intermediating a "two-sided market" of merchants and consumers. However, the bigger-picture question is whether Jet is waging a stealth price war on the entire retail industry by creating cost value for customers on a grand scale, and further conditioning buyers to expect the absolute rock-bottom price on everything. E-commerce researcher Boomerang Commerce estimate Jet is cheaper than Amazon on fully 81 percent of products.[21]

Since its launch in July 2015, the company has amassed more than 100,000 users (a number that may grow rapidly in the wake of a reported $100 million advertising campaign), and is seeking a valuation north of $3 billion.[22] The company concedes it has no plans to turn an operating profit for at least five years, but maintained initially it will do so, once a threshold of 15 million users is reached (how its path to profitability is impacted by the recent move to stop charging for memberships is unclear).[23] This raises questions about the sustainability of such a model. But as we have seen with value vampires in the past, such as Napster, where it would be hard to argue that Napster ultimately "won," the firms in this market compelled to engage in a competitive "race to the bottom" may be the collateral damage of this potentially profound digital disruption.

Value Vacancies

Digital disruption is not purely a bad-news story for incumbents. In fact, there is another scenario that presents itself as industries move toward the center of the Digital Vortex: the possibility of capitalizing on "value vacancies." A value vacancy (Figure 3, next page) is a market opportunity that can be profitably exploited via digital disruption. (In "Digital Vortex," the DBT Center defined

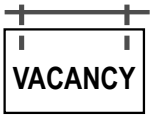
digital disruption as "the effect of digital technologies and business models on a company's current value proposition, and its resulting market position.") These market opportunities can be in adjacent markets, entirely new markets, or digital enhancements to existing markets. If value vampires constitute the threat posed by digital business models, value vacancies represent the upside. Incumbents react defensively to value vampires but can go on the offensive to pursue value vacancies.

In "Digital Vortex," we took pains to underscore that incumbents could outmaneuver digital disruptors if they emulate the agility and speed of their upstart competitors. The ability to sense and occupy a value vacancy plays an enormous role in the success of an incumbent that finds itself in the center of the Digital Vortex. The industry unbundling and recombination characteristic of the Digital Vortex means many different types of firms, from many different sectors, can pursue market opportunities and prevail. This is partly what makes value vampires scary—they can come after your market seemingly out of nowhere—but also what makes value vacancies so crucial to competitive success.

As in the situation of a hotel vacancy, occupants of a value vacancy must recognize that the space is theirs on a temporary basis, and that eventually, someone else will want the room. Unlike classical competitive constructs of white space, value vacancies are, by their very nature, fleeting. As Rita Gunther McGrath observes in her book *The End of Competitive Advantage*, managing amid this perpetual change is a formidable task: "Basing your strategies on a new set of assumptions can seem daunting, even if you know it's the right thing to do. Even more challenging is shifting the ultimate goal of your strategy from a sustainable competitive advantage to a transient one—you can no longer plan to squeeze as much as you can out of any existing competitive advantage unless you are already well into exploring a new one."[24]

As noted, the competitive landscape of the Digital Vortex era—driven by industry unbundling, combinatorial disruption, and exponential change—resembles a kaleidoscope of ever-changing pieces, more so than a stable mosaic. This aspect of the Digital Vortex represents a blunt corrective to the notion of a so-called "blue ocean strategy," in which innovators secure for themselves a quasi-permanent standing that "makes the competition irrelevant."[25] The idea of "market boundaries"—the interstices between opportunities, firms, and their competitive positions—is less and less relevant. Value vacancies are not necessarily competitive voids, and do not require *de novo* market formation, but are best understood as opportunities to create cost value, experience value, or platform value for customers by exploiting digital tools and business models.

Figure 3
Value Vacancies Defined



A market opportunity that can be profitably exploited via digital disruption.

- Allows incumbents to go on offense; represents the upside of digital disruption for established players
- Can be in adjacent markets, entirely new markets, or digital enhancements to existing markets
- Tends to be temporary due to competitive dynamics of Digital Vortex (industry unbundling, recombination, exponential change), rather than long-lasting
- To occupy a value vacancy, incumbents must move rapidly and practice "combinatorial disruption" that creates customer value on multiple fronts

Source: Global Center for Digital Business Transformation, 2015

As we also discussed, the most dangerous value vampires are adept at combinatorial disruption, fusing cost value, experience value, and platform value to create step-change improvements for customers. To occupy value vacancies, companies also must be well-versed in combinatorial disruption—using seemingly disconnected technologies and business models to create new markets and synergies. This level of customer value is often the price demanded to dwell in a value vacancy.

The Value Vacancy Expert: Apple

In "Digital Vortex," we highlighted Tesla as an exemplar of combinatorial disruption, leveraging its innovative offerings in software and battery power to disrupt multiple industries. Tesla is indeed a great example of how to use digital technologies and business models to occupy value vacancies. But let's consider another company famous for its ability to capture new markets—not a "dorm-room disruptor" like Napster, but instead a Fortune 500 company: Apple. Apple provides a clear example of how a large enterprise can be a disruptor, rather than a "disruptee."

Apple is now the largest distributor of recorded music in the world. Fifteen years ago, such a statement would have been unthinkable. Apple was not even in the music business, and was viewed by some as a sort of niche player in the technology industry. It is now a leading incumbent in the smartphone business, again a market it came to dominate from a position of an outsider. Apple cemented its position as a market leader in personal computing, not just by adding features and functionality to its core products (Mac desktops and laptops), but by revolutionizing an entire category of computing: tablet devices. There is no need to revisit the meteoric rise of Apple under the leadership of Steve Jobs. Instead, we should consider Apple from the standpoint of how its story exemplifies value vacancies, their importance in predicting competitive success, and how they are perpetually contested by disruptive rivals.

Apple astutely recognized the music industry was ripe for disruption, not simply because incumbents were charging too much for music, but because they did not sell music the way customers wanted to buy it: by the song, in a format that made it easy to listen to—wherever and whenever they wanted. The market had already undergone some early-stage disruption in the form of digitization and dematerialization (CDs, MP3 file format, P2P file sharing), which suggested opportunities to create cost value, experience value, and platform value.

At its Macworld event in 2001, Apple introduced iTunes and ushered in a new phase of digital disruption. What was then a venue for digital music sales (movies, television shows, books, and other categories were added later) was not merely an e-commerce front-end; Apple created a digitally enabled ecosystem that monetized digital music, and offered customers an integrated, elegant device (the iPod, and later iPhone and iPad) on which to enjoy it, no matter where they were. That ecosystem approach would prove instrumental in the company's ability to occupy future value vacancies, such as when the company introduced the App Store.

While iTunes did not offer its customers free music, it sold albums for less than CDs ($6.99 to $9.99), and unbundled songs from albums, selling them for 99 cents to $1.29.

iTunes also allowed customers to organize their music and create their own "albums" with playlists. In subsequent years, it added analytics with Genius, which intelligently pairs songs that go well together, based on data from millions of iTunes customers (i.e., platform value). Most important, iTunes brought all the music customers wanted to buy in a single online store. Customers could pay by entering their Apple ID, which was connected to a credit card, removing the "friction" of purchasing music from stores or multiple sources. Apple took the innovation of digital music and combined it with a device that made it portable and a method for organizing and acquiring it. In the process, it seized a value vacancy that disrupted the physical music value chain, and dealt a crippling blow to incumbent consumer electronics firms and retailers.

Apple was able to occupy a value vacancy in digital music distribution because it satisfied a market need that music labels and retailers had an interest in not meeting. If digital disruption means one thing, it is the end of "artificial" revenue in which customers are forced to pay for things they do not value (see Table 2).

Apple's music sales have been in a slow but steady decline over the past three years as the value vacancy it successfully carved out and inhabited has created a wave of new innovators. To fend off attackers like Pandora and Spotify, Apple introduced its own streaming service, Apple Music, and a 24/7 radio service called Beats 1 to provide new sources

Table 2
What You Want, Where and When You Want It

	Cost Value	Experience Value	Platform Value
Business Model	**Hard Bargain:** Tough negotiations with music labels, which needed to monetize digital music **Pay as You Go:** Paying only for what is used / consumed	**Power to the People:** Self-service **Right Here, Right Now:** Immediate gratification (immediate purchases) and music could be enjoyed anywhere (iPod, iPhone) **Just 4 You / Robo-Tasking:** Genius created playlists automatically using analytics; suggests songs and artists for purchase on iTunes store that align with personal tastes **Nonfriction:** Pay by entering Apple ID	**Chain Gang:** Infinitely scalable one-to-many distribution model **Connect the Dots:** Connected music buyers and labels / artists via an e-commerce platform
Customer Value	Customers could pay only for the music they wanted (singles, albums) Digital music prices significantly lower than physical, even for full album	iTunes and iPod / iPhone made it easy to obtain, organize, and consume music	Customers could acquire a broad range of songs and albums, legally and with high file quality

Source: Global Center for Digital Business Transformation, 2015

of revenue (such as advertising) and create or extend cost value, experience value, and platform value for customers.[26] With Pandora and Spotify both threatening the music business in a way not seen since Napster (and iTunes) more than a decade before, Apple—the music-industry incumbent—must respond. Winners in the Digital Vortex know they must constantly pursue and occupy value vacancies, lest they themselves face revenue stalls, margin compression, or obsolescence. Apple's 2014 launch of the Apple Watch and Apple Pay, even a rumored foray into the automotive business, are the latest in a series of strategic moves to continue to invest in value vacancies and secure its position in the future.

Room at the Inn: Dollar Shave Club and WeChat

As was the case with taxi companies, firms that sell razor blades would probably be forgiven in years past for not considering themselves on a high-velocity trajectory toward the center of the Digital Vortex and competitive disruption. This market has indeed historically tended toward stability and is dominated by two giants—Procter & Gamble (which owns the Gillette brand) and Schick, a division of Energizer Holdings. For its part, P&G is, in fact, a world leader in the use of information technology to create business value, with disruptive innovation processes that have become leading case studies of digital business transformation.[27]

However, several innovative companies are battling for the $33 billion men's grooming product market, and this space may be set for a major shake-up. Dollar Shave Club is one disruptor challenging the Gillette-Schick duopoly with a deft combination of cost value and experience value. Customers of Dollar Shave Club reportedly pay between one-third and one-half of what P&G and Schick charge for a razor of comparable quality. Instead of purchasing a pack of razors at a store—an experience that can be cumbersome and exasperating, as it is typically under lock and key—customers pay a subscription to have razors delivered to their door.

The rapid success of Dollar Shave Club has captured the attention of analysts and investors, and the company is now valued at over $615 million.[28] More important, the business model that Dollar Shave Club has championed is rapidly winning market share. Eight percent of all razors sold in the United States are now sold by Dollar Shave Club and similar models (such as Harry's), up from virtually zero in 2012. Its rapid ascent caught P&G and Schick by surprise, and growth is expected to increase by 25 percent per year for the next five years. As one P&G executive recently stated, "The growth has been very significant, and consumers' needs and habits are changing."[29] The success of Dollar Shave Club further underscores that simply because a firm's products are physical is not a guarantee of safety—digital disruption can impact all sectors. But as we saw with other value vacancies, such as iTunes, the hunters are becoming the hunted: P&G has introduced a Pay-as-You-Go-based model of its own for buying razors in hopes of occupying the value vacancy associated with subscription-based consumption of shaving products.[30]

WeChat, a mobile messaging app developed by Tencent in China, is used by 600 million people.[31] Sensing a value vacancy in the consumer financial services market, a completely different industry than its own (communications), WeChat launched a new service to offer consumer loans via its app. The service, called Weilidai ("tiny loan" in English), allows users to borrow up to 200,000 yuan ($31,350) and receive approval within minutes.[32] Users provide their bank account information and

other basic personal information, which Weilidai uses to assess creditworthiness, utilizing its own data and loan status information from the People's Bank of China.

Through its new service, WeChat is moving to fill a value vacancy using several types of value. The Weilidai service offers cost value through the provision of certain advantageous loan terms, such as not requiring collateral. It offers significant experience value to consumers because they can simply pull out their phones, enter a few details, and obtain a loan in minutes. There is no need to travel to a bank office, or even to sit down in front of a computer. This is a much better experience for borrowers than the traditional, lengthy and paper-intensive process of obtaining a loan. WeChat also offers platform value to consumers because it is highly likely that consumers are already users of the app and able to access the WeChat platform easily on their phones. Because the app integrates many other types of functionality (such as messaging and food ordering), users benefit from being part of a larger platform—a "one-stop shop."

WeChat's owner, Tencent, also stands to benefit in the longer term from this new offering through the relationships it will build with consumers in the area of financial services. By gaining a foothold in consumer finance with this offering, the company sets itself up to cross further industry boundaries in the future.

Conclusion

In the froth of the Digital Vortex, change is the only constant. An organization must be able to change rapidly as conditions evolve. Companies that cannot innovate, take decisions, or execute at speed are vulnerable to digital disruptors that specialize in doing so.

Whether a firm is coming to grips with a value vampire, or is seeking to inhabit a value vacancy, it must possess what we referred to in our earlier paper, "Digital Business Transformation: A Conceptual Framework," as "digital business agility." At its most basic, digital business agility is the capacity of an organization to use digital means to change. Digital business agility is actually best thought of as a kind of meta-capability, which in turn rests on three underlying capabilities: hyper-awareness, informed decision-making, and fast execution.

The average lifespan of "white space" is dwindling. Predicting the future in a kaleidoscopic landscape governed by exponential change is increasingly unmanageable. These conditions are endemic to the Digital Vortex, and make "the capacity of the organization to use digital means to change" the uppermost concern. In their book *The Only Sustainable Edge*, John Hagel III and John Seely Brown urge leaders to move beyond the orthodoxy of "core competencies"[33] to contemplate a broader notion of "accelerated capability building" as the source of durable advantage. Capabilities, in their framework, are the "recurring mobilization of resources for the delivery of distinctive value in excess of cost."[34] Being able to mobilize resources—both tangible and intangible—across an ecosystem of partners (rather than just inside the four walls of a lone firm) to speed innovation and create new customer value is essential to competitive success in the Digital Vortex.

Consider a sporting analogy: imagine one firm is the best badminton player in the world. Then the badminton "industry" is disrupted, and the new opportunity is in boxing. This company is

ill-equipped for the new competitive scene. Its deep specialization in badminton is no longer a strategic asset. But if that company had not invested exclusively in badminton, and had instead worked on ensuring it had a combination of flexibility, muscle mass, hand-eye coordination, and cardiovascular fitness, it would not matter if the new competition were boxing, weight-lifting, or darts—it would be positioned to adapt. Digital business agility is the equivalent of the "fitness" of the firm.

Companies that possess digital business agility respond quickly and effectively to emerging threats to their business, and seize new market opportunities before their rivals even notice them (hyper-awareness). They use information advantages to dissect sources of value, and formulate winning strategies and value propositions (informed decision-making). And they move quickly to change course, counter threats, and capitalize on opportunities, tapping into platforms to create exponential change (fast execution). These capabilities enable them to:

- Differentiate and bulletproof their core businesses, making it harder for digital disruptors to replicate or supersede the value they provide
- Wring maximum value from declining businesses when value vampires hover
- Move into value vacancies that all companies will need in order to maintain growth in the wake of disruption

It is no coincidence that the same companies—Amazon, Apple, Google, Netflix, Tesla—keep coming up in discussions about digital disruption. All these companies recognize that the struggle for market supremacy in the Digital Vortex is never-ending, and all have systematic strategies to occupy value vacancies over and over again. This is why we see Amazon launching a space venture, Apple moving into payments, Google branching into self-driving vehicles, Netflix undertaking television production, and Tesla entering the energy storage business. This is motivated by both greed (the growth potential of value vacancies) and fear (the understanding that they themselves are vulnerable to attack). Whether these specific investments will pay dividends, or are a result of vision or hubris, is immaterial: all depend upon a high level of digital business agility.

Over the next several months, the DBT Center will introduce a series of new research findings that spell out strategies for dealing with digital disruption—both the threats and the opportunities—along with a concrete roadmap for transforming the business to create a sustainable competitive posture in the Digital Vortex. Our forthcoming paper, "Disruptor and Disrupted: Strategy in the Digital Vortex," presents a series of strategies firms can use when confronting digital disruption, either defensively, as with a value vampire, or when going on offense, upon detecting a value vacancy. It will also delve more deeply into the pillars of digital business agility: hyper-awareness, informed decision-making, and fast execution. Later, the DBT Center will also release "People Leadership in the Digital Vortex," which examines some of the workforce transformation levers firms must address to bring about digital business agility and drive true transformation within their organizations.

Stay tuned.