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Ecosystem 2.0: Climbing to the next level

After a first wave of trials, incumbents are shaking up value chains to attract new ecosystem customers—and tap potentially huge pools of value.

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As COVID-19 accelerates customers' migration to digital, with consumers of all ages going online for everything from food to cars to doctor visits, some companies may feel that the channels, platforms, and approaches they have relied on for years are burning up faster than ever.

The pandemic has magnified a previous trend in which many traditional corporations tried to create or participate in digital ecosystems, only to fall short. These ecosystems consist of interconnected sets of services through which users fulfill a variety of cross-sectoral needs in one integrated experience. Today's dominant ecosystems were launched by ascendant tech companies, which have used hyperscale platforms to compete with, disintermediate, and often substitute for the offerings of traditional competitors by controlling customer interfaces and control points such as search, advertising, and messaging.

The market understands this power. Most of the companies with the world's highest market capitalizations are tech companies that generate much of their revenue from the digital ecosystems they created (Exhibit 1). Many of these ecosystems are B2C plays. Others, such as Jabil's, represent B2B spaces. Some companies tackle both: Amazon, for example, ties together e-commerce, cloud computing, logistics, and consumer electronics, while China's Tencent provides services including social media, gaming, finance, and cloud computing.

Can more traditional competitors play this new game? To shed light on that question, we recently looked at the ecosystem strategies of 100 incumbent companies. Our findings suggest there is a path for more established players to use ecosystems to level the playing field. This path has been opened up, in part, by the ubiquity of digitization

Exhibit 1

Six of the world's top seven companies are ecosystem companies.

Top 7 companies by market capitalization,[1] $ billion

[1]As of August 5, 2020.
Source: S&P Capital IQ; McKinsey analysis

and data and the emergence of advanced analytics, tools that give companies better insight into customers and market niches, allowing them to personalize products as never before. The path has also been clarified by the mistakes incumbent companies made in their early efforts to participate in digital ecosystems, during an era that might be called Ecosystem 1.0. Absorbing those lessons while making the most of new digital technology can help companies move up their industry's power curve in a hurry, executing on practices that turn so-so ecosystem plays into markedly better ones. That's the promise of Ecosystem 2.0.

An evolving model

How do ecosystems work? For starters, they create value along two dimensions. They allow participants to consolidate a range of customers, often across sectors. Think of this as the horizontal vector. On the vertical vector, ecosystem participants strengthen or even dominate touch points along customer journeys (both B2C and B2B). Of course, ecosystem participants don't try to do this by building everything they need in-house. Instead, ecosystem organizers provide incentives to and partner extensively with other participants, who may be within their traditional industry boundaries or outside of them. These moves can unleash distributed innovation and create new efficiencies along value chains to improve customer experiences while opening new avenues of value creation for a wide range of participants.

To participate successfully in ecosystems, traditional companies must often change the way they think about customers. Instead of limiting themselves to services within their historical industry borders, they may venture beyond in an effort to serve customers from one end of the customer journey to the other. For instance, opportunistic companies in the housing market—such as the United Kingdom's ZPG—are trying to create end-to-end ecosystems that may span search, property comparisons, mortgage shopping, household moving, switching phone and cable companies, and access to home-improvement professionals. In fact, we estimate that at least a dozen sectors, including B2B services, mobility, travel and hospitality, health, and housing, are reinventing themselves as vast ecosystems, networks of networks that could add up to a $60 trillion integrated network economy by 2025.

These ecosystems develop in virtuous cycles through network effects. By offering products and services that individual companies could not create on their own, ecosystems draw in more and more customers, which creates even more data, which allows artificial intelligence (AI) to fashion even better offerings, which in turn further improves processes and wins more customers. As ecosystems bridge openings along the value chain, they create a customer-centric, unified value proposition in which users can enjoy an end-to-end experience for a wide range of products and services through a single access gateway. Along the way, customers' costs go down even as they gain new experiences, all of which whets their appetite for more.

Consumers and companies understand the appeal. Seven in ten consumers we surveyed said they value ecosystem offerings that simplify their purchase journey. Perhaps more surprisingly, 60 percent of US banks we surveyed said they were likely to form or join an ecosystem.

Major technology vendors and suppliers are fueling the growth by keying their strategies to ecosystem players. They furnish hardware and software for platform building and set up data exchanges (application programming interfaces) for ecosystem partners. The growth of 5G communications is helping to make interconnections faster and more seamless, while "as a service" cloud offerings have multiplied the ways partners can plug into ecosystems. Advanced technology providers are also providing the tools to manage vast databases and using AI to improve how ecosystems understand and attract customers.

Regulators also may be helping out, as they start to sort through the risks and benefits of a more networked economy. In several regions of the world, regulators are looking at ways to level the playing field between digital platforms and traditional companies. The frameworks emerging from their work could ensure data security, portability, and interoperability for consumers and ecosystem partners.

The lessons of Ecosystem 1.0

These technology enablers and regulatory patterns hold considerable promise for incumbent players looking to play the ecosystem game. No, not every company is going to be an Amazon or a Tencent. The ecosystem strategies that companies pursue will vary in scope and ambition, as they should. But our analysis suggests that the efficiencies and potential of ecosystems are such that even a moderate success built on a moderate budget can lead to measurable gains.

To evaluate the success of existing strategies and operating models, we studied 100 traditional companies that have launched ecosystem strategies.[1] While there is a lot of activity across this group, few incumbents have achieved significant financial gains. About half have merely started experimenting with ecosystems, perhaps via a low-risk experiment or cross-sector partnership. Some 40 percent have gone far enough to gain customer traffic and clear a viable path to meaningful economic impact. No more than 10 percent of incumbents have established ecosystems that have gained sufficient scale to deliver 5 percent or more of company revenues (Exhibit 2).

The fact that relatively few incumbents have registered big gains may not be surprising. All these companies began in the nondigital world, and most have been experimenting with ecosystems for only a few years. As they do, many encounter organizational hurdles in addition to technological ones. As we dug into their experiences, though, we were able to carve out four lessons from Ecosystem 1.0.

Lesson 1: Go deep or go home

Going deep does not mean that every incumbent should make a bet-the-company move into organizing or participating in an ecosystem. It does mean that companies should understand the complexities and unfamiliar opportunities that ecosystems present. Many companies are constrained by their own incrementalism. To protect existing lines of businesses, they think small. But the very reason ecosystems exist is to mobilize and incent diverse participants to collectively address the end-to-end needs of consumers.

Doing so requires deep strategic thinking about the key touch points along relevant customer journeys. It means probing value chains for areas where smart shifts can drive big improvements, the way Amazon revolutionized customer experience with one-click shopping and one-day delivery. Even if your company's participation and investment in an ecosystem are small, your thinking about the customer journey must go deep.

Lesson 2: Move strategically, not conveniently

In launching an ecosystem, incumbents too often covet revenue pools that are on the doorstep of their core businesses. They believe that making small, intuitive moves, such as adding a few clever features or apps to their website, is sensible and sufficient. For example, one bank buffed up its online-lending app, trusting that design tweaks and an advertising push would lure borrowers from beyond its core lending businesses and geographies. Executives were disappointed: few customers even tried the app, much less used it to secure a loan. Why? Because the app didn't lower borrowing costs or make interactions easier—two key elements of any ecosystem's value proposition to customers.

The bank's team hadn't thought deeply about what would be necessary to shift new customers to their offering. It never invested in the digital talent or capabilities needed to discern user pain points and deliver products that addressed those problems at scale.

Lesson 3: Partner with vision

We know of many cases where two CEOs, keen on duplicating the marquee successes of digital leaders, launched ecosystem initiatives with a burst of enthusiasm and bold

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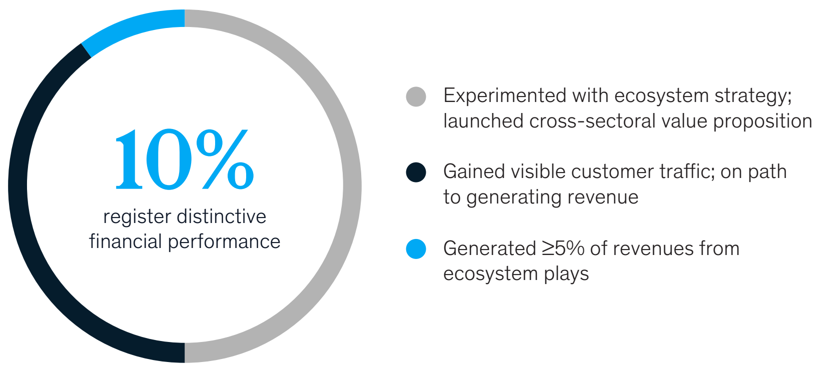
[1] Some companies in our sample have announced plans for ecosystems and provided details of their strategies.

Exhibit 2

Many have experimented with an ecosystem strategy, but few have succeeded in creating significant value.

Share of companies by extent of ecosystem play,[1] %



[1]Sample comprises established companies (often market leaders) in a particular industry that have moved to noncore activities; excludes Alibaba, Alphabet, Amazon, Baidu, Google, Netflix, and Tencent.

visions of combining forces along value chains or pursuing attractive new markets. Invariably, however, their plans foundered on details such as which points along the value chain the company is best positioned to control versus those that partners should own, how participants could mesh capabilities, or how they will jointly manage the novel operating model of their ecosystem.

This kind of failure to develop a deep shared vision prevented an online advertising company and a financial institution from trying to build an ecosystem with breakthrough potential for both. The advertiser rejected the revenue-sharing proposal, and the financial player ended up spending heavily on a gap in its value chain that could have readily been filled with the advertiser's analytics skills. Neither company had a clear notion of how pooling their expertise would bring in additional customers or revenue. Nor, perhaps, did they share a convincing long-term vision of where their market was headed, a vision that would clarify who would do what while lowering perceived risk for the rest of the potential participants they would need to fully build an end-to-end offering for customers. As a result, both companies failed to expand from mere regional players to national powers.

Lesson 4: Clear the path to impact

Some incumbents do the hard work of deliberating carefully about where to play along horizontals and verticals, assemble all the necessary capabilities for the task, and yet fail to achieve scale or meaningful financial returns. One reason this can happen is that companies don't get the organizational model right, which itself represents a failure to integrate the lessons of experiments and trials of Ecosystem 1.0.

Here's what can go wrong inside the four walls of your company: functions or business units may resist change because they aren't persuaded of the potential value; incentives aren't tailored to nurture ecosystems; data are siloed; leaders aren't role models who mobilize change. Ecosystems require strategic and financial foresight, but to succeed they also require careful design and governance planning within the organization to serve the new ecosystem approach.

The principles of Ecosystem 2.0

When embarking on ecosystem strategies, many companies use standard frameworks to determine which new revenue pools to pursue. As a result, they rarely look beyond the obvious adjacencies. What's needed for the evolving world of Ecosystem 2.0, however, is a holistic approach guided by the following three principles:

1. *Use strategic mapping to identify control points.* Holistic ecosystem strategies spring from a top-down view of the potential span of impact, as well as a nuanced approach designed to nurture multiple initiatives by the many players participating in an ecosystem. The first step, whether you are organizing or participating in an ecosystem, is mapping against your existing business the horizontal and vertical dimensions of the large ecosystem in which you operate or would like to operate. The map will illuminate "control points," or places on the map where the company could maximize impact on the value chain by deploying or attracting the right capabilities into the ecosystem. The map will also reveal how far removed your business is from these control points. Companies that find themselves closer to a control point might look to organize an ecosystem around it. If they find themselves further away, they might look to move closer or choose instead to participate in ecosystems formed by more natural owners of a given control point.

   In general, control points are where capabilities can best be deployed to remove pain points and smooth the course of customers' journeys. Mastery of one or more of these control points provides the base for horizontal and vertical moves that can propel your company into new sectors, new sets of customers and business partners, and even new businesses.

2. *Lock in impact with precise capabilities.* Mapping is a forcing mechanism for prioritizing control points. Companies that want to create value from the control points they have identified must then assemble and attract the capabilities needed to improve customer journeys. To do so, they may have to invest in reworking and tailoring existing capabilities, or they may need to attract partners that can fill the gaps. The elements that incumbents often lack are advanced digital skills such as AI, functional know-how such as digital marketing, high-level supply-chain and logistics skills, and innovation capabilities to increase the value of products and services. As we mentioned, tech companies have made it easier than ever for incumbents to find appropriate partners to deliver such digital expertise. Articulating the right vision for where the market is headed, combined with creating a platform that, by lowering interaction costs and boosting learning, lowers the investment costs for other companies, helps make the whole greater than the sum of its parts and promotes distributed innovation.

Locking in impact with appropriate capabilities at these control points is how ecosystems and the companies in them extend their reach and create value. Successful companies work on control points with focus and intentionality to align ecosystems precisely with what customers want and expect—and to attract into the ecosystem the partners they need to accomplish that.

3. *Design the organization for many participants and customers.* Successful ecosystems are designed to win market gains and create value for all participants. That's certainly what investors want to see. But companies that intend to orchestrate or participate in ecosystems must balance a tricky set of issues both within and beyond their own boundaries. Internally, they have to find the right organizational model. Here, companies typically err by going to extremes. One extreme approaches too narrowly, through an organizational silo—say, tackling the entire housing ecosystem through the department or function that works on mortgages. In this model, capabilities will be lacking, and achieving scale difficult. At the other extreme, companies use the venture-capital model to buy companies they think are needed, such as technology-platform providers, and then struggle to integrate the acquisition with their current capabilities, go-to-market approaches, and data systems. The right model will fall somewhere in the middle, tailored to both internal and market context.

Externally, orchestrating companies must encourage collaboration, in part through transparent sharing of data, in part by being careful to leave value on the table for all participants (rather than hoarding all of it), and in part by thinking through and designing mechanisms for dispute resolution and the cross-ecosystem learning that collaboration enables. Particularly for companies in the orchestrator's position, success requires protocols and designs from which all participants benefit and profit. That includes benefiting customers, of course, which is perhaps the most difficult piece of all. One financial-institution CEO girding for the challenge told us, "We proved we can do this for 20,000 customers. Now we need to scale it to 20 million."

Ecosystem 2.0 in action

In theory, participating successfully in ecosystems or orchestrating them can sound like a high-wire act. In practice, it may not feel as daunting. Let's look at the experiences of three incumbents that successfully applied the principles from the previous section.

Mastering control points

At one global bank, leaders decided they would finally confront a problem that had bedeviled them for years: how it could better serve the small-business market. A marketing push and the addition of a small-business area to their well-regarded website had done little. Executives realized that if they were ever to make a successful horizontal move into a market crowded with sophisticated competitors, they needed a much better understanding of the needs of small-business customers. They assembled a team from business development and lending operations to map out small-business journeys and identify the biggest pain points. The much-needed exploration returned valuable discoveries. The team found that their traditional value-chain strengths, which served large corporate clients well, were a poor fit for small-business owners. But their efforts did identify two potential control points: small businesses needed help initiating new business propositions and managing their ongoing businesses effectively.

Bank leaders took an Ecosystem 2.0 approach to the problem. To get an edge in the first control point, they went outside to partner with a company specializing in company registration and launch-related services. But for the second control point—delivering targeted services to help improve business administration—the team found that they had many of the relevant assets and expertise in-house. Senior management authorized a substantial investment to ensure that this in-house group could deliver a set of distinctive small-business services. The team then forged a partnership between an outside invoicing and accounting-services player and an in-house design team to integrate its partnership offerings with its existing banking services.

When it had armed itself with substantial services at critical small-business control points, the bank tested its offerings in a small market and quickly began attracting new customers. Top leaders authorized the significant investment needed to scale the new business line, sweetened the revenue-sharing agreement with its partner to secure this critical alliance, and approved plans to further develop the nascent ecosystem.

Reworking the value chain

An industrial-products manufacturer faced new global competition and slowing growth. During a yearly strategic review, senior leaders asked the strategy team whether there were opportunities along its value chain that could capitalize on the company's sizable base of loyal customers. The manufacturer's products were equipped with sensors to create data to evaluate performance, which supported an existing after-sales service business. Strategists reasoned that there might be additional control points to exploit and, in collaboration with marketing and sales, discovered that many of its customers were relatively inexperienced in leveraging data analytics to guide businesses decisions and were eager for better insights. The company decided to offer its own data-analytics services, and it set about creating an ecosystem of partners who could make that happen.

The central challenge was combining the company's proprietary data from equipment sensors with outside data and number-crunching skills. To add a macro lens, the company teamed up with a well-regarded forecaster of economic and industrial business conditions. It partnered with a start-up and a large global transportation company that both had expertise in AI-backed logistics. It brought in another promising start-up that used AI to generate B2B end-customer insights for buyers of its industrial gear. This cobbled-together data-services business delivered significant share gains in its very first year, helped defer a planned move into the space by a major digital player, and attracted users beyond the company's core product lines. The company eventually partnered with a global manufacturer to expand into new niche markets.

From vertical to horizontal

An emerging-market bank had successfully expanded into several new segments. Wherever it went, the bank had a commanding ecosystem control point: thanks to its superior analytics capabilities, it could introduce seamless digitized banking journeys that were very popular. With strong brand recognition across its markets and an increasing number of customers reaching middle-class status, the bank's top leaders decided the time had come to exploit that control point horizontally. Believing that their proven platform might attract customers in other sectors, they led a mapping exercise looking at consumer journeys in sectors well beyond traditional banking and finance.

Combining that research with analytics that discerned purchasing trends among its banking clients, leadership decided that a bold lateral move into e-commerce, travel, food and dining, and even health services might pay off.

They had no illusions about their own organization; they knew it lacked the entrepreneurial capabilities for such an effort. So they set up a new entity to build and manage a platform that came to include dozens of partners. A few years later, the company is attracting several million customers each month to its nonbanking ecosystem offerings, while its banking and finance businesses have grown rapidly as the ecosystem has expanded.

Just a few years ago, incumbent companies were only awakening to the shifts in competition and organization that ecosystems might bring. Since then, players have accumulated lessons and notched successes. The focus now is on proven practices that lead to scale and improved returns. In the emerging world of Ecosystem 2.0, data are the holy grail, the breakdown of sector borders is a given, and successful players try to lock in control points to expand horizontally and vertically across the grid. Every company needs to be watching this trend closely, since the players that first master the new architecture are likely to capture sizable benefits. Q

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