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Lessons From Hollywood's Digital Transformation

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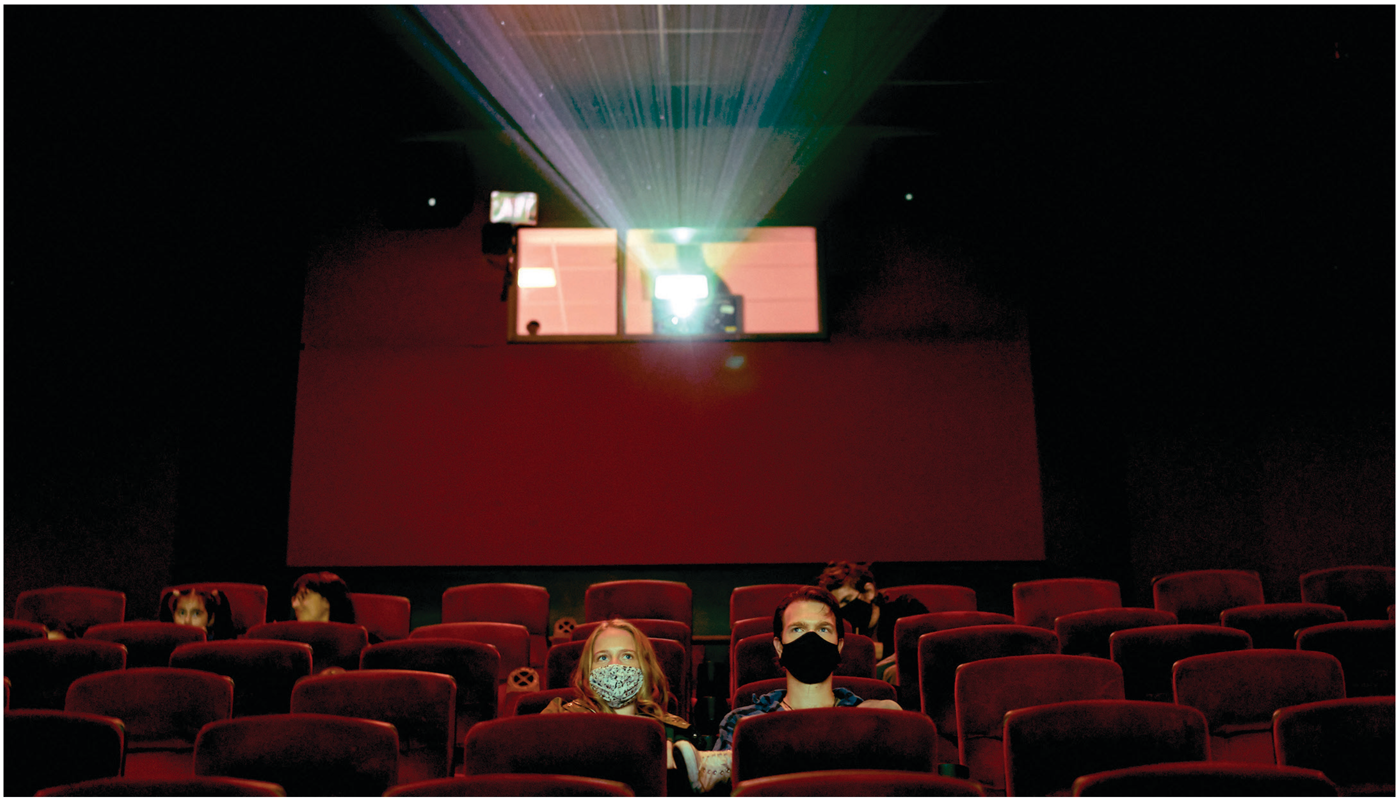

When business leaders talk about digital transformation, they often pay more attention to the word *digital* than the word *transformation*. That's an easy but serious mistake. When the subject comes up, the first question that anybody should ask is this: What kind of transformation are we really talking about, and how does it differ from the other market transformations my firm has always faced?

I have some thoughts about that. For the past 20 years, in my research and my teaching, I've focused on how digital transformation impacts firms and markets — and that work has allowed me to identify two important characteristics of digital transformation. Each creates new challenges and opportunities for industry leaders.

The first is that digital transformations tend to create abundance where there was once scarcity. After all, what could be more abundant than digitally encoded information that can be reproduced an infinite number of times, at no additional cost, and without loss of quality? Because most business models are based on the idea of controlling scarce resources, this aspect of digital transformations can be very disruptive and even hard to conceptualize.

The second is that digital transformations often affect many areas of a firm's competitive environment at the same time. This expanded scope can cause experienced managers who are used to evaluating threats from individual market transformations to miss the combined threat caused by multiple digital changes that are occurring simultaneously.

Let's consider the experience of the motion-picture industry over the last decade, which illustrates how these two characteristics can create challenges for managers, even experienced ones at historically dominant firms.

In 2015, my colleague Rahul Telang, Trustees Professor of Information Systems at Carnegie Mellon University's Heinz College of Information Systems and Public Policy, and I invited a senior executive from a major Hollywood studio to speak to our class about how technology was changing his business. At one point, Rahul asked him whether he was worried about the threat that new entrants such as Amazon, Netflix and Google might pose to the market power of major studios. The executive scoffed. “The same six studios have dominated my business for the last 100 years,” he said. “And there’s a reason for that.”

This executive was right: The same six studios *had* dominated their industry for over 100 years, during which time they’d faced massive shifts in almost every aspect of how their content was created, distributed and consumed. If none of those changes had altered their market power, why would the digital transformation they were confronting in 2015 be any different?

Because that transformation was creating new kinds of abundance and a new, dramatically faster rate of change.

Those six studios had maintained their power throughout the 20th century because they were able to control three key scarce market resources: the financial and technological means of creating content, the channels necessary to distribute content and the ability to use copyright law to control how consumers accessed content.

What they didn’t realize in 2015, however, was that digital technologies were making each of these scarce resources abundant. New digital technologies were democratizing access to the tools necessary to create content. New digital channels were allowing creators to reach their audience without having to navigate the scarce capacity of broadcast television stations, movie theaters and store shelves. And digital piracy was allowing consumers to access content for free, in a way that challenged the studios’ established business models.

While digital transformation was creating abundance in the scarce resources that had defined market power, it was also creating a new scarce resource, and therefore a new source of competitive advantage: customer attention. The problem the studios faced was that they didn’t have direct access to their customers in any of their existing channels. Sure, they could use box-office receipts or Nielsen television ratings to know how many consumers watched a movie in a particular city, or the general demographic characteristics of consumers who watched last night’s prime-time broadcasts, but they didn’t know anything about these customers as individuals, and they didn’t control the channels that could allow them to use new detailed sources of customer data to manage and mediate customer viewing behavior.

Worse, the firms who could — Netflix, Amazon and Google’s YouTube — were using detailed customer data to consolidate their power over downstream digital channels, and leveraging that power to vertically integrate upstream into content creation.

In 2015, one might have imagined that the major studios would simply shrivel up and die like so many other market-leading firms in other “disrupted” industries. But they haven’t. And the reason they haven’t reveals a path forward for managers in industries facing digital transformation.

Why were motion-picture studios able to respond to the threat posed by new digital technologies? Because they stopped protecting their existing business model, which involved selling access to scarce content sold in scarce channels by filling seats in theaters, selling advertisements on prime-time television and selling shiny plastic disks for $20 a pop, and instead rediscovered their underlying business mission — which was creating great entertainment and getting it in front of the right audience.

Guided by that new perspective, the studios began to embrace new technologies and new business models. This involved creating vibrant new digital-distribution platforms, among them Disney+, HBO Max, Peacock and Hulu; engaging heavily in restructuring to align their old organizational structures with their new business reality; and making significant cultural shifts away from gut-feel marketing and toward data-driven and evidence-based decision-making.

There are three lessons here for firms facing digital transformation.

First, look at the scarce resources that have always defined market power in your industry and ask whether digital transformation might replace that scarcity with abundance. Could digital abundance weaken the value of your firm’s brand name as it did in the hotel industry? Could it diminish your control over the production and dissemination of information as it did in the news industry? Could it even change the nature of your product as it did with the encyclopedia, mobile phone, taxi and automobile industries?

Second, evaluate whether digital transformation is creating new scarce resources that are outside your control — and what organizational and cultural changes are needed to access these new sources of competitive advantage.

Third, instead of mourning the changes that this transformation may impose on your established business model, look carefully at your underlying mission, and see whether and how you can use new digital technologies to better fulfill that mission.

While each of those lessons is important, the third one is key. It’s natural to view digital transformation primarily as a threat. It takes leadership to see the opportunity. That’s exactly how leaders in the entertainment industry responded. If a mission-driven response to digital transformation worked in Hollywood, imagine what it could do for your firm.

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