

The Meaning of Digital Transformation

by **Dr Claude Diderich** | innovate.d, Switzerland

Digital transformation is key in today's business environment to achieve growth, profitability, and sustained competitive advantage. Many firms grapple with the concept. They focus their efforts on using technology in the areas of data handling and process automation. Successful digital transformation requires focusing on the firm's business model in its competitive environment. This means understanding technology as a tool that supports a firm's strategy, operating model, competitive positioning, and customer-value-creating capabilities, rather than as an outcome in itself.

Digital transformation has become a buzzword in recent years. But the underlying concepts are not that new. Indeed, for over 30 years, firms have used digital technologies, including the internet, to support and improve their businesses. In the early days, digital transformation was all about technology and its use to automate operations. With the rise of Web 2.0 around the year 2000, digital transformation intensified the focus on digitalizing customer relationships. Digital marketing has become key to reaching the right customers with the most relevant products and services. Many leading technology companies, including Google and Facebook, have built their business models around digital advertising, which is a primary channel for digital marketing.

Conceptualizing the use of digital technologies to support growth, profitability, and competitive advantage entails identifying three stages of digital maturity:

1. *Digitization*—Digitization describes the maturity stage of a firm when analog data, like faxes or handwritten notes, are transferred to the digital world. It is all about making analog information available using digital technologies. The key digitization processes include structuring and classifying data. Although digitization may look easy at first, it is not! For example, the medical profession is still struggling today to digitize patient data and make it available to treating physicians while ensuring proper data privacy, as required by frameworks like the Healthcare Insurance Portability and Accountability Act in the United States or the German Patient Data Protection Act.
2. *Digitalization*—Although data is at the core of successfully using digital technologies, digitalization takes digital maturity to the next level. It describes how technology is used to automate and transform existing business processes by focusing on efficiency and effectiveness. Digitalization is typically directed inward. The most prominent success stories of the digitalization maturity stage involve supply chain automation. Dell Technologies and Amazon Marketplace are typical examples of companies leading in supply chain digitalization.
3. *Digital transformation*—The third digital maturity stage is about using technology to achieve prosperity by taking a business perspective, rather than a technology perspective. Technology is used to enhance the customer experience and optimize the value proposition delivered. In contrast with the digitalization maturity stage, digital transformation is about using technology to create customer value and subsequently, appropriate profits. At the core is using technology to improve a firm's strategy, operating model, organization, and management capabilities. Digital transformation cuts across multiple layers of a firm's business model, which includes

targeted markets, offered products and services, organizational design, cognition, creativity, capabilities, and resources.

To understand how firms can leverage *digital transformation* to achieve the highest level of digital maturity, let me start by clarifying what digital transformation means.

Definition 1. *Digital transformation is the process of transforming the business model of a firm by using technologies to achieve growth, profitability, and sustained competitive advantage.*

The focus is on the firm and its business model—that is, how it creates and captures value—rather than on the use of technology. Digital transformation can be approached from four different yet complementary perspectives:

Strategy perspective. Digital transformation focuses on aligning the use of technologies with the firm's strategy. Relying on specific technologies may allow a firm to adapt its business model to outperform its competitors. For instance, firms may transform their business models from selling products to offering products as a service—like the tool manufacturer Hiltl. Approaching digital transformation from the strategic perspective also means repositioning the firm's brand, implementing superior data-driven price discrimination schemes, and supporting innovation capabilities.

Operating model perspective. The operating model perspective of digital transformation extends the digitalization maturity stage by relating used technology to the whole business model, including customer channels, instead of only individual processes. It touches the firm's overall IT architecture. The focus is on efficiency and effectiveness. Outsourcing and interface management play important roles, and technology is used to measure and monitor business performance.

Competitive positioning perspective. It is rare to see firms that can sustain a blue ocean strategy. Digital transformation helps identify areas where firms can attain a distinct market position, based on technology and valued by customers. For example, a firm may use 3D virtual reality technology to support customers performing their own maintenance, rather than sending over maintenance staff.

Customer perspective. The fourth digital transformation perspective aims at using technology as a support tool throughout the whole customer journey. Customer-centric digital transformation has remodeled many industries by providing online search and transaction channels that increase the range of products and services offered, while simultaneously lowering the search and due diligence costs. The focus is on creating value for customers using technology.

Digital transformation is not a one-way street. It is a web of opportunities that firms can and should exploit. The challenge in doing so is that there is no one-size-fits-all solution, the same ways as there is no single best strategy. Success often requires an external perspective. Even more important is understanding technologies and what they can and cannot do in the context of a firm's strategy.



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