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What Do You Really Mean by Business "Transformation"?

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Today's corporate watchword word is *transformation,* and for good reason. One study suggests that 75% of the S&P 500 will turn over in the next 15 years. Another says that one in three companies will delist in the next five years. A third shows that the "topple rate" of industry leaders falling from their perch has doubled in a generation. Software is eating the world. Unicorns are prancing unabated. Executives at large companies rightly recognize that they need to respond in turn.

And yet.

When executives say transformation what do they *really* mean? Often, the word confuses three fundamentally different categories of effort.

The first is *operational,* or doing what you are currently doing, better, faster, or cheaper. Many companies that are "going digital" fit in this category — they are using new technologies to solve old problems. A big operational change can be jarring and drive real business impact, but it doesn't fit dictionary definitions of transformation, such as "a marked change in form, nature, or appearance" or "to change (something) completely and usually in a good way." Sure, costs will be lower, customer satisfaction might go up, but the essence of the company isn't changing in any material way. And, in a quickly changing world playing an old game better is simply insufficient.

The next category of usage focuses on the *operational model.* Also called core transformation, this involves doing what you are currently doing in a fundamentally different way. Netflix is an excellent example of this type of effort. Over the last five years Netflix has shifted from sending DVDs through the mail to streaming video content through the Web. It also has shifted from simply distributing other people's content to investing heavily in the creation of its own content, using its substantial knowledge of customer preferences to maximize the chances that content will connect with an audience. Customers still turn to Netflix to be entertained and to discover new content, but the fundamental way Netflix is solving that problem has changed almost completely.

The final usage, and the one that has the most promise and peril, is *strategic*. This is transformation with a capital "T" because it involves changing the very essence of a company. Liquid to gas, lead to gold, Apple from computers to consumer gadgets, Google from advertising to driverless cars, Amazon.com from retail to cloud computing, Walgreens from pharmacy retailing to treating chronic illnesses, and so on. Executed successfully, strategic transformation reinvigorates a company's growth engine. Poor execution leads naysayers to pounce and complain that a company should have "stuck to its knitting."

Defining what leaders mean when they drop the word *transformation* matters, because these different classes of efforts need to be measured and managed in vastly different ways. Operational model transformation should change the metrics the company uses to track performance. For Netflix, a DVD-based model requires managing warehouse utilization and physical distribution costs. A streaming model requires managing website uptime and bandwidth costs. If a company is using the same metrics before and after its so-called "transformation" effort, it really hasn't transformed in any material way. Strategic transformation changes a company's competitive set. In its core advertising business, Google competes against other content and technology players; its driverless car will competes against manufacturers like General Motors and BMW. Similarly, historically Apple competed against Microsoft, IBM, and Dell; the iPod and iPhone led it to take on new companies like Sony, Nokia, Motorola, and more.

Not all of these efforts are of equal impact. Focusing on "today better" operational efforts does nothing more than create parity with the best executors of yesterday's model. It is a recipe for short-term survival, not long-term sustainability. Leaders instead should be thinking about how to blend together operational model and strategic transformation to execute what Innosight calls a *dual transformation*. "Transformation A" strengthens today by reinventing the core operating model. "Transformation B" creates tomorrow's core business. The efforts should be connected and coordinated through a carefully constructed capabilities link. This is the way that leaders can rise to the existential challenge of disruptive change to own their future, rather than be disrupted by it.

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