

Competing in a world of sectors without borders

Digitization is causing a radical reordering of traditional industry boundaries. What will it take to play offense and defense in tomorrow's ecosystems?

by Venkat Atluri, Miklos Dietz, and Nicolaus Henke

Rakuten Ichiba is Japan's single largest online retail marketplace. It also provides loyalty points and e-money usable at hundreds of thousands of stores, virtual and real. It issues credit cards to tens of millions of members. It offers financial products and services that range from mortgages to securities brokerage. And the company runs one of Japan's largest online travel portals—plus an instant-messaging app, Viber, which has some 800 million users worldwide. Retailer? Financial company? Rakuten Ichiba is all that and more—just as Amazon and China's Tencent are tough to categorize as the former engages in e-commerce, cloud-computing, logistics, and consumer electronics, while the latter provides services ranging from social media to gaming to finance and beyond.

Organizations such as these—digital natives that are not defined or constrained by any one industry—may seem like outliers. How applicable to traditional industries is the notion of simultaneously competing in multiple sectors, let alone reimagining sector boundaries? We would be the first to acknowledge that opportunities to attack and to win across sectors vary considerably and that industry definitions have always been fluid: technological developments cause sectors to appear, disappear, and merge. Banking, for example, was born from the merger of money exchange,

merchant banking, savings banking, and safety-deposit services, among others. Supermarkets unified previously separate retail subsectors into one big “grocery” category. Changes such as these created new competitors, shifted vast amounts of wealth, and reshaped significant parts of the economy. Before the term was in vogue, one could even say the shifts were “disruptive.”

Yet there does appear to be something new happening here. The ongoing digital revolution, which has been reducing frictional, transactional costs for years, has accelerated recently with tremendous increases in electronic data, the ubiquity of mobile interfaces, and the growing power of artificial intelligence. Together, these forces are reshaping customer expectations and creating the potential for virtually every sector with a distribution component to have its borders redrawn or redefined, at a more rapid pace than we have previously experienced.

Consider first how customer expectations are shifting. As Steve Jobs famously observed, “A lot of times, people don’t know what they want until you show it to them.” By creating a customer-centric, unified value proposition that extends beyond what end users could previously obtain (or, at least, could obtain almost instantly from one interface), digital pioneers are bridging the openings along the value chain, reducing customers’ costs, providing them with new experiences, and whetting their appetites for more.

We’ve all experienced businesses that once seemed disconnected fitting together seamlessly and unleashing surprising synergies: look no farther than the phone in your pocket, your music and video in the cloud, the smart watch on your wrist, and the TV in your living room. Or consider the 89 million customers now accessing Ping An Good Doctor, where on a single platform run by the trusted Ping An insurance company they can connect with doctors not only for online bookings but to receive diagnoses and suggested treatments, often by exchanging pictures and videos. What used to take many weeks and multiple providers can now be done in minutes on one app.

Now nondigital natives are starting to think seriously about their cross-sector opportunities and existential threats that may lurk across boundaries. One example: We recently interviewed 300 CEOs worldwide, across 37 sectors, about advanced data analytics. Fully one-third of them had cross-sector dynamics at top of mind. Many worried, for instance, that “companies from other industries have clearer insight into my customers than I do.” We’ve also seen conglomerates that until recently had thought of themselves as little more than holding companies taking the first steps to set up enterprise-wide consumer data lakes, integrate databases, and optimize the products,

services, and insights they provide to their customers. Although these companies must of course abide by privacy laws—and even more, meet their users’ expectations of trust—data sets and sources are becoming great unifiers and creating new, cross-sectoral competitive dynamics.

Do these dynamics portend a sea change for every company? Of course not. People will still stroll impromptu into neighborhood stores, heavy industry (with the benefit of technological advances, to be sure) will go on extracting and processing the materials essential to our daily lives, and countless other enterprises beyond the digital space will continue to channel the ingenuity of their founders and employees to serve a world of incredibly varied preferences and needs. It’s obvious that digital will not—and cannot—change everything.

But it’s just as apparent that its effects on the competitive landscape are already profound and that the stakes are getting higher. As boundaries between industry sectors continue to blur, CEOs—many of whose companies have long commanded large revenue pools within traditional industry lines—will face off against companies and industries they never previously viewed as competitors. This new environment will play out by new rules, require different capabilities, and rely to an extraordinary extent upon data. Defending your position will be mission critical, but so too will be attacking and capturing the opportunities across sectors before others get there first. To put it another way: within a decade, companies will define their business models not by how they play against traditional industry peers but by how effective they are in competing within rapidly emerging “ecosystems,” comprising a variety of businesses from dimensionally different sectors.

A WORLD OF DIGITAL ECOSYSTEMS

As the approaching contest plays out, we believe an increasing number of industries will converge under newer, broader, and more dynamic alignments: digital ecosystems. A world of ecosystems will be a highly customer-centric model, where users can enjoy an end-to-end experience for a wide range of products and services through a single access gateway, without leaving the ecosystem. Ecosystems will comprise diverse players who provide digitally accessed, multi-industry solutions. The relationship among these participants will be commercial and contractual, and the contracts (whether written, digital, or both) will formally regulate the payments or other considerations trading hands, the services provided, and the rules governing the provision of and access to ecosystem data.

Beyond just defining relationships among ecosystem participants, the digitization of many such arrangements is changing the boundaries of

the company by reducing frictional costs associated with activities such as trading, measurement, and maintaining trust. More than 80 years ago, Nobel laureate Ronald Coase argued that companies establish their boundaries on the basis of transaction costs like these: when the cost of transacting for a product or service on the open market exceeds the cost of managing and coordinating the incremental activity needed to create that product or service internally, the company will perform the activity in-house. As digitization reduces transaction costs, it becomes economic for companies to contract out more activities, and a richer set of more specialized ecosystem relationships is facilitated.

Rising expectations

Those ecosystem relationships, in turn, are making it possible to better meet rising customer expectations. The mobile Internet, the data-crunching power of advanced analytics, and the maturation of artificial intelligence (AI) have led consumers to expect fully personalized solutions, delivered in milliseconds. Ecosystem orchestrators use data to connect the dots—by, for example, linking all possible producers with all possible customers, and, increasingly, by predicting the needs of customers before they are articulated. The more a company knows about its customers, the better able it is to offer a truly integrated, end-to-end digital experience and the more services in its ecosystem it can connect to those customers, learning ever more in the process. Amazon, among digital natives, and Centrica, the British utility whose Hive offering seeks to become a digital hub for controlling the home from any device, are early examples of how pivotal players can become embedded in the everyday life of customers.

For all of the speed with which sector boundaries will shift and even disappear, courting deep customer relationships is not a one-step dance. Becoming part of an individual's day-to-day experience takes time and, because digitization lowers switching costs and heightens price transparency, sustaining trust takes even longer. Over that time frame, significant surplus may shift to consumers—a phenomenon already underway, as digital players are destroying billions to create millions. It's also a process that will require deploying newer tools and technologies, such as using bots in multidevice environments and exploiting AI to build machine-to-machine capabilities. Paradoxically, sustaining customer relationships will depend as well on factors that defy analytical formulae: the power of a brand, the tone of one's message, and the emotions your products and services can inspire.

Strategic moves

The growing importance of customer-centricity and the appreciation that consumers will expect a more seamless user experience are reflected in the flurry of recent strategic moves of leading companies across the world. Witness Apple Pay; Tencent's and Alibaba's service expansions; Amazon's decisions to (among other things) launch Amazon Go, acquire Whole Foods, and provide online vehicle searches in Europe; and the wave of announcements from other digital leaders heralding service expansion across emerging ecosystems. Innovative financial players such as CBA (housing and B2B services), mBank (B2C marketplace), and Ping An (for health, housing, and autos) are mobilizing. So are telcos, including Telstra and Telus (each playing in the health ecosystem), and retailers such as Starbucks (with digital content, as well as seamless mobile payments and pre-ordering). Not to be left out are industrial companies such as GE (seeking to make analytics the new "core to the company") and Ford (which has started to redefine itself as "a mobility company and not just as a car and truck manufacturer").¹ We've also seen ecosystem-minded combinations such as Google's acquisition of Waze and Microsoft's purchase of LinkedIn. Many of these initiatives will seem like baby steps when we look back a decade from now, but they reveal the significance placed by corporate strategists on the emergence of a new world.

While it might be tempting to conclude as a governing principle that aggressively buying your way into new sectors is the secret spice for ecosystem success, massive combinations can also be recipes for massive value destruction. To keep your bearings in this new world, focus on what matters most—your core value propositions, your distinct competitive advantages, fundamental human and organizational needs, and the data and technologies available to tie them all together. That calls for thinking strategically about what you can provide your customers within a logically connected network of goods and services: critical building blocks of an ecosystem, as we've noted above.

Value at stake

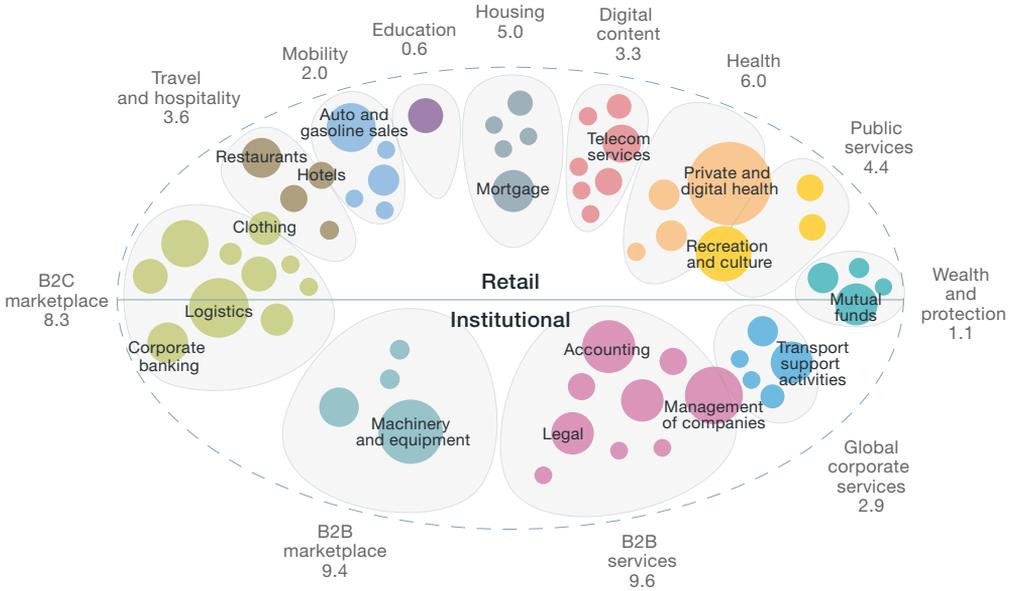
Based on current trends, observable economic trajectories, and existing regulatory frameworks, we expect that within about a decade 12 large ecosystems will emerge in retail and institutional spaces. Their final shape is far from certain, but we suspect they could take something like the form presented in Exhibit 1.

¹ See Nicolaus Henke, Ari Libarikian, and Bill Wiseman, "Straight talk about big data," *McKinsey Quarterly*, October 2016; and "Bill Ford charts a course for the future," *McKinsey Quarterly*, October 2014, both available on McKinsey.com.

Exhibit 1

New ecosystems are likely to emerge in place of many traditional industries by 2025.

Ecosystem illustration, estimated total sales in 2025,¹ \$ trillion



¹Circle sizes show approximate revenue pool sizes. Additional ecosystems are expected to emerge in addition to the those depicted; not all industries or subcategories are shown.

Source: IHS World Industry Service; Panorama by McKinsey; McKinsey analysis

The actual shape and composition of these ecosystems will vary by country and region, both because of the effects of regulations and as a result of more subtle, cultural customs and tastes. We already see in China, for example, how a large base of young, tech-savvy consumers, a wide amalgam of low-efficiency traditional industries, and, not least, a powerful regulator have converged to give rise to leviathans such as Alibaba and Tencent—ideal for the Chinese market but not (at least, not yet) able to capture significant share in other geographies (see sidebar, “China by the numbers”).

The value at stake is enormous. The World Bank projects the combined revenue of global businesses will be more than \$190 trillion within a decade. If digital distribution (combining B2B and B2C commerce) represents about one-half of the nonproduction portion of the global economy by that time, the revenues that could, theoretically, be redistributed across traditional sectoral borders in 2025 would exceed \$60 trillion—about 30 percent of world revenue pools that year. Under standard margin assumptions, this would translate to some \$11 trillion in global profits, which, once we subtract

approximately \$10 trillion for cost of equity, amounts to \$1 trillion in total economic profit.²

SNAPSHOTS OF THE FUTURE

Again, it's uncertain how much of this value will be reapportioned between businesses and consumers, let alone among industries, sectors, and individual companies, or whether and to what extent governments will take steps to weigh in. To a significant degree, many of the steps that companies are taking and contemplating are defensive in nature—fending off newer entrants, by using data and customer relationships to shore up their core. As incumbents and digital natives alike seek to secure their positions while building new ones, ecosystems are sure to evolve in ways that surprise us. Here is a quick look at developments underway in three of them.

Consumer marketplaces

By now, purchasing and selling on sites such as Alibaba, Amazon, and eBay is almost instinctive; retail has already been changed forever. But we expect that the very concept of a clearly demarcated retail sector will be radically altered within a decade. Three critical, related factors are at work.

First, the frame of reference: what we think of now as one-off purchases will more properly be understood as part of a consumer's passage through time—the accumulation of purchases made from day to day, month to month, year to year, and ultimately the way those interact over a lifetime. Income and wealth certainly have predictive value for future purchases, but behavior matters even more. Choices to eat more healthily, for example, correlate to a likelihood for higher consumption of physical fitness gear and services, and also to a more attractive profile for health and life insurers, which should result in more affordable coverage.

The second major factor, reinforcing the first, is the growing ability of data and analytics to transform disparate pieces of information about a consumer's immediate desires and behavior into insight about the consumer's broader needs. That requires a combination of capturing innumerable data points and turning them, within milliseconds, into predictive, actionable opportunities for both sellers and buyers. Advances in big data analytics, processing power, and AI are already making such connections possible.

² Our conclusions, which we arrived at by analyzing 2025 profit pools from a number of different perspectives, are based upon several base expectations about the coming integrated network economy, including average profit margin and return on equity (for each, we used the world's top 800 businesses today, excluding manufacturing initiatives), as well as the cost of equity (which we derived from more than 35,000 global companies based upon their costs of equity in January 2017).

CHINA BY THE NUMBERS

China has unique regulatory, demographic, and developmental features—particularly the simultaneity with which its economy has modernized and digitized—that are accelerating the blurring of sector borders. Still, the numbers speak for themselves and help suggest both the scale that digital ecosystems can quickly reach and the patterns likely to take hold elsewhere as ecosystem orchestrators in other countries stretch into roles approximating those played by Alibaba, Baidu, Ping An, and Tencent.

Alibaba



120 billion

assets under management by Yu'E Bao¹

175 million

total Alipay transactions in one day²

44%

of global mobile-wallet spending, achieved by Alipay³

Baidu



346 million

online users

130 million

users of Ping An Good Doctor⁴

25 million

unique visitors daily to autohome.com.cn

Tencent



889 million

WeChat users⁵

70 minutes

spent every day by average WeChat user⁶

61%

of users open WeChat more than ten times every day⁷

46 billion

“red packets” sent via WeChat for the lunar new year⁸

¹ As of September 2016.

² As of August 2016.

³ In 2016; see *Global Payments*

Report 2016, Worldpay,

November 8, 2016, worldpay.com.

⁴ As of March 2017.

⁵ As of Q4 2016.

⁶ As of March 2016.

⁷ As of June 2016.

⁸ For Lunar New Year falling in 2017; see “WeChat users send 46 billion digital red packets over Lunar New Year—Xinhua,” Reuters, February 6, 2017, reuters.com.

Large Chinese players have expanded their digital presence by ‘land grabbing.’

Selected examples



2000

<p>Market, consumption</p> 	<p>Search</p> 	<p>Messaging</p> 
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2017

<p>Market, consumption</p> <ul style="list-style-type: none">  Alibaba.com, Taobao, Tmall  Baidu Wei Gou, Wanda e-commerce  We Store, Xi Yuan 	<p>Search</p> <ul style="list-style-type: none">  Baidu Map, Baidu Search  Sogou 	<p>Messaging</p> <ul style="list-style-type: none">  QQ, WeChat
<p>Dining</p> <ul style="list-style-type: none">  Ele.me  Baidu Nuomi, Baidu Takeout Delivery  Meituan-Dianping 	<p>Entertainment, gaming</p> <ul style="list-style-type: none">  Alibaba Games, Alibaba Music, Alibaba Picture  Baidu Games, Baidu Music, Baidu Video, iQIYI  QQ Music, Tencent Games, Tencent Video 	<p>Finance</p> <ul style="list-style-type: none">  Ant Financial Services Group  Baidu Consumer Credit, Baidu Wallet, Baidu Wealth Management  Caifutong, Tenpay, WeBank
<p>Healthcare</p> <ul style="list-style-type: none">  Alihealth  Ding Xiang Yuan 	<p>News, encyclopedia</p> <ul style="list-style-type: none">  Baidu Baike, Baidu News 	<p>Transportation</p> <ul style="list-style-type: none">  }  }  } <p style="text-align: right;">} Didi Chuxing¹</p>

¹Formed by merger of Didi Dache (backed by Tencent) and Kuaidi Dache (backed by Alibaba) and acquisition of Uber (backed by Baidu).

This all generates a highly robust “network factor”—the third major force behind emerging consumer marketplaces. In a world of digital networks, consumer lenders, food and beverage providers, and telecom players will simultaneously coexist, actively partner, and aggressively move to capture share from one another. And while digitization may offer the sizzle, traditional industries still have their share of the steak. These businesses not only provide the core goods and services that end users demand, but often also have developed relationships with other businesses along the value chain and, most important, with the end users themselves. Succeeding in digital marketplaces will require these companies to stretch beyond their core capabilities, to be sure, but if they understand the essentials of what’s happening and take the right steps to secure and expand their relationships, nondigital businesses can still hold high ground when the waves of change arrive.

B2B services

The administrative burdens of medium, small, and microsize companies are both cumbersome and costly. In addition to managing their own products and services, these businesses (like their larger peers) must navigate a slew of necessary functions including human resources, tax planning, legal services, accounting, finance, and insurance.

Today, each of these fields exists as an independent sector, but it’s easy to imagine them converging within a decade on shared, cloud-based platforms that will serve as one-stop shops. With so many service providers available at the ease of a click, all with greater transparency on price, performance, and reputation, competition will ramp up and established players can anticipate more challengers from different directions. At the same time, it’s likely that something approaching a genuine community will develop, with businesses being able to create partnerships and tap far more sophisticated services than they can at present—including cash-planning tools, instant credit lines, and tailored insurance.

Already, we can glimpse such innovations starting to flourish in a range of creative solutions. Idea Bank in Poland, for example, offers “idea hubs” and applications such as e-invoicing and online factoring. ING’s commercial platform stretches beyond traditional banking services to include (among other things) a digital loyalty program and crowdfunding. And Lloyds Bank’s Business Toolbox includes legal assistance, online backup, and email hosting. As other businesses join in, we expect the scope and utility of this space to grow dramatically.

Mobility

Finally, consider personal mobility, which encompasses vehicle purchase and maintenance management, ridesharing, carpooling, traffic management, vehicle connectivity, and much more. The individual pieces of the mobility puzzle are starting to become familiar, but it's their cumulative impact that truly shows the degree to which industry borders are blurring (Exhibit 2).

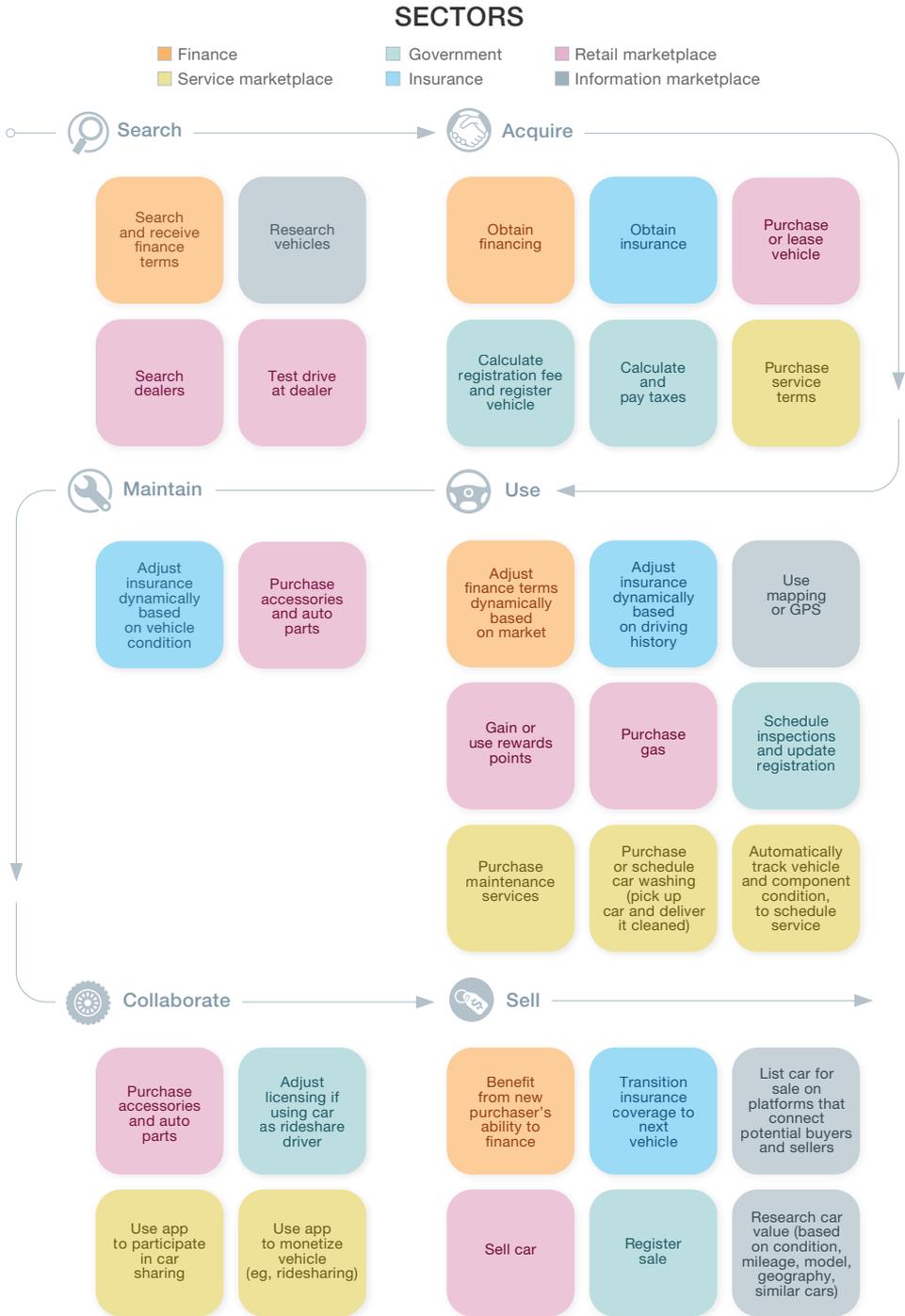
EMERGING PRIORITIES FOR THE BORDERLESS ECONOMY

These glimpses of the future are rooted in the here and now, and they are emblematic of shifts underway in most sectors of the economy—including, more likely than not, yours. We hope this article is a useful starting point for identifying potential industry shifts that could be coming your way. Recognition is the first step, and then you need a game plan for a world of sectors without borders. The following four priorities are critical:

- ***Adopt an ecosystem mind-set.*** The landscape described in this article differs significantly from the one that still dominates most companies' business planning and operating approaches. Job one for many companies is to broaden their view of competitors and opportunities so that it is truly multisectoral, defines the ecosystems and industries where change will be fastest, and identifies the critical new sources of value most meaningful for an expanding consumer base. In essence, you must refine your "self vision" by asking yourself, and your top team, questions such as: "What surprising, disruptive boundary shifts can we imagine—and try to get ahead of?" and "How can we turn our physical assets and long-established customer relationships into genuine consumer insights to secure what we have and stake out an advantage over our competitors—including the digital giants?" That shift will necessarily involve an important organizational component, and leaders should expect some measure of internal resistance, particularly when existing business goals, incentives, and performance-management principles do not accord with new strategic priorities. It will also, of course, require competitive targeting beyond the four walls of your company. But resist the impulse to just open up your acquisition checkbook. The combinations that make good sense will be part of a rational answer to perennial strategic questions about where and how your company needs to compete—playing out on an expanding field.
- ***Follow the data.*** In our borderless world, data are the coins of the realm. Competing effectively means both collecting large amounts of data, and developing capabilities for storing, processing, and translating the data

Exhibit 2

Different sectors come into play at every stage of the mobility ecosystem.



into actionable business insights. A critical goal for most companies is data diversity—achieved, in part, through partnerships—which will enable you to pursue ever-finer microsegmentation and create more value in more ecosystems. Information from telecommunications-services players, for example, can help banks to engage their customers and make a variety of commercial decisions more effectively. Deeper data insights are finally beginning to take ideas that had always seemed good but too often fell short of their potential to turn into winning models. Consider loyalty cards: by understanding customers better, card providers such as Nectar, the largest loyalty program in the United Kingdom, and Plenti, a rewards program introduced by American Express, can connect hundreds of companies of all sizes and across multiple industries to provide significant savings for consumers and new growth opportunities for the businesses that serve them. Meanwhile, the cost of sharing data is falling as cloud-based data stores proliferate and AI makes it easier to link data sets to individual customers or segments. Better data can also support analytically driven scenario planning to inform how ecosystems will evolve, at which points along the value chain your data can create value, and whether or where you can identify potential “Holy Grail” data assets. What data points and sources are critical to your business? How many do you have? What can you do to acquire or gain access to the rest? You should be asking your organization questions like these regularly.

- ***Build emotional ties to customers.*** If blurring sector boundaries are turning data into currency, customer ownership is becoming the ultimate prize. Companies that lack strong customer connections run the risk of disintermediation and perhaps of becoming “white-label back offices” (or production centers), with limited headroom to create or retain economic surplus. Data (to customize offerings), content (to capture the attention of customers), and digital engagement models (to create seamless customer journeys that solve customer pain points) can all help you build emotional connections with customers and occupy attractive roles in critical ecosystems. You should continually be asking your organization, “What’s our plan for using data, content, and digital-engagement tools to connect emotionally with customers?” and “What else can we provide, with simplicity and speed, to strengthen our consumer bond?” After all, Google’s launch of initiatives such as Chrome and Gmail, and Alibaba’s introduction of enterprises such as Alipay and the financial platform Yu’E Bao, weren’t executed merely because they already had a huge customer base and wanted to capture new sources of revenue (although they did succeed in doing so). They took action to help ensure they would keep—and expand—that huge customer base.

- *Change your partnership paradigm.* Given the opportunities for specialization created by an ecosystem economy, companies need more and different kinds of partners. In at least a dozen markets worldwide—including Brazil, Turkey, and several countries in Asia, where in many respects data are currently less robust than they are in other regions—we’re seeing a new wave of partnership energy aimed at making the whole greater than the sum of its parts. Regardless of your base geography, core industry, and state of data readiness, start by asking what white spaces you need to fill, what partners can best help with those gaps, and what “gives” and “gets” might be mutually beneficial. You’ll also need to think about how to create an infrastructural and operational framework that invites a steady exchange with outside entities of data, ideas, and services to fuel innovation. Don’t forget about the implications for your information architecture, including the application programming interfaces (APIs) that will enable critical external linkages, and don’t neglect the possibility that you may need to enlist a more natural integrator from across your partnerships, which could include a company more appropriate for the role, such as a telco, or a third-party provider that can more effectively connect nondigital natives. And don’t assume that if you were to acquire a potential partner, you’d necessarily be adding and sustaining their revenues on a dollar-for-dollar basis over the long term.

No one can precisely peg the future. But when we study the details already available to us and think more expansively about how fundamental human needs and powerful technologies are likely to converge going forward, it is difficult to conclude that tomorrow’s industries and sector borders will look like today’s. Massive, multi-industry ecosystems are on the rise, and enormous amounts of value will be on the move. Companies that have long operated with relative insularity in traditional industries may be most open to cross-boundary attack. Yet with the right strategy and approach, leaders can exploit new openings to go on offense, as well. Now is the time to take stock and to start shaping nascent opportunities. 

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