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Introduction [00:00:00] Welcome to Accenture's X-as-a-service files the podcast for business leaders helping their companies transform using innovative digital business models. Here, you'll learn from some of the industry's leading movers and shakers, senior executives from companies around the globe who are changing the way the world works and plays by delivering all types of compelling subscription services. Join your host Kevin Dobbs Accenture as X is a service managing director who brings 20 plus years of experience as an entrepreneur, CEO and senior executive to the table. Kevin has led dozens of as a service business transformation for some of the largest technology and industrial companies globally. Now let's get to today's episode.

Kevin [00:01:04] Thanks for tuning in today to our X-as-a-service Files podcast. My name is Kevin Dobbs and I run our as a service practice here at Accenture. And today we're really excited to have Steve Strongin from Goldman Sachs. And he's going to help us decode kind of digital transformation from a Wall Street perspective. So, Steve, welcome.

Steve [00:01:26] Thank you Kevin. It's a pleasure to be here.

Kevin [00:01:29] So in the last segment, we really talked about how Covid it is impacted the market and how a lot of companies are reevaluating maybe the use of digital platforms, digital technologies and their business. Very interesting. So, in this segment, we really want to kind of talk about, you know, what does Wall Street think about this? And, you know, how does Wall Street think about value? And you mentioned in the last segment about hope projects. I want to definitely drill into that a little bit. And then, you know, how is it for executives, if I'm running a company and I'm building a new digital business, how do I communicate with Wall Street? You know, what are some maybe ideas or tips or tricks that you can share? But if we kick it off, you know, today when you're thinking about these valuable companies who have the highest multiples in the market, what are some of the kind of attributes of those type of companies that Wall Street looks at?

Steve [00:02:30] You know, you have to be careful because companies can have very different business models and the markets may look for different things with different business models.

Kevin [00:02:39] Ok

Steve [00:02:40] When you talk about mature companies, the market is typically looking for real cash flows that are forecastable, easy to see, easy to understand, and you understand why they will be persistent. When you talk about sort of younger companies and that doesn't necessarily mean pure age, it can also be the nature of businesses they’re in. Media companies, as an example, always have to renew themselves, right? The name may survive, but they're not selling the same product they were selling 50 years ago.

Kevin [00:03:18] Right.

Steve [00:03:20] And those companies need to have a sort of understanding of two things. One is that the market as opposed to the company. What is that market doing right? And then secondly, what is the ability of that company to innovate, create and grab part of that market? So, for instance, you know, if you look at the analysis of a biotech company, right? The first bit of analysis will be how many people have the disease, right? Then the question will be, you know, what chance does this company have of getting some of those people as customers?

Kevin [00:03:56] Right.

Steve [00:03:57] So it can be very different depending on the nature of the business. For most companies, most larger companies, they typically have portfolios of revenue streams and there is a cadre of analysts who analyze those revenue streams. And the more predictable and easier they are to see, the more the market will pay for it. And then - and this is the part, I think, where companies get confused by those other companies ok - and then how much money are they going to waste trying to reinvent themselves to something they are not right? How much discipline are they going to observe? So, you know, there are companies that sell discipline and there are companies that sell hope. Most companies are in a much better position to sell discipline than they are to sell hope.

Kevin [00:04:44] Yeah, it seems kind of in your piece “What the Market Pays For” you talk a little bit about that. And you talk about kind of I guess the nightmare scenario for Wall Street is you've got this strategy that you're pursuing, but it's not really going to pay off. But you know what? We're gonna go down swinging. We'll keep spending no matter what. And, you know, a good company turns into a bad company because they're kind of following a hope project too far.

Steve [00:05:16] Right. And often one they can't possibly do. You know, imagine, if you would, Blockbuster announcing that they were going to become a cloud company and compete directly with Amazon, right? Interesting enough, the more money Blockbuster has, the day they make that announcement, the more frightening the market will be, because whatever that number is, is what's about to be wasted. On the other hand, if they've made the announcement that Netflix made at that same moment, which is basically we're exiting the physical business. We're going to become a production company. The market is then going to have a sort of wait and see attitude, right? Because that's a reasonable strategy. Not clear if Netflix was in a position to execute on it but at least they've not announced, 'we're committing mass financial suicide.' Then the question is, B, can they develop a track record of being able to deliver that process? One show, then two shows, then three shows, right? Created ability, a rhythm of predictability. You know, different businesses allow you a different level of predictability. You know, if you're selling a service, a true service - storage, streaming - that can actually be a monthly revenue.

Kevin [00:06:33] Recurring revenue. We like that. Yes.

Steve [00:06:36] That's right. You love it as long as it really is recurring, right? And as long as what you're spending to maintain it isn't just as variable as the revenue itself. So, if you think about, you know, a media company, right? The volatility there, right? The revenue side is going to lock down, right? We have this many customers. They pay us a monthly fee. There the risk is how much you're going to spend to have program. And so, whenever you talk about a digital strategy, you're basically looking for a way of creating a thinner business model. Fewer people on the ground, fewer dollars in locked up capital. That's more predictable.

Kevin [00:07:16] And I would argue with what we also see is we like companies who have platforms. We talked about that in the last segment. But what we like to see is kind of margin expansion over time, that actually the more customers you put on your platform, you're making more money as opposed to kind of these - we call them kind of fake business models - where on the outside it looks, let's say, like a recurring revenue business but in order to scale, you need to throw a lot of people at it. And that business over time is not very attractive.

Steve [00:07:49] Exactly right. In fact, the way I would define a platform is exactly the phrase you use there. It's the one where the marginal cost of business is low. Where you're going to do the same thing. And there's different ways to create that platform. You know, there are companies...ADP is an example of this...where it's their regulatory knowledge of all the reporting and withholding rules for all these jurisdictions. It's not their computer systems, right? Amazon's cloud is a more classic economies of scale load balancing system.

Kevin [00:08:23] Right.

Steve [00:08:25] Right? But it is that notion that there are some economies of scale or scope that allows you to expand your client base at a low cost. And when you have that, you have a great platform. Now, there's an alternative business model which can be embedded in some platforms that I think is just as important, which is a good utilizer of other people's platforms.

Kevin [00:08:48] Yeah.

Steve [00:08:49] You can't be the platform in everything. You know, Apple has been one of the more adventurous companies in exploring the answer to this question where, you know, they used to make their own chips. Not a good idea.

Kevin [00:09:06] Right. Too expensive.

Steve [00:09:07] Too expensive, too much development, right? They do design some of their own chips, but not others. They do create certain layers of their own software, but not others, right? So, they're an incredibly difficult company, to summarize, unless you are a software engineer and a hardware engineer because they've chosen these very thin layers of hardware and software to own and outsource the rest.

Kevin [00:09:35] And what they've also done, which is interesting, is they've created - which we talk out to our clients a lot about - ecosystems. So one of the things they have the App Store which is under attack right now from Fortnite and others who don't want to pay 30 percent of their revenues, but that over time has been a fantastic model because as long as you give access, the more people who jump on that, the more money you're going to make. Same thing about Apple Pay, which is kind of their financial services play. You know, it was just basically opening up their customer base to a whole new, you know, model. And they got all that leverage out of that model.

Steve [00:10:14] That's right. And as I said that's straightforward. The problem with that analysis and its glory is that there aren't a lot of those opportunities in the world.

Kevin [00:10:25] Yeah.

Steve [00:10:27] And it doesn't take that many interests before they stop being good entry points, right? You probably wouldn't recommend anybody goes into the business of making screens. Doesn't have a lot of players. Great platforming but there's too many players. The other business model, which I typically refer to as boutique can be just as effective. Which is I'm going to use other people's platforms and I'm going to focus on understanding my customer and their needs. This is a big part of digital strategies. Digital strategies have allowed you to narrow your target as well as broaden it. And there's money to be made in both of those. Let me give you a really simple example that I think is incredibly important. The difference between an advertising model and a subscription model in media. When you're in an advertising model, you need shows that attract lots of people. So, you are always competing for the mass market. In a subscription model, you're looking for the next customer. You don't care about the one you already have. So, you can be really niche-y and very successful as long as you do it at a good price.

Kevin [00:11:39] So, Steve, one of the things we think about, like these Hope projects or even let's say you had a digital business inside of your core business. One of the things is I always look at this as almost like companies are doing startups inside of their core company. But, you know, when companies become successful and let's say, you know, it goes from being an idea to actually generating revenue and doing kind of a fair, fair amount of revenue out on the market. Talk about how you expose those kind of businesses or what. What's the strategy around kind of communicating that back up to Wall Street? Because I think we were talking earlier, maybe you’re sub optimizing your value because you're kind of burying some really good things inside your company.

Steve [00:12:23] So let me do that by giving you sort of the Wall Street's dream presentation on this and Wall Street's nightmare presentation on this. And I think you'll realize that a lot of companies do this. The nightmare, rather. OK. So, I have well-established business. There are new entrants. Ok. And I'm going to go. Yes. We realize these new entrants. We have a lab. We have great people of that lab. We are pursuing 30, 40 projects to make sure that we can fight off those new entrants and preserve our market, the ones that work, we're gonna fund. The ones that don't work, we're gonna kill, but we intend to protect our marketplace. That's the good presentation. The nightmare one is. Let me tell you about these three fantastic innovations we have that are better than the ones that are selling at 60 multiples on the outside and how committed we are to them and how they're going to remake the universe. When Wall Street here’s that speech, they don't hear the remake universe. They hear here's a CEO who's going to spend every anything and everything to prove he's right. Right. This is this is someone who's become a believer. I don't need a believer running a successful company. I need an accountant running a successful company.

Kevin [00:13:41] So, almost, it's like when I when I think about because reading your report about this, one of the things that made me think about is maybe you should be managing that almost like you would if it was an outside startup. You know, you've got to get your seed funding and then you've got to hit some thresholds. Once you do that, either you're going to run out of money and go out of business or it's like, OK, you made it through that gate. You go get your series A, you get your series B, but there's like thresholds or outcomes that you need to satisfy before you're going to get more money. And it kind of prevents you from, like you said, just being the true believer and spend whatever you have because at some point you just run out of money. You can't do it anymore.

Steve [00:14:25] Exactly right. But there's a there's a bit of intuition and that I want to emphasize that gets lost in the sort of normal narrative. Options have value because they fail well, not because they succeed well. So, if you take a project and we're gonna run that, we're going to run that project in a well-supplied, rich company with lots of engineers. And we're going to run it at a shoestring at a startup, in that in that really good company that has better engineers, easier ability to monetize, easier ability to complete. Right. You'd be lucky to get a one multiple for that project. On the shoestring you'd probably get 30. Now, why is the shoestring getting paid more for that project at that good company? It's because when that project goes wrong, the shoestring is just going to go away. We're the good company is going to keep putting in good money after bad. OK. So, the fact that the good company can execute better. Actually, reduces the value of the project. That's one of those things that causes people's heads to explode mathematically. Right. So, we can do it better. Yes, that's the problem. It's not an easy conversation.

Kevin [00:15:40] It's almost when you when you're talking about this, I think about Google had many businesses and they've summarily shut them down when they didn't work. They just said, well, we tried it. It didn't work. They shut it down. Maybe more companies need to have that discipline. If things don't work. Just say that you're not going to fund them anymore. And in fact, if anything, that may give you more valuation credibility the next time you do a project because it's like they have fiscal discipline.

Steve [00:16:07] You're right. They also did something else that was equally important, which is where you got Alphabet. Is they separated them out so that anyone could see what was being spent, so they could see they were all being closed when they fail.

Kevin [00:16:21] OK.

Steve [00:16:22] Right. Right. There's a real tendency, particularly for pet projects, to hide them. Yeah. Make it hard to know how much money was spent. Right. Google had so many of those. They were forced to separate them out. They were forced to isolate them. And then they stopped. And this is the second point. Stop weighing on valuation. It isn't that Google got more credit for them because they were isolated. It's they start getting penalized for it, right. For the good companies. You're gonna get paid for your revenues. You're going to get penalized for your R&D. The little companies get rewarded for their R&D. Life's unfair sometimes.

Kevin [00:17:03] Well, Steve, this has been like the first episode. Very fascinating. And I learned a lot. I know. Hopefully, our listeners learned a lot, too. And we'll look forward to continuing the conversation in the next episode. I look forward to it.

Closure [00:17:23] Thank you for listening to Accenture XaaS Service files. Please be sure to visit our podcast Web site at Accenture.com slash XaaS service files that's Accenture dot com slash x a a s dash f i l e s. Where you can listen to more conversations with other industry leaders about their vision and perspectives on innovative digital business models. You'll also find more great insights from these leaders on our blogs that accompany each episode. And of course, we always appreciate it when you rate and review the show. Be well and we'll catch you again on the next episode of the XaaS files where we'll learn about the next venture in the digital transformation business journey.