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Strategic transformations in a disruptive digital environment

Digital technologies have created new markets and **disrupted** many others. As a consequence, many firms are operating in a highly turbulent and transformative business environment where senior executives are often drawn into the hype that new digital technologies create (North and Oliver, 2014). This in turn can lead to a change in firm strategy and **business model** at a time when dynamic and **unpredictable market** conditions increase the risks associated with getting the big strategic decisions wrong.

This paper illustrates how two media firms, Sky Plc and Pearson Plc, adapted, reconfigured and transformed their businesses to meet the demands of an operating environment characterized by inexorable changes in digital technologies. It examines their over-arching vision, **corporate strategies** and **financial performance** over two business cycles and concludes that business leaders should not dispense with the basic principles of good strategic business unit **portfolio management** in their attempts to take advantage of market opportunities. The results of these strategic transformations are in stark contrast to each other and leads to the conclusion that CEOs and their executive teams should create a 'portfolio business' that can withstand the turbulence created by the digital environment and not 'bet the company' at a time when market dynamics are so uncertain.

Develop strategies that seize new market opportunities and transform the firm.

Firms are reconfigured and transformed from the top down, with Corporate Strategy communicating the firm's vision, direction and scope. This strategy also articulates the level of resource investment in new assets, operating routines, capabilities and competencies that will transform the firm and take advantage of market opportunities. However, the process of transforming a firm can be an expensive business and one that carries a higher risk of failure for senior executives due to the level of uncertainty inherent in many markets (Bjelland and Chapman Wood, 2008).

Both Sky Plc and Pearson Plc are firms that have consistently placed ambitious levels of growth at the heart of their corporate strategies. These strategies have aimed to seize the new market opportunities provided by an increasingly digital operating environment, which when viewed over the long-term, have transformed their firms.

For example, since its inception in 1995, Sky Plc has consistently focused on one primary corporate objective, that is, 'maximising value for shareholders by focusing on profitable growth'. As a '*single product pay-tv firm'* they generated revenue of £777m in 1995 – a figure which had increased to £11,965m by 2016. Their consistent focus on the growth of pay-tv subscriber numbers and revenues was delivered by a strategic recipe of: negotiating the rights to premium content (sports, film and TV); developing new conditional access technologies; delivering a high quality customer service; and the acquisition of firms for their technological capabilities.

Sky's corporate strategy extended their perimeter of activities to take advantage of the opportunities provided by the digital environment and the harmonisation of technology and regulation across Europe. In 2006, they broadened the focus of their growth strategy by extending the scope of their operations into the provision of UK based broadband and mobile telephony. This strategic move repositioned the company from being a single product pay-tv provider into a '*multi-product, multi-platform entertainment and communications firm'*. Their corporate perimeter was further extended, geographically, with the acquisition of Sky Italia and Sky Deutchland (2014), which in turn transformed the company into a world class pay-tv operation in Europe and provided a platform on which to expand their growth ambitions. Driven on by a succession of ambitious corporate growth strategies, Sky has successfully transformed the firm from being a '*single product pay-tv firm*' into a '*European multi-platform, multi-product media firm'.*

Pearson Plc have also consistently focused on corporate growth by *'investing in high growth markets with high profit potential'.* In 1995, their corporate revenue was £1.83bn and had grown to £4.55bn by 2016 (peaking in 2011 at £5.86bn). During this period, Pearson transformed their organization from being a *'holding company'* for a number of businesses that ranged from publishing to investment banking and tourist attractions. Between 1995-2000 they had made $5bn of acquisitions (global news, TV production, broadcasting and distribution firms) with their expansion into high growth media markets which transformed the firm into an *'international media company'* with three strategic business units: business information, consumer publishing and education. The emergence of digitalization and new media provided many market opportunities for Pearson, however, by 2005, their corporate vision argued for 'strategic flexibility' and the need to constantly think about where future opportunities for their firm could be found. Their attention subsequently changed to the role that education would play in their business, and by 2006, they had declared themselves to be an *'international media and education company'*. By 2008, Pearson had started to sow the seeds of their next transformation, by declaring their next strategic move would be to reconfigure company structures and resources toward the potential opportunities provided by an emerging global middle class population of three billion. In 2009, Pearson declared themselves to be a *'world-leading education company'* where digital technologies would make their content more personal and more valuable and provide access to new, bigger and faster growing sources of corporate revenue.

They transformed the company, again, in 2012 by declaring their desire to be the *'world's leading learning company'* which subsequently meant the disposal of the Financial Times Group and their stake in The Economist in 2015. As a consequence, they had transformed their business into a *'single product learning company'* that focused on schools, higher education, English and business education. At the time, John Fallon, CEO stated that "Global education is a once-in-generation opportunity and Pearson is uniquely placed to grasp it" [1].

Strategic transformation and corporate financial performance

As case studies of strategic transformation, both firms are in stark contrast to their form, nature and appearance now, compared to 1995. Over the past 20 years, Sky Plc and Pearson Plc have set ambitious corporate growth objectives and strategies that focussed on the opportunities provided by an increasingly digital environment. However, they have executed these strategies in different ways, with different outcomes in terms of revenue performance (see Figure 1). Sky Plc has transformed from being a 'single product media firm' into a 'European multi-platform, multi-product media firm' with impressive results. In contrast, Pearson has engaged in four strategic transformations, moving from being a 'holding company' into their current form as a 'single product learning company' which has subsequently resulted in a consistent decline in corporate revenues.

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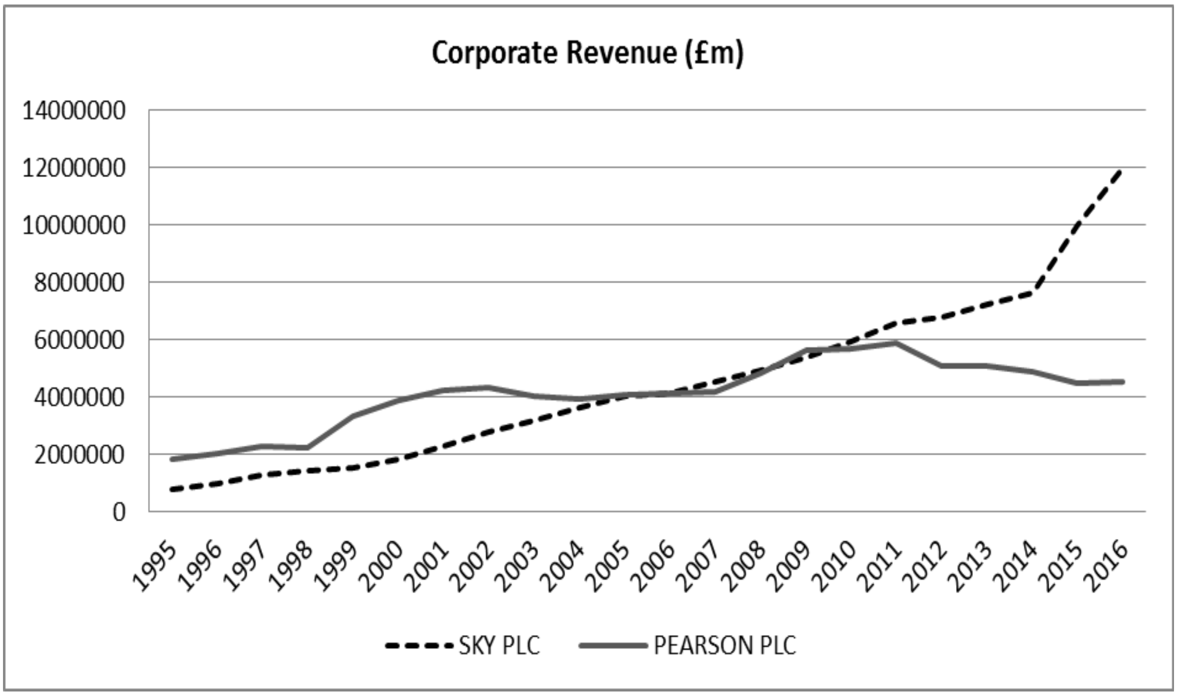
Figure 1: Strategic transformation and revenue performance



Source: Thomson Reuters DataStream

The persistent effects of digital disruption mean that business leaders are faced with a unique challenge in terms of navigating and managing the strategic transformation (Henry, 2007) of their firms at a time when the relentless pace of digital innovation is creating so much uncertainty. These case studies illustrate why firms need to create a portfolio business that takes advantage of the market opportunities created by innovative digital technologies, whilst off-setting the risks associated with digital disruption. Pearson's reliance on a single product business in an uncertain and digital operating environment has backfired following a slump in their core US education market. In essence, they 'bet the company' on a single product which has resulted in the largest pre-tax loss, £2.6bn for 2016 [2], in their history.

Winning at strategic transformation

The CEOs and executive teams at both Sky Plc and Pearson Plc have been able to consistently comprehend and successfully negotiate the challenges of an uncertain digital environment. Their ability to detect external signals in a dynamic environment and identify corresponding market opportunities provided the stimulus for the strategic transformation of their firms, which for the most part, has delivered strong revenue performance over the long-term. The differentiating factor between the strategic transformation and performance of these two is the central role that a diversified portfolio has played in off-setting the risks involved in operating in a dynamic and unpredictable market.

In order to 'win at strategic transformation' business leaders need to be mindful of the benefits that a diversified portfolio brings to the table. Making significant investments in emerging digital technologies, operations and processes that ultimately transform the firm is a risky business. Off-setting the potential threats from poor strategic investment decisions with a diversified portfolio may be an obvious solution – but Pearson Plc bet the company in an uncertain environment – and they got it wrong.

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Notes

All financial data, unless otherwise stated, has been sourced from Thomson Reuters DataStream.

[1] Fallon, J. (2012). Annual Report and Accounts 2012, p.8, Pearson Plc.

[2] Annual Report and Accounts 2016, p.30, Pearson Plc.

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