INTRODUCTION

WHY I WROTE THIS BOOK AND HOW IT WILL HELP YOU

In my work with top leaders of digital and traditional companies around the globe, I kept hearing the same questions. Why have the dozen or so digital giants—these include Amazon, Facebook, Google, and Alibaba—grown so big so quickly? Will they continue to dominate? Do other companies even stand a chance to compete against them?

The digital giants have forever changed our experiences as consumers and employees. Lower prices, greater convenience, instant access to relevant information—all these things are now common expectations among consumers and even among businesses that buy from other businesses. And all are driven by digital technology, specifically the use of algorithms.

Algorithms—the mathematical rules by which data is processed—had existed for hundreds of years. When computers made it possible to process them very quickly and at low cost, people like Jeff Bezos of Amazon, Mark Zuckerberg of Facebook, and Larry Page and Sergey Brin of Google leapt at the chance to use them to solve a broad spectrum of problems. Unconstrained by management orthodoxy, these leaders let their imaginations soar. Some of the problems they tackled were small, as in Bezos's initial desire to offer readers a vast selection of books at a low price; his ambition expanded from there. Others were big, as in Google's aim to "organize the world's information."

The impact of these exceptional leaders and organizations is obvious, but the why and how of their success are not. So I set out to study exactly why and how the digital giants turned the competitive order on its head.

My research over the past five years made one fact crystal clear: Creating competitive advantage is different in the digital age. Until recently the greatest competitive advantage went to companies that controlled distribution channels, had hard assets on the largest scale, or had established brands or patents. Today those advantages no longer ensure that a company will outcompete others.

In the digital age, competitive advantage is the ability to win the ultimate prize—the consumer's preference—*repeatedly,* through continuous innovation on behalf of the consumer, and to create immense value for shareholders at the same time.

Competitive advantage comes as much from what a company *does* as from what a company *has:* how it perceives the consumer experience, selects leaders, organizes work, and makes money as well as its ecosystem and access to data and funding. The sources of competitive advantage, once developed, can be hard for traditional companies to match, because they are ingrained (a mindset for exponential growth and an action-oriented culture). They are cumulative (more data leads to better consumer insights; larger scale generates more cash). And they are systemic (better predictions lead to more customer satisfaction and lower costs, which in turn increase revenues and cash gross margin, which provides the cash to innovate and serve the consumer better).

This book has two main purposes: to fully explain the sources of a digital giant's formidable competitive advantage, and to help other companies see a path to building theirs. From my observation of digital companies, I have identified a new set of rules for creating competitive advantage. These new rules explain what *any company*—whether it is a digital giant or a traditional company—must do to prosper in this digital age. For legacy companies that are becoming digital, this book will fill in the pieces that leaders often miss when they focus on technology alone. For example, it might encourage them to be bolder in redesigning how work gets done as they build their digital capability (see chapter 7 on how Fidelity Personal Investing did just that).

For traditional companies that have not yet begun to move, this book is a call to action. By explaining how digital companies compound their competitive advantages, it shows how quickly traditional advantages can erode and how inadequate existing mindsets and tools have become. The gap between the digitals and nondigitals widened during the coronavirus outbreak, when digital companies were able to adjust quickly to the abrupt changes in consumer behavior, supply chains, and work life, and their competitive advantage in moneymaking gave them more cash to sustain the business.

In April 2020, in the midst of the pandemic, Netflix CEO Reed Hastings wrote a letter to shareholders posted to Netflix's website for investors that reassuringly reminded them that "Netflix's culture is designed to empower decision making at all levels of the company." He went on to say that within two weeks of the shelter-in-place orders going into effect in Los Angeles, most of their animation production team was back up and running, working from home. On the postproduction side, they were able to get 200+ projects going remotely. And most of their series writers' rooms were operating virtually.

The coronavirus shock was extreme. But even in a normal period, the burning question is: Against today's digital behemoths, do others stand a chance? Unequivocally, yes. Traditional companies across the board are in the early stages of becoming digital. The ones that rethink their competitive advantage sooner will quickly overtake their peers and, yes, they can challenge born-digital players. Amazon boomed during the coronavirus pandemic. So did Walmart, because it was further along in digitizing its business than many legacy retailers.

No competitive advantage is ironclad. It must be earned on a daily basis. Amazon still dominates e-commerce, but Walmart is on the rise. For years Netflix was virtually alone in the video streaming market space, but now digital giants Amazon and Apple have ramped up their presence, along with traditional players Disney, NBC, and WarnerMedia.

Netflix subscribers surged to 182 million in the first three months of 2020 when everyone was stuck at home, but by late April 2020, Disney+ had amassed a respectable 50 million subscribers, NBCUniversal launched that month with 15 million, and AT&T's awaited launch of HBO Max was imminent.

The means for gaining competitive advantage are increasingly available. Algorithms and expertise can be acquired at relatively low cost. And funding continues to flow to companies that adopt metrics and models that reflect the new fundamentals of moneymaking.

Knowing the new rules of competition will raise your perspective and help you set the course in the complex and fast-changing landscape.

Chapter 1 explains the underlying forces that have turned a handful of start-ups into trillion-dollar-market-value giants in fewer than twenty-five years. My point is to show you exactly why they have changed the competitive landscape, and what it means for your future. Chapter 2 describes some conventional business practices that no longer work and some common beliefs that must be dispelled.

Chapters 3 through 8 explain each of the new rules for creating competitive advantage and use real-company examples to show how to put them to work Monday morning. Chapter 9 will give you encouragement to act by showing how quickly some legacy companies have moved.

It has been my mission in life to provide insights and knowledge that are useful to practitioners. I hope this book succeeds in that mission.

RETHINKING COMPETITIVE ADVANTAGE

CHAPTER 1

WHY THE DIGITAL GIANTS ARE WINNING

In February 2019, as Hollywood's elite convened for the 91st Academy Awards ceremony, Netflix found itself in a war of words with famed director Steven Spielberg. *Green Book*, the movie Spielberg had backed, won the Oscar for Best Picture. But Spielberg made it clear that he didn't think *Roma*, another strong contender that had been produced by Netflix, should have been in the running for an Oscar at all.

Spielberg's argument against *Roma* was that it was streamed by Netflix directly to consumers after an exclusive run of just three weeks in movie theaters. Traditional films are shown in theaters for months at a time. Shortcutting a theatrical release, Spielberg argued, deprives moviegoers of an immersive big-screen experience and puts the entire theater system at risk.

As the Academy's board of governors prepared to debate the issue, one governor remarked: "The rules were put into effect when no one could conceive of this present or this future."

Actually, Netflix CEO and cofounder Reed Hastings conceived of this future nearly two decades ago, before broadband was widely used. Then Hastings did what leaders of every successful digital company do. He exploited new technology to create the future he imagined much faster than other people thought possible.

Imagining new market spaces and revenue pools that can scale up at unprecedented speed is just one way that born-digital companies—those that were digital from the start—have gained a huge competitive edge in recent years. Thinking differently about how to make money and fund growth is a second way. And using algorithmic technology to reorganize work and enhance decision-making is yet a third.

In today's competitive age, traditional companies need to know what they're up against and learn from the born-digital players how to build competitive advantage.

The New Nature of Competition

Back in 2000, even as Netflix built its competitive advantage by sending out DVDs by mail as opposed to having consumers visit retail video stories like Blockbuster, its leaders knew that broadband technology would someday be fast enough, cheap enough, and good enough for consumers to watch movies sent or streamed to their devices directly, anywhere at any time. The technology still wasn't advanced enough in 2005 when Hastings told *Inc.* magazine's Patrick J. Sauer: "We want to be ready when video-on-demand happens."

In 2007, the time had come. About half of U.S. residences had access to broadband, and Netflix was ready to begin streaming movies into the homes of its customers. YouTube was experiencing rapid growth, and Hulu, owned in partnership between NBC and Comcast, sprang up around the same time. Netflix flourished because of a powerful combination of elements.

For one thing, Netflix charged a monthly subscription fee that gave consumers access to unlimited videos—a novelty at a time when most people rented one or a few DVDs or VHS tapes at a time. To be sure that consumers would not run out of new things to watch, Netflix licensed content from traditional media companies. Subscribers could watch popular new film releases without leaving home and for the first time could binge-watch their favorite old TV shows.

None of that would have been possible without a technology platform that could deliver a smooth viewing experience. But Netflix's digital platform didn't just transmit signals through broadband connections—it also gathered data about its customers' viewing habits along the way. Algorithms got increasingly better at analyzing that data to help subscribers find content they liked amid a widening array of options.

Building its digital platform, securing broadband spectrum, paying licensing fees, and hiring technology experts to write and refine the algorithms all contributed to Net-