



EXECUTIVE FOCUS

Digital transformation, the Holy Grail, and the disruption of business models: An interview with Michael Nilles



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In this Executive Focus, Andreas Hinterhuber interviews Michael Nilles—chief digital information officer of Henkel AG & Co.—and discusses the game-changing opportunities that digital transformation presents to companies that embed a digital core into their business models. Nilles sees digital transformation as the Holy Grail: a force that is not easy to find, not easy to capture, and that has the potential to dramatically improve the customer experience. In the business-to-consumer (B2C) channel, the Holy Grail for Henkel's Beauty

Care business is the beauty tech ecosystem, a series of connected devices harnessing big data and augmented reality allowing for the creation of meaningful, personalized, and direct relationships with consumers. In the business-to-business (B2B) channel, the Holy Grail is Henkel's digital twin along the digital thread. Henkel builds a digital twin along the entire value chain of the customer—starting with the initial customer request via deployment, until and after sales service—to sell outcomes to customers. In B2B, the digital twin enables outcome-based servitization. Digital technologies are thus more than enabling technologies: Digital technologies allow the creation of fundamentally new disruptive business models. The digital transformation needs small, agile teams with end-to-end responsibility for project delivery, start-up mentality, and customer obsession. Finally, key metrics of the digital transformation are digital efficiency/productivity, digital revenues, and digital growth (net of cannibalization).

Andreas Hinterhuber for Business Horizons: Thank you for taking the time to meet with me, Mr. Nilles. To begin, how do you interpret digital transformation?

Michael Nilles: Digital transformation is like the quest of the Holy Grail: different for each business. I use the term Holy Grail purposefully since

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the Holy Grail is not so easy to find and not so easy to capture. We are constantly asking the question: What is it that is moving the needle in terms of the long-term impact of business model disruption?

Take our beauty care business unit, for example, a business with globally about €4 billion in revenue. The market dynamics are changing rapidly: Consumers now demand personal, meaningful, and direct relationships with brands. We see new business models emerging such as subscription-based businesses. In B2C, the Holy Grail of digitalization—the force that is moving the needle in terms of disruption—is our beauty tech ecosystem. We build a digital ecosystem around the consumer.

So, digital transformation is the use of technology to create customer value that could not have been created in the absence of technology?

Some executives and academics see digital transformation as enabling technology. I disagree. Digital transformation goes far beyond technological enablement. Digital technology, for sure, is also an enabling technology that leads to efficiency improvements in the supply chain or other functions. Digital transformation fundamentally improves existing business models or disrupts existing business models. The point is this: Digital transformation will lead to the disruption of business models, either by us or by competitors, and—paraphrasing Steve Jobs—I would rather disrupt my own business than have a competitor do it. This is why we invest in start-ups since some of these companies will one day disrupt current business models.

One key aspect of digital transformation is building digital business models. One example is Streetbees, a Henkel dx portfolio company that uses digital technology to create a meaningful relationship between consumers and brands by allowing consumers to directly give insights into their buying and usage behaviors. Streetbees encourages consumers to record their decisions, emotions, and attitudes in the brick-and-mortar world with their own words, using video, photo, and text on their digital devices. This is an approach that is really in contrast to pure, traditional market research.

This is one example where digital transformation leads to disruptive opportunities that simply would not have been possible before. Another great example is eSalon, a direct-to-consumer (D2C) business focused on individually customized hair coloration for at-home application. The consumer

can shop a truly personalized product as part of a subscription model or as a one-time purchase. This, again, is a digital business model, where technology is deeply embedded in the business model. This close link between digital transformation and digital business models is also reflected in McKinsey's growth framework.

In Horizon 1 (extend and defend core businesses), digital technology is an enabling technology. In Horizon 2 (build emerging businesses) and in Horizon 3 (create genuinely new businesses), digital technology is deeply embedded in the business model.

I appreciate the link between McKinsey's three horizons of growth framework and the role of technology in the context of digital transformation. In Horizon 1, digital is an enabling technology; in Horizons 2 and 3, digital technologies are the building blocks for disruptive new business models. Great insight. Let us now explore a world that I know better than the B2C world: B2B adhesive technologies is Henkel's largest business unit with over €9 billion in sales.

In B2B, the digital transformation is essentially built on data. In our adhesives technologies business unit, we are a global market leader for one reason: we understand customer needs, we have the right technologies, and we know how to apply them to create custom solutions. We are a know-how company. So, what is the Holy Grail of the digital transformation in B2B? It is the so-called digital twin along the digital thread. We build a digital twin along the entire value chain, from the original customer request to production, supply chain, deployment, and after-sales service.

In B2B, digitalization thus enables digital servitization: selling business outcomes as opposed to selling products and services. How do you define key business outcomes, or KPIs if you prefer, which you guarantee to your customers? Once they are defined, what does a pricing model look like?

For me, a good example is industrial goods companies, which transform from a pure product business to a service business and ultimately to data-driven, outcome-based service models. You typically move within such a service transformation from a service delivery model based on break/fix to a service model based on outcomes: you are for instance guaranteeing a certain uptime of your machinery. Customer uptime is the key

factor in the price the customer pays, with agreed-upon penalties for severe underperformance. I had the chance to drive such a transformation myself.

This is a good example of value-based pricing.

You should consider that such a pricing model is the result of a long experience in the product business in the first place. You typically build on a very long history and experience in the product business. Starting with a simple break/fix model, you then shift toward a company offering services. And building on that, you offer service contracts based on human experience. For a data-driven, outcome-based business model, you have to offer digitalized services such as 24/7 remote monitoring or preventive maintenance. The experience and the evolution of the service delivery model then have to go along with the development of digital capabilities, allowing you to deploy digital technologies.

Which company is, in your view, best-in-class in digital transformation? From which company or which industry are you currently learning?

Except for born-digital companies, there are, as of today, few product-based or service-based companies that have mastered the digital transformation. GE under Jeff Immelt was an early leader. Immelt's strategy of building an industrial internet and an open platform, Predix, was a pioneering and bold move at the right time. GE's five pillars of digital transformation (see [Figure 1](#)) still capture the main challenges quite well.

As we now know, the strategy of GE was great, but the company ultimately had to deal with other issues than digital transformation. There are few lighthouses to serve as examples of getting the implementation right. There are, this is clear, no easy answers on how to get digital transformation right.

There is, however, one fundamentally important shift that I would like to point out: a move within product architecture toward a software-driven stack. Consider Tesla. One thing that Tesla did extremely well was the development of an own digital stack, enabling the company to update the software—and thus, the car—over the air (OTA). An OTA software update is almost like getting a new car, over the air! This is what industrial businesses can learn from Tesla: industrial companies could complement their traditional product architecture with a software-based architecture with OTA updates. OTA update capability is then a key value driver and many machinery companies are struggling with this challenge.

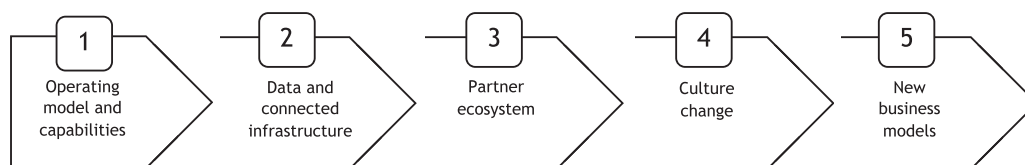
The second thing that Tesla is doing extremely well is the D2C approach. Tesla knows its real customers and is very well managing the relationship with them along various touchpoints.

Let us now turn to organizational aspects of digital transformation. Which capabilities, what type of structure are relevant to implement the digital transformation?

Structural changes are required to implement the digital transformation successfully. In July 2020, Henkel changed its own digital structure: Henkel dx is the name of our new organizational unit that now combines digital capabilities, traditional IT, new ventures, and business expertise under one roof. Our mission is "creating the next"; we are truly committed to creating the next big opportunity for Henkel as well as more operational things like the next level of better services. In our dx compass, we have identified five cultural drivers that are crucial for our digital transformation (see [Figure 2](#)).

- Business and customer obsession: Every day, without exception, we think and live business, customer, and consumer first. Our passion is to

Figure 1. The five pillars of the digital transformation



Source: Adapted from Talya and Mattox (2016)

Figure 2. The cultural drivers of the digital transformation

FIVE CULTURAL DRIVERS TO EMBED DIGITAL INTO OUR DNA

**Business & Customer Obsession**

Every day, without exception, we think and live business, customer and consumer first. Our passion is to create high impact and value through digital innovation. We believe in the power of digitalization.

**Business Domain Expertise**

We are trusted experts to our businesses. We speak their language and deeply understand business models, products, processes, and the dynamics of our markets. We never stop improving ourselves.

**Proud to be Tech**

Our heartbeat is technology. We love software, data, and analytics. We take pride in building tech to solve the toughest business challenges. We are passionate about exploring emerging technologies and leveraging their full potential.

**BizDevOps**

Together we create, develop, and operate everything end-to-end. By bringing together our business domain and tech experts, we leverage our unity of effort. This enables our dedicated and interdisciplinary teams to deliver a better and faster outcome.

**Startup Mentality**

We are bold, persistent, and committed to growth. We believe in the power of open ecosystems. Driven by the market, we test and learn, we build fast (in weeks, not months), and are always ready to adapt.

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We know little about the origins of innovation in the context of digital transformation. There is one recent piece of research that suggests that the digitization of existing products and services is mainly driven top-down, whereas the creation of radically new digital products and services is mainly a bottom-up approach. What is your take on this?

In my opinion, this view is too simple and probably incorrect. As a prerequisite for innovation, companies need to change their mindset about innovation from viewing innovation as a closed-system approach to viewing innovation as an open, collaborative approach where intellectual property (IP) protection is not the only question anymore. Key to managing innovation

OUR AMBITION

BECOMING DIGITAL BUSINESS LEADER IN OUR INDUSTRIES

Digital applied is our world. We see economies, societies, customer and consumer behavior massively changing and thereby reshaping our markets. Radically focusing toward individual customer and consumer needs, we build digital and data-driven business models to optimize, transform, and disrupt, turning threats into opportunities. Consequently, we aim to play at the digital forefront of our industries.

DRIVEN BY OUR MISSION

CREATING THE NEXT

We are creative minds. Our dedication to innovation is endless. From ideation to business impact. What we have achieved today won't be enough for tomorrow. We explore the impossible, push boundaries to make it happen. At all levels and without limits. Applying data and digital, from continuous optimization to the next big thing. Together, we are CREATING THE NEXT.

Figure 3. The three horizons of growth and key performance indicators of the digital transformation

	Horizon 1	Horizon 2	Horizon 3
	Extend and defend core businesses	Build emerging businesses	Create genuinely new businesses
Role of digital technologies	Enabling technologies	Creation of new, disruptive business models	Creation of new, disruptive business models
Key metrics	Digital efficiency/productivity	Digital revenues Digital growth (net of cannibalization)	Digital revenues Digital growth (Net of cannibalization)

successfully in the context of the digital transformation is a mindset change toward open innovation aimed at producing solutions that can be connected to an ecosystem. This requires a true transformation of the traditional innovation mindset.

In terms of the origins of innovation, companies need to provide alternative pathways for innovative ideas. They need to develop a roadmap for digital innovation outlining key activities and initiatives. I see three alternative pathways:

1. Strategic innovation, aimed at producing disruptive new business models, is top-down. Getting these big bets right is difficult and risky.
2. Open innovation, by contrast, is diffuse and bottom-up: we co-innovate with other companies, with start-ups, and with academics—we get a lot of impulses on data models related to innovation from academics and the contribution of academics to corporate innovation should not be underestimated.
3. Incubation, finally, is also bottom-up. On the one side, via corporate venturing activities we invest in start-up companies not only through acquisitions but also through minority shareholdings; we see the latter as a viable scouting model to get insights into emerging trends and cutting-edge technologies. On the other side, we have internal incubation activities in the form of a digital innovation fund. The logic for investing internally, i.e., in ideas coming from Henkel employees around the globe, is quite similar to the logic of investing

externally: people come with ideas, they get money with literally zero bureaucracy and we apply the metrics of any brave venture capitalist expecting that out of ten ideas, eight will fail. For our internal incubation, we have announced digital innovation hubs in Berlin, Shanghai, and Silicon Valley to provide a platform to commercialize one or two successful ideas rapidly on a global scale.

In sum, innovation in the context of the digital transformation takes three distinct formats: strategic innovation from the top aimed at producing disruptive new business models, open innovation and incubation, bottom-up, which can both produce incremental and radical innovation.

Thank you. A final question concerns metrics. Which key performance indicators (KPIs) do you use to keep your digital transformation on track?

The most important digital KPIs are digital revenues, digital growth (net of cannibalization), and digital efficiency/productivity. Digital revenues and digital growth are closely linked to transforming and disrupting the business model. Digital productivity/efficiency KPIs are closely linked to optimizing the current business model. There is therefore a clear correlation between strategy—disruption versus improvement of the business model—and the KPIs that we are using (see [Figure 3](#)).

Michael, I truly thank you for the privilege of having this first-rate exchange of thoughts on digital transformation.

Thank you. I enjoyed it.