EY Building a better working world

The CEO Imperative: How mastering ecosystems transforms performance

Ecosystem business models are enhancing performance, accelerating innovation and driving transformational growth for organizations.

In brief

- A growing number of companies across geographies and sectors are making ecosystem business models a strategic imperative to drive stakeholder value.
- Those companies that exhibit leading practices in their management and execution of ecosystem business models outperform those that do not.
- Companies effectively managing ecosystem business models report benefits to innovation and operational efficiencies both within their organization and the market.

All CEOs are being challenged to transform their organizations to adapt to a much changed – and continually changing – business context. In response, a growing number of CEOs are embracing ecosystem business models – and with good reason.

A study of more than 800 business leaders leveraging at least one ecosystem business model has revealed that ecosystems make-up on average 13.7% of their total annual revenues, drive 12.9% in cost reduction and generate 13.3% in incremental earnings.

But not all ecosystems are created equal. High-performing ecosystems drive on average 1.5 times the cost reduction, and generate 2.1 times the incremental revenue growth, compared to low-performing ecosystems. In fiscal year 2020, companies with high-performing ecosystems also experienced higher average revenue growth and net profit margin overall.

In this edition of The CEO Imperative Series, which provides critical answers and actions to help CEOs reframe the future of their organization, we offer new insights into the rise of ecosystems, how they are driving transformational growth and the best practices of high-performing ecosystems.

What is an ecosystem business model?

We define a business ecosystem as a partnership between two or more entities that creates more value than any individual participant could create on its own.

Ecosystem business models are formed to co-create a product or service, market to a common set of customers and share in the value they generate.

At least one participant, the orchestrator, coordinates activities between participants, and all participants have their brands present in the final proposition.

We have explored the evolution of business ecosystem in previous articles, defining what business ecosystem means, why it matters and how organizations can create value through ecosystem integration.

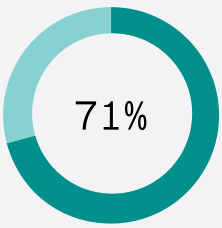
1 Ecosystems are on the rise

A growing number of organizations are generating value from ecosystem business models.

In the 2021 CEO Imperative Study, 31% of CEOs surveyed indicated that their strategy includes an external ecosystem of business partnerships. The 2021 EY Ecosystem Study shows that companies that have embraced ecosystems are generating significant value as a result. The EY study revealed that 69% of business leaders from companies that are part of an ecosystem believe ecosystems are very important to their company's current success, and 91% agree that ecosystems have increased the resilience of their business. As further evidence of success, compared to an ecosystem survey conducted by EY in 2020, these companies are also expanding their use of ecosystems: the average number of relationships has increased from five to seven, with 58% of respondents having more than four active ecosystems.

Further corroborating the increasing strategic importance of ecosystems, many companies are ramping up investment. For example, according to their 2020 annual report, IBM (an EY ecosystem partner) is investing US$1 billion in its hybrid cloud ecosystem so that its partners can play a much bigger role in fulfilling the needs of their clients.

The ecosystem era has arrived



believe ecosystems are very important to their company's current success.

Case study: a curated ecosystem to enable self-disruption

Nationwide Insurance required a new brand and a new technology platform to access a customer segment that might otherwise have been unobtainable. Recognizing that its existing approach to innovation and value creation would not be able to deliver the desired results in the required timeframe, Nationwide collaborated with the EY organization to launch Spire, a platform that helps enable customers to get an auto policy issued within minutes in a purely digital experience.

Spire was enabled using EY Nexus™, a digital platform for financial services that runs on Microsoft Azure and has access to an ecosystem of partners whose technologies can be added according to a company's specific needs.

Survey respondents reported that ecosystems are contributing on average 13.7% of total annual revenues, 12.9% in cost reduction and 13.3% in incremental earnings. In some industries, these figures are even higher, with respondents in the telecommunications industry reporting an average of over 16% in both cost reduction and incremental earnings.

One of the factors driving the increasing adoption of ecosystem business models is technological improvements. The cloud economy has dramatically lowered the technical and operational hurdles that made ecosystems difficult to set up in the past. In particular, the ability of digital platforms to enable multiple entities to connect through application programming interfaces (APIs) and to iterate quickly and effectively has made ecosystem value easier to develop and offer to end clients.

2 How ecosystems are driving transformational growth

Organizations that master ecosystems outperform those that do not across multiple measures.

While the majority of companies that operate an ecosystem are satisfied with the results, we identified a segment of respondents with "high-performing ecosystems". These ecosystems are more likely than others to account for a large share of their company's annual revenue and adopt best practices in ecosystem management. See our methodology for more details on how we identified high-performing ecosystems.

High-performing ecosystems generate significantly more value for their organizations compared to low-performing ecosystems. On average, high-performing ecosystems generate 1.5 times more cost reduction and incremental revenue growth, compared to low-performing ecosystems. This advantage is true across most sectors, with some – such as technology – showing even larger gaps.

Companies with high-performing ecosystems also tend to outperform. In fiscal year 2020, companies with high-performing ecosystems had higher average revenue growth (7.8% for higher-performing vs. 5.4% for low-performing) and net profit margin (10.6% for high-performing vs. 8.1% for low-performing).

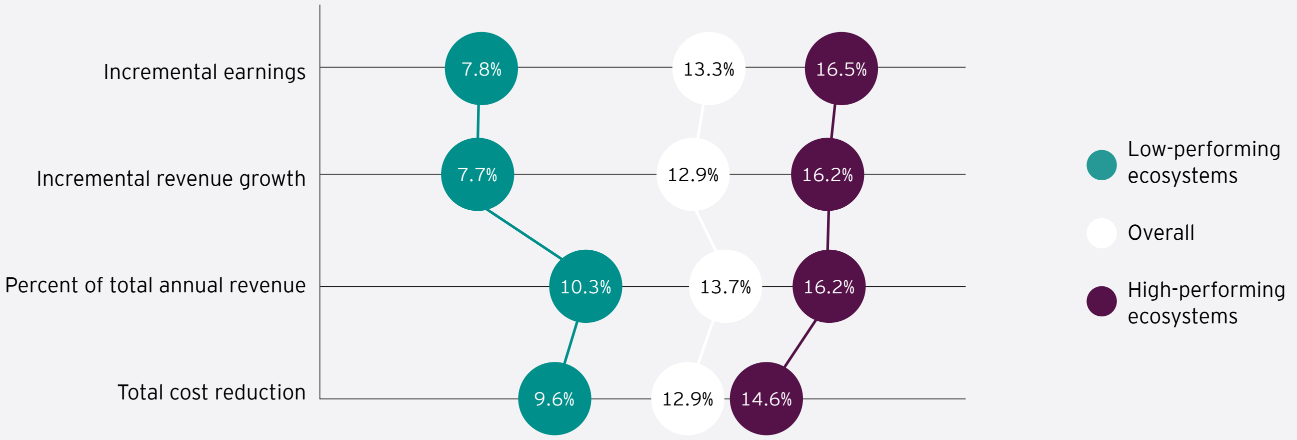
Method

To identify respondents with high-performing ecosystems, we looked at two factors:
1) the ecosystem's contribution to the company's annual revenue and 2) The company's adoption of best practices to build and operate an ecosystem. We used advanced statistics (latent class regression) to cluster respondents into groups. This identified three groups of ecosystems with the below characteristics:

- High-performing (37% of respondents): Tend to have high revenue contribution & adoption of best practices
- Medium-performing (40%): Tend to have moderate revenue contribution & adoption of best practices
- Low-performing (23%): Tend to have low revenue contribution & adoption of best practices

The financial impact of ecosystem business models

Reported by respondents FY2021



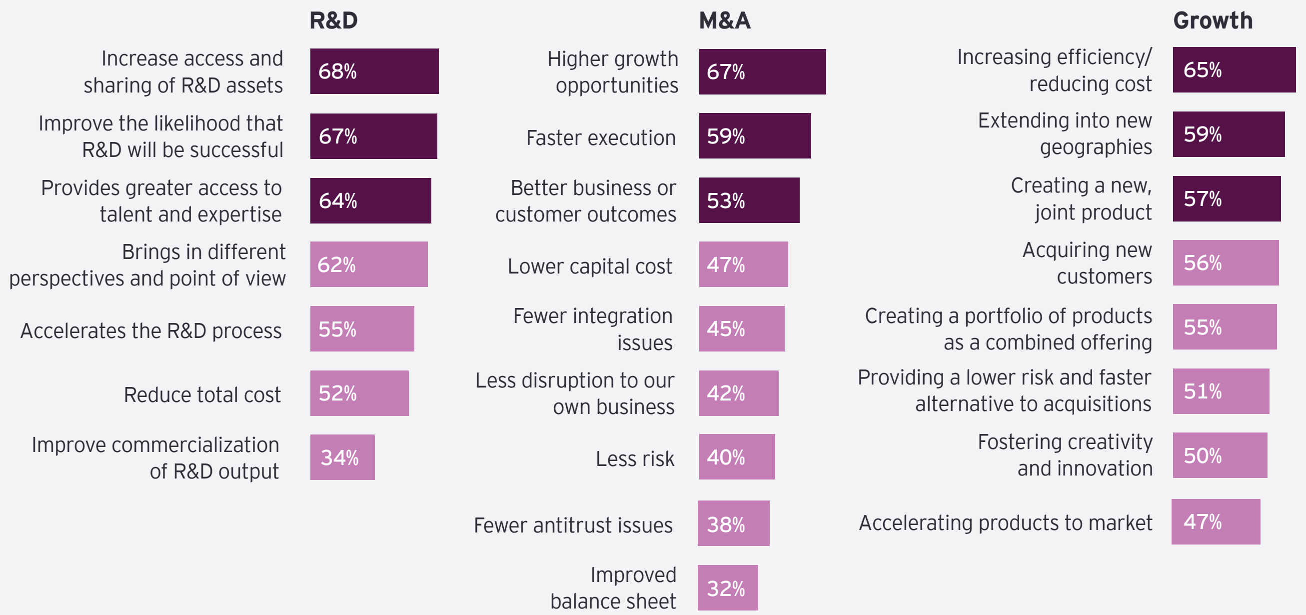
Note: The financial contribution of ecosystems assumes they meet their current/projected goals for the current fiscal year (FY21). "Incremental revenue growth" and "Incremental earnings" refers to additional contribution above current levels. For example, if current earnings are 10% and incremental earnings are 5%, total earnings are 15%. Number of respondents varies by segment and sector. Average number of respondents is 30; minimum is 17; maximum is 45.

Leaders of high-performing ecosystems are more likely to report advantages of ecosystems over traditional approaches in three key areas:

- **Growth:** Ecosystems drive growth through new joint offerings and access to new geographies, while helping deliver at lower cost reduction.
- **R&D:** Ecosystems provide access to the right assets, talent and expertise which contributes to a higher likelihood of R&D success.
- **M&A:** Ecosystems lead to better business outcomes vs. M&A, in part by providing higher growth opportunities and faster execution.

Advantages of ecosystem business models over traditional business models

% of respondents with high-performing ecosystems citing a specific advantage



Innovation and market transformation

The benefits of ecosystem business models extend far beyond the boundaries of the individual organization and have the potential to impact entire markets and value chains. Over 85% of executives agree that ecosystems are an effective way to connect large companies with small disruptors and foster innovation across value chains and with adjacent industries.

At EY, we are seeing this wider impact of ecosystem business models play out in the market as organizations use ecosystems not only to forge new relationships, but also to challenge sector boundaries to innovate at scale. For example, online retailers are partnering with brick-and-mortar stores to offer customers a more convenient experience, and global technology companies are tapping into an innovative ecosystem of start-ups to fuel technology development.

Case study: a blockchain ecosystem game-changer for the gaming industry

Microsoft Xbox's legacy royalty processing system took 45 days to access validated financial information about royalties earned, a lag that with the related paperwork proved cumbersome to many game publishers, especially the small firms with limited resources.

Microsoft Xbox and EY teams worked together to help transform this system, implementing a transparent blockchain ecosystem that automated the royalty process, reducing the manual effort and operational hours associated with processing royalties for publishers. Creators now have more trust in the process and can focus on creating new games.

3 Mastering ecosystems

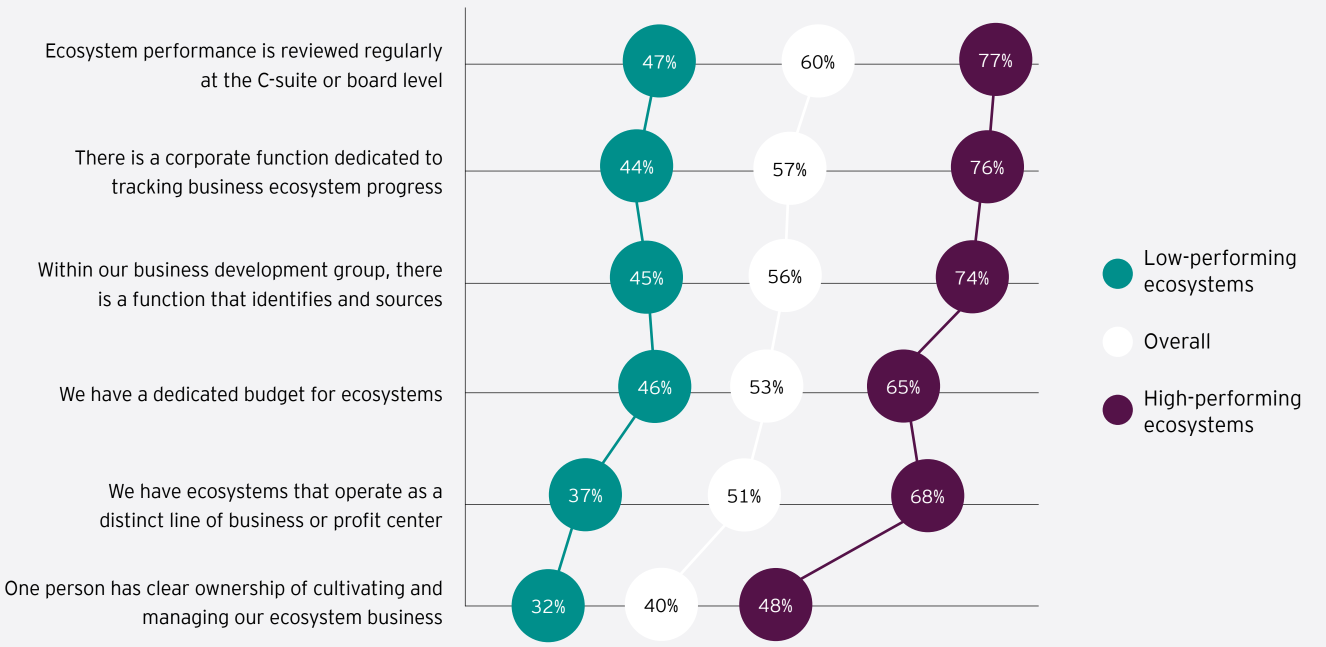
Recommendations and next steps for strategic integration of ecosystem business models.

As CEO, how do you ensure your company is best placed to generate value with ecosystem business models? Over 90% of organizations with high-performing ecosystems take at least three of the following actions to source, build and manage their ecosystem relationships:

1. **Ensuring regular review at the C-suite or board level:** when senior management and directors help to drive ecosystem strategy, there is clarity of purpose (77% of high-performing ecosystems).
2. **Creating a function that tracks progress:** when ecosystems are measured against dedicated KPIs, results improve (76% of high-performing ecosystems).
3. **Creating a function that identifies potential partnerships:** when experts oversee the makeup of an ecosystem, quality ticks up (74% of high-performing ecosystems).
4. **Allowing ecosystems to operate as a distinct line of business:** when ecosystems are given autonomy, they tend to deliver outsized results (68% of high-performing ecosystems).
5. **Developing a dedicated ecosystem budget:** when a company invests in ecosystems as a strategy, things get done in a timely and effective manner (65% of high-performing ecosystems).
6. **Giving clear ownership to one person:** when an ecosystem leader (Chief Ecosystem Officer) is hired, objectives are more likely to be met (48% of high-performing ecosystems).

Best practices for mastering ecosystem

% of respondents citing a specific best practice



Of course, the list is not a panacea. Every company will encounter challenges in setting up and maintaining an ecosystem. Three of the most common are:

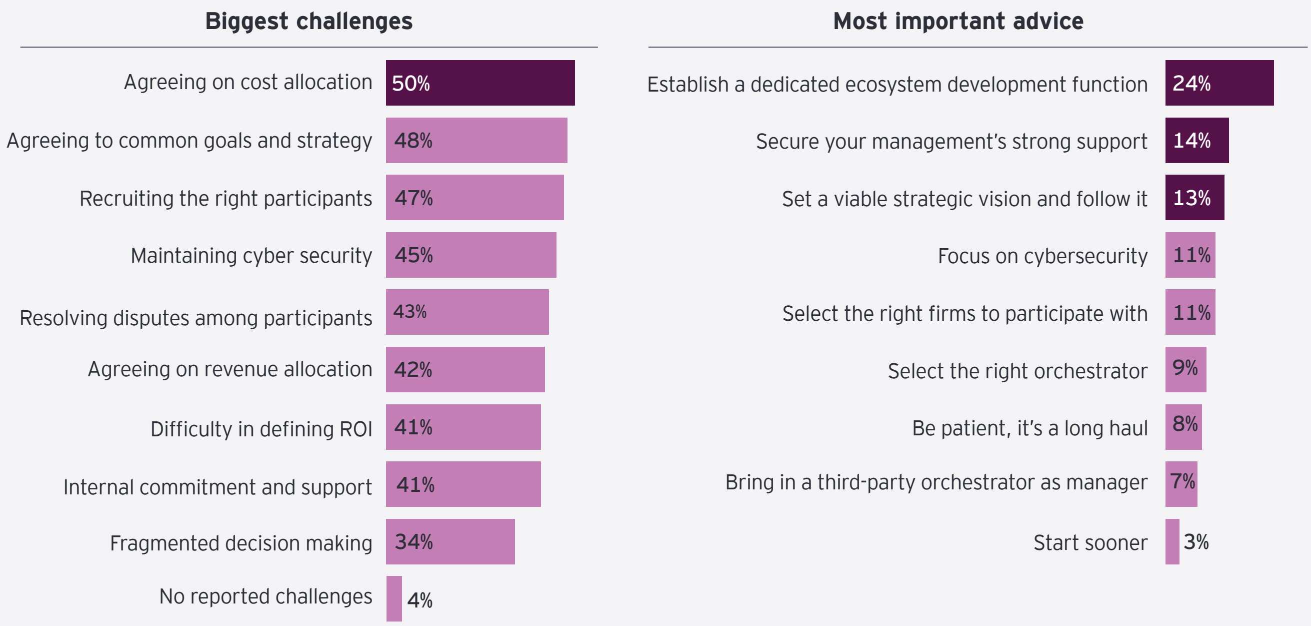
- Agreeing on common goals and strategy
- Resolving disputes between participants, notably cost and revenue allocation
- Ensuring the ecosystem has the right participants

Another key issue is data interoperability — the ability of systems and services to create, exchange and consume unambiguous data. Differing data privacy regulations, for example, mean this is an ongoing challenge for ecosystem participants.

These issues should be addressed as part of the relationship definition and contractual process, and specific relationship KPIs should be established and assessed during regular reviews to continually optimize your ecosystem's performance.

Doing ecosystems well

% of those with high-performing ecosystems citing specific advice/challenges



As more organizations explore and begin their journey towards business ecosystem value creation, it is also essential that they can understand and identify the correct models to participate in or orchestrate. To help with this first step, recently we identified seven distinct ecosystem business models, each of which has a set of distinguishing attributes and characteristics.

Creating long-term success

With ecosystem business models demonstrating significant operational and performance impact over traditional approaches such as building or buying, a growing cohort of companies across geographies and sectors are making them a strategic imperative.

That being said, ecosystem relationships and business models are technically, operationally and commercially complex. They also impact every aspect of an enterprise, yet many companies are not structured or culturally aligned to participant in, orchestrate or monetize them. The EY CEO Imperative Study revealed that 88% of CEOs believe the ability to form, lead and manage ecosystems will define successful leadership teams. However, only 48% of survey respondents with high-performing ecosystems indicated they had an ecosystem lead, and when they do, it is usually a functional title that does not guarantee the holder has cross-departmental authority.

Given ecosystems' increasing strategic importance, there is a clear opportunity for business leaders to refresh their talent strategy and appoint a Chief Ecosystem Officer — an individual at the highest level in the organization who can move ecosystems from a silo to an enterprise-wide growth and value-creation strategy.

Whichever way ecosystems are operationally embraced, for those that make ecosystems a strategic imperative and integrate them into the fabric of how they create value, the rewards can be transformational.

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> Appointing a Chief Ecosystem Officer may be an effective way that companies can overcome the challenges associated with developing successful ecosystems.

Summary

With the number of companies participating in and/or orchestrating business ecosystems increasing, there is no doubt that the era of ecosystem is here. The EY Ecosystem Study shows that companies evidencing leading practice in their mastery of ecosystem outperform those who do not.

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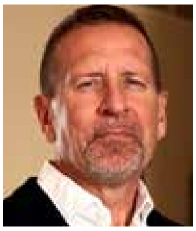

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