Finding Your Place in the New World of Communications, Media and Entertainment

Distribution models are forcing communications, media and entertainment executives to participate in network platforms where their companies can contribute differentiated value and generate meaningful returns. A reliable framework is a critical first step for evaluating each company’s fit within the industry’s continuously transforming value chain.
Executive Summary

It’s not breaking news that ever-accelerating advances in digital technology are reshaping the very essence of the communications, media and entertainment (CME) industries. Freed from the constraints of any physical medium, digital content is being produced more quickly, distributed more easily and consumed more broadly than ever before. Smart devices for media consumption, and more, are becoming more pervasive and less expensive to own and operate, fueled by mobility and ubiquitous broadband access, creating a self-reinforcing cycle of growth and change among service providers, content providers and consumers.

The rapid pace of innovation from all quarters presents great challenges to industry executives charged with leading their companies through the sea of digital change. As traditional boundaries fall, it will become much more difficult for companies with similar value propositions to coexist. In response, select industry players are leveraging digital technologies to reduce costs, create new products and services and expand into non-traditional markets. This is spurring established organizations to question the very core of their traditional business models and forcing other players – young and old – to work overtime to protect what had been their advantage. In all cases, there is a clear need for all companies to formulate or revisit their strategies for harnessing and profiting from the forces of change.

History provides valuable insights. While the details may be new, core challenges to today’s CME companies are not novel. Over the years, these industries excelled at beating back competitive threats by embracing new technology and altering their business models and product offerings, as well as leveraging disruptive process change to their own benefit.

Case in point: Piracy proliferated when cassette tapes and VCRs went mainstream; by embracing these piracy-prone technologies to create new distribution channels and entertainment experiences, the music and film industries ultimately earned record profits. Another example is the movie studios of the 1930s, which faced indirect competition from radio as a source of entertainment. Studios responded by producing content for radio, turning radio programs into feature films and introducing innovations (such as synch-sound and color) that enhanced the cinematic experience and ushered in cinema’s Golden Age.
Fast forward to today: Content delivered “over the top” (OTT) via the Internet and Voice over Internet Protocol (VoIP) are just two of the latest developments to challenge communications providers and content creators. These services are part of the emerging competitive battlefield on which CME companies can and will distinguish themselves. Formulating or analyzing an enduring strategy in a market characterized by complexity and continuous change won’t be easy. With all the potential options to pursue, it’s critical for CME companies to define how they will create distinctive value in one or more of three fundamental roles of the industry value chain: production (P), search (S) or delivery (D).¹

While these fundamental roles of the value chain are not new, the options for creating value in each category are dramatically different today. In conjunction with researchers from the Massachusetts Institute of Technology (MIT), we have developed a strategic planning framework that can help strip away some of the clutter and enable CME executives to focus on the core of how their companies create and sustain value in the quickly evolving global marketplace. The PSD framework helps identify the strategic areas on delivery platforms, or ecosystems, where complementary parties can share risk and generate collective value. These emerging platforms boost each participant’s ability to contribute differentiated value and reap meaningful returns.

An Ever-Changing World

The CME industries were among the first to be forever altered by the emergence of the commercial Internet, since their products were easy to digitize and distribute as bits and bytes to an enthusiastic global audience. Change is being driven by five interrelated and unrelenting digital forces (see sidebar, page 3).

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The Five Digital Forces

Digital forces are reshaping the industry in ever-changing ways. The convergence of information goods, powerful computing devices and inexpensive digital communication is changing business and society through five digital forces:

- **Globalization**: Today’s global economy is remaking the nature of supply and demand. As artificial barriers disappear, consumers enjoy a new world of choice no longer limited by geographic borders. Companies benefit from larger markets and global sourcing, while concurrently needing to fend off challenges from foreign competitors.

- **Millennialization**: With the onslaught of consumers who came of age in this millennium, companies need to respond to their digitally-centric lifestyle, which turns consumers into producers, empowers individuals to share their voices and transforms the way people evaluate and consume products and services, both digital and physical. This phenomenon has become mainstream and is spreading to all age groups.

- **Prosumerization**: There are two meanings to this term. The first refers to the phenomenon of professionals leveraging tools created for the consumer market and, in the process, creating innovative new content types (such as TV episodes shot on consumer-grade video cameras for an earthly look). The second is the converse: amateurs using equipment geared toward creating content that would previously have required professionals to create. The amateur-produced Super Bowl commercials are an example of the latter. Created at the intersection of shrinking costs and the increasing quality of tools needed to create salable information products, prosumerization has lowered the break-even point for producers and given birth to low-overhead startups that can compete directly with capital-intensive (and sometimes debt-burdened) incumbents.

- **Business virtualization**: Companies can become empowered to focus on their core strengths by partnering with third parties that can better execute contextual business processes. When purposefully pursued, virtualization can reduce costs, increase agility and boost quality by moving some process steps to specialists that excel in those specific functions, freeing resources for more creative and business-critical matters.

- **Cloud platformization**: Digital platforms are increasingly becoming the systems of engagement through which organizations deliver critical pieces of the value chain. Often delivered via the cloud, digital platforms provide interfaces that bring together suppliers, customers and third parties into a mutually reinforcing synergy. These platforms are replacing traditional middlemen and can level the playing field by granting small players and new entrants access to formerly closed markets.

Nowhere are the effects of the five forces more pronounced than in the CME industries. As they reshape industry structures and redefine what it means to be successful, companies in these sectors face difficult competitive challenges, while seizing new revenue opportunities. Executives need a set of stable strategic tools to harness the tempestuous changes wrought by these forces.
What Change Looks Like: Today’s Newspaper Value Chain

To view the digital forces in action, consider how the newspaper value chain has been radically reshaped in recent years. Historically, newspapers competed in markets delimited by location. The Internet has globalized this competition, so that today, papers’ Web sites now attract readers from all over the world. At the same time, whereas many newspapers enjoyed captive markets or competed with only a few alternative publications, every newspaper that posts content to the Web now competes with every other one for readers’ time and attention, and for the accompanying advertising revenue.

This massive shift from local to global reach and international competition influences almost every aspect of the industry. The most prominent changes to the newspaper value chain are detailed in Figure 1. Each change is labeled according to the force(s) driving the transformation (G=Globalization, M=Millennialization, P=Prosumerization, V=Business virtualization, C=Cloud platformization).

How the Five Forces Impact the Newspaper Value Chain


Figure 1
The value chain can be deconstructed as follows:

1) **The traditional newspaper value chain followed a very linear process,** in which journalists created content that proceeded through the editorial, technical and logistic processes necessary for delivering the article to a newstand or subscriber’s home. Today, journalists have begun to “publish” news for consumers to read that bypasses the conventional editorial and production process.

2a) **Web 2.0 platforms give “millennialized” newspaper readers more input into the content creation process.** Non-journalist readers now play a part in creating newspaper content when reporters reach out to the community for help researching a story.

2b) **Many local events are now covered by people without professional training.** While a substantial amount of this content appears in the online version, papers now include citizen journalist articles on the printed page, as well.

3) **A key function of newspapers is to curate articles so readers can get the information they need from a single source.** As journalists blog and tweet the news as it happens, new services that assimilate the content of these blogs are appearing. *The Huffington Post* is one important example. Now, readers can visit sites such as Muckrack.com that blend blogs with tweets from a large number of journalists representing numerous newspapers and media.

4) **As new types of services begin to aggregate content from journalists, a larger disruption to the newspaper business comes from sites that aggregate content from newspapers after it enters circulation.** Internet news portals such as Google News organize content from major news sources into one convenient place. Readers visit one aggregator rather than a series of individual newspaper sites, which helps the consumer save time but absorbs much of the advertising revenue that otherwise would go to the individual newspapers that created the content.

New aggregation business models are appearing that further shift revenue from newspapers to online companies. Whereas traditional articles provided links to published content, new entrants add a small content component to the information they aggregate. These companies provide a summary or commentary, along with a link to the original content, although many readers never click on that link.

5) **For decades, newspapers have provided low-impact ways for readers to provide feedback about content** (by sending a letter to the editor, for example, or by appealing to a newspaper’s ombudsman). As such, the newspaper information flow remained largely unidirectional. This changed, however, when newspapers began to include interactive Web 2.0 technologies. It is now easier than ever for readers to comment on articles and make suggestions, to which content providers can react in near-real-time.

6-7) **As more content distribution moves to the Web, the dynamics of newspaper circulation are changing.** Readers increasingly read their news online. Aggregation services are becoming important intermediaries. At the same time, readers begin to play a very important role in the circulation and distribution process. When readers find articles they like, they can now share them with friends via social media platforms.

Newspapers are still working to adjust their business models to capitalize on Web 2.0 and social capabilities. The industry has not yet found a way to replace the revenue it has lost. (See “*A Brave New World of Connected Media*” for additional insights.)
Lessons from the Past

Ironically, the industries struggling the most to adapt to the impact of digitization are the ones with the most experience holding their ground against threats introduced by new technology. Time and time again, these industries have faced potentially deadly disruptions and yet found ways to adapt to and even benefit from the threats. In the 20th century, both music producers and film studios faced strong threats from free content but managed to survive and eventually thrive.

Thrown back on their heels, these industries devised a variety of counterattacks to developments that threatened their existence:

- **Free offerings**: Just as free music on the radio threatened the recording industry, the introduction of television forced Hollywood to adapt to a world in which their customers could watch movies for free. As households bought televisions, people stopped going to the movies. In the early 1940s, the average person went to the movies more than 30 times per year. By the 1970s, movie attendance had dropped 83% to approximately five movies per year.

  Movie studios searched for ways to recoup lost box office revenue. Like the music industry’s response to radio, the major studios used technology advances to enhance their product. Wide-screen Cinemascope and Panavision productions helped differentiate the theatrical experience from the small, relatively square television picture.

  In communications, Skype is a no-cost alternative to telephone service and poses a very real threat to telcos. Under the freemium option, some features and content are available at no charge, while pay subscribers are entitled to higher level benefits. Wireless and cable providers are countering by focusing on enriching data services and including phone services as part of the larger communications services bundle.

  On the entertainment side, Hulu and similar offerings stream recent network television content to Internet viewers. In creating Hulu, the participating television networks have accepted that the future lies in streaming video. If they do not embrace the shift, others will control the gateway to consumers. What makes Hulu remarkable is that the media partners involved are creating a new platform to optimize future revenue potential at the expense of many traditional offerings.

- **Piracy**: A problem since the invention of the printing press, piracy has become rampant throughout the globe as new technologies facilitate the high-quality duplication of copyrighted works. A look at trade publications or a visit to the Web sites of the Recording Industry Association of America (RIAA) and the Motion Picture Association of America (MPAA) shows that stopping piracy has become the key issue for companies in these industries. They are not alone, as other industries that rely on copyrighting find themselves victims of the distribution of unauthorized reproductions.

  Yet this is not new. The compact cassette tape enabled music consumers to copy LPs onto blank media rather than purchase a second copy from the record label. When the industry lost its battle to prohibit the sale of blank tapes, it co-opted the new medium to capitalize on the shift in consumer listening habits. Within five years of the Walkman’s debut, sales of cassettes surpassed vinyl records. Within eight years, the cassette overtook all other formats combined.
The shift from music at home to music on-the-go, as well as the industry’s embrace of a disruptive technology despite the piracy risk, lined the wallets of the record labels. What has worked, however counterintuitive it may be, is embracing disruptive technology and using it to create new, highly lucrative markets. Oftentimes, new or alternate business models are necessary to accomplish this.

- **Direct and indirect substitutes:** Direct substitutes compete in the same market as the incumbent by offering a product or service that meets the same consumer needs. Indirect substitutes do not fulfill the same customer needs but compete for scarce resources such as attention, time or discretionary spending. Cell phone text messaging, instant messaging and e-mail are all indirect substitutes for wire-line communications services. The telecommunications industry has repurposed these wire-line customer relationships into broadband and video customer relationships, while continuing to provide voice services either through their own cell phone services or low-cost digital voice services.

CME companies in the pre-digital world beat back threats time and again by changing their technology, altering their business models and/or product offerings and co-opting disruptive technology to serve their profit-making goals.

### The Next Big Competitive Shift: ‘Over the Top’

CME companies’ mettle is being tested yet again, with an important competitive shift now under way. The rise in OTT search and delivery of content via the Internet will dramatically shift revenue from traditional streams to these modern offerings— or potentially erode them altogether.

In the cable industry, examples of OTT include on-demand video services, such as Hulu, iTunes and Amazon Instant Video for consumption on TVs, computers and mobile devices. These offerings are substitutes for the cable industry’s core video distribution business model. Because of the Internet, the packaging and delivery of video— and the means to search for available shows and movies— is changing rapidly. Millennial consumers in particular are adopting the new model in droves, as evidenced by NBA.tv and MLB.com.

Leading cable television players recognize they cannot wish away OTT’s strategic imperative and must instead find profitable ways to meet changing consumer expectations. At a recent industry conference, Time Warner CEO Jeff Bewkes said his industry should allow viewers to access content on any device or platform: “We as an industry have to look at the interfaces and let the consumer use the interface they want. If they like what Apple does, or Netflix does, you’ve got to let them use that.”

At the same conference, Bewkes and other cable executives— News Corp. COO Chase Carey and Cox CEO Pat Esser— endorsed OTT distribution models that let consumers access subscription video programming on the Web and mobile devices. Carey and Ted Sarandos, Netflix chief content officer, added that the industry faces challenges keeping up with the rapid changes in technology and rates of consumer adoption to new devices and platforms.
“We get hung up too much on the rules of the past. We need to figure out how do we adopt and embrace these new technologies and ways to deliver a better customer experience,” Carey said. Bewkes noted that it shouldn’t matter which device a consumer uses to watch video, including big TV screens on a wall or tablet computers. Sarandos agreed, saying, “I think that we are at the very first stages of a reinvention of television.”

In recent memory, iTunes and Amazon seized the high ground by providing dominant search and delivery capabilities for music and books. For companies participating in content creation and distribution, the specter of a dominant search and delivery player is both a threat and an opportunity.

Under the traditional business model for video, content moves from publisher to cable provider, with the cable provider splitting the search function between channel providers (packaging of shows at defined times during the day) and themselves (channel guide and subscription channel packages). This model is changing (see sidebar, below).

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**Quick Take**

**Sarah’s Story**

Sarah, age 21, is moving into her first apartment. She needs Internet access but is thinking of saving money by subscribing to Hulu Plus rather than basic cable.

Sarah values television programming and cost savings. As broadband has become essential to modern consumers, she will subscribe to an Internet service provider. She wants to be able to watch what she wants, when she wants it, and quickly find the shows she’s interested in. Therefore, the size of the video library and the available programs matter to her, as does the ease with which she can search.

How the programs are delivered, however, is not a concern. The service merely needs to work. Whether she subscribes to an OTT service like Hulu Plus or gets videos delivered directly through a cable channel does not matter, as long as she can watch on her laptop. Being able to watch the show on her TV as well would be a bonus. She will pay for the service that can deliver the shows she wants, when she wants them, on her preferred device – as long as prices are comparable.

The cable company that delivers her Internet service can leverage its relationship with her by bundling a video-on-demand feature with her Internet service for an incremental price increase similar to a Hulu subscription with unbundled broadband. But price is only part of the decision process – if the cable company can provide a search engine that approximates or exceeds the performance of Hulu Plus, it will offer substantial value to Sarah.

At the same time, Sarah needs her desired content to be available. If the cable company can offer a wider selection or more shows that meet Sarah’s taste, it will provide her with greater value, and she will be more likely to choose cable TV over Hulu Plus.
A host of new entrants is on the scene, ready, willing and able to provide value to today’s consumer. Each player in the scenario needs to evaluate what it can do to deliver the experience desired by a millennial like Sarah. CME companies must realize that the search experience impacts their ability to engage with and retain customers. Without search, consumers will struggle to find content, and this can result in missed engagement and monetization opportunities for all players in the value chain. To respond effectively, CME players should ask themselves these questions:

- Should we work more closely with one of the many established search and delivery providers, such as cable providers, iTunes or Netflix?
- What is the impact to the communications provider?
- Will service provider data caps impact the business models of the content companies and new search providers?
- How can the content providers avoid enabling a dominant search provider?

**The Production, Search, Delivery Model**

A company’s business model often evolves over time as it confronts definitive changes in transaction costs. As such, businesses and industry structures built to manage yesterday’s transactions may no longer be efficient when faced with new ways to produce goods and services or coordinate work.

After searching for the fundamental transaction costs that are common throughout the communications, media and entertainment sectors, we found that these companies create value by managing only three types of transactions: production, search and delivery (PSD). The PSD framework provides a way to evaluate any company’s position in fast-evolving value chains and forms a basis for building a move-forward plan.

PSD’s basic elements include:

- **Production**: Production means “making goods available for use.” This includes the act of creating content and, where appropriate, manufacturing the media in which the content is embedded (i.e., book, DVD, etc.).

- **Search**: Search means matching different parties together so they can trade. This applies to matching consumers with information goods, as well as matching talent and labor with firms that need it. Essentially, the role of search in the PSD model is to reduce the “friction” and transaction costs associated with matching the factors of production, information goods and the people who want to consume these goods. Note that search, as we define it here, goes well beyond the idea of digital search embodied in search engines such as Google.

- **Delivery**: Delivery is transmitting or communicating information and information goods as part of the trading process. In physical products, shipping is a part of delivery. For digital products, delivery includes transmitting the goods over a communications channel. Delivery is getting information from one point to another.
The PSD framework cuts to the most essential level of how industry players create value. Companies are subject to attack in a PSD role when new companies find better ways to manage transaction costs or introduce new value-added features and capabilities. They then have the opportunity to outmaneuver the competition by finding and performing tasks better suited to their strengths.

The PSD framework helps companies focus on how to create distinctive value, identifying and separating core revenue-generating transactions from supporting, non-core activities—distinctions that often become blurred after long periods of stability. The PSD framework enables organizations to take a step back and rethink their business in light of today’s digital realities, analyzing questions such as:

• To which function do you add value?
• How is that function changing?
• Are there competitors beyond traditional industry boundaries that reduce friction better or create more value for consumers than you do?
• How can you continue to reduce friction in a world where transaction costs are continuously diminished due to globalization and technological advances?

The Changing Book Publishing Value Chain

The book publishing industry provides an example of how the PSD model can be used to understand how long-established functions can be rationalized out of the value chain as technology and business model changes reduce the friction within an industry (see Figure 2).

Traditional Book Publishing Value Chain


Figure 2
In the traditional book publishing value chain:

1) **An author creates content by writing a manuscript.**

2) **An agent plays a search role** by matching an editor or publisher with suitable author-produced content.

3) **Editors manage the search process** by finding content that matches their readers’ tastes.

4) **The print-ready master of the book is created** during the production process.

5) **The publishing house markets the book** to wholesalers, book clubs and retailers, generating awareness among business-to-business customers. The publisher also markets the book to consumers, making them aware that a book that potentially matches their interests will soon be released.

6) **Physical printing and binding is a production process** that makes the content available in a form usable by consumers.

7) **Printed books are warehoused and shipped** as part of the delivery process that transports the books from printing press to store shelf.

8) **Wholesalers are intermediaries that help retail stores find and order books that their shoppers want to read.** Similarly, book clubs pick books that they think will match the interests of their members. Wholesalers and book clubs then use a shipping service to deliver the books to retailers and club members respectively.

9) **Retailers serve a dual role.** First, they provide a filtering service for their shoppers by searching for titles that will be of interest to their customers. Retailers historically have provided an important service by reducing consumers’ search costs by pre-filtering the available selection, thus reducing the choices to a manageable number of titles. Customers take delivery at the bookstore, enabling the trade and ultimate source of value chain monetization.

The book industry is changing quickly. With the rise of digital publishing, long-time functions within the industry are disappearing (compare Figures 2 and 3).

### eBook Value Chain


Figure 3
The move to digital is eliminating the traditional production, printing and binding, warehousing and wholesaling links from the value chain. The ability to carry unlimited titles is also opening mainstream online retail venues to self-published authors, further changing the industry value chain. Professional writers and respected scholars increasingly take advantage of new self-publishing opportunities. At the same time, aspiring amateurs can now write their masterpieces on their laptops and sell them through the world’s largest bookstores.

Platforms 101

Platforms are increasingly the gateways through which CME companies will engage with their customers to transact business. Platforms such as iTunes, YouTube, Netflix, Hulu, Verizon Digital Media Services (VDMS), Xfinity Streampix, etc. have emerged, and more are expected to hold over time. A platform is a foundational technology or service that is used beyond a single company and is subject to network effects, which means that its value is based on the number of users. Platforms provide connectivity, expand variety, match different users with each other (i.e., suppliers and consumers) and set prices within the market. The platform provides rules that mediate transactions among users.

Platforms are changing the shape of industry value creation. Platform users transact with each other at the same time that they transact across the platform, communicating across, up and down the network. Key to a successful strategy will be a company’s PSD functions within the platform-mediated market. Sustainably valuable resources will still determine competitive advantage and will drive users toward one network rather than another. However, if a company does not have a sustainably valuable role in production, search or delivery within the platform ecosystem, it will not have a lasting competitive advantage. If the platform ecosystem itself is not valuable and inimitable, then another competitor platform is likely to dominate.

The industry landscape of the future is already taking shape with notable platform leaders. Today, the video game market is dominated by three platforms: Wii, Xbox and PlayStation. Amazon is a powerhouse in the publishing industry. iTunes dominates digital music and video download sales. The future shape of the key industry sectors will be defined by how incumbents and new entrants offer value to various consumer types.

Platforms are changing the shape of industry value creation. Platform users transact with each other at the same time that they transact across the platform.
One thing is certain: Future strategy will pivot around platform participation. A carefully crafted platform strategy can increase the profits of incumbents or help new entrants rise to powerful gate-keeping positions within industry segments.

Given the fundamental role platforms are playing, here are some key questions to ask when formulating your company's platform strategy:

- Should you join an existing platform, create a new one in an uncontested space or launch a platform in a market dominated by others?
- Is your objective to maximize revenue now or invest in growing the platform to capture greater revenue in the future?
- Will your offering be valuable, rare and non-substitutable within the network, thereby decreasing the chances it will rapidly be imitated by others?
- Will your capability reduce friction within the industry and within the platform ecosystem?
- Is your contribution to the ecosystem better than another that has already joined or is likely to join the platform market?
- Will the platform ecosystem offer a distinct value proposition?
- How will a change to the platform ecosystem (a member exiting, another entering, etc.) affect your value proposition?

Looking Ahead

The first step to thriving in this changing market is to understand how the five forces – globalization, millennialization, prosumerization, business virtualization and cloud platformization – impact your company’s strategic position in the PSD value chain. We believe the PSD model is an important addition to your toolkit to help your company devise and constantly reassess your business strategy to survive, if not thrive, amid these trying times.

Given how digital forces are radically changing the PSD roles, industry executives should continually ask the following questions:

- Are there other companies (inside or outside of your industry) that manage the same PSD functions as your organization?
- Is your competitive advantage derived from the synergy of performing multiple PSD roles? What opportunities exist to perform a new role for customers or other companies, either by your company or through an alliance?
- Is your platform strategy aligned to support the changing landscape and your competitive position?
- Does your company’s strategy strengthen traditional positions or fortify key new PSD roles?

As your company addresses these PSD questions, it should at the same time consider the implications of required operational changes. Your organization will likely need to revisit and potentially adjust its organizational structure, business process and technology platforms to add much-needed flexibility and agility to thrive amid accelerating change. There is no better time than the present for repositioning your company’s operating model to assimilate and master its PSD roles.

Companies across the CME spectrum are already figuring out how to harness disruptive forces to their betterment. Understanding your organization’s place in this new world is a necessary precursor to leading it.
Footnotes


2. In his seminal work Future Shock (Random House, 1970), noted futurist and author Alvin Toffler predicted a time in the not-too-distant future when the roles of producer and consumer would merge. He later coined the term “prosumer” to convey the role of this new consumer type in a subsequent book, The Third Wave (Random House, 1984).


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