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## Data Dexterity: The New Moat Of The Information Economy

Law360, New York (February 22, 2017, 10:49 AM EST) -- Warren Buffett, one of the world's successful investors, likes to evaluate companies in terms of the "moats" that protect them. To Buffett, a business' "moat" or competitive advantage is "the primary criterion of a great business."<sup>[1]</sup>

Over the past year, companies have used moats created by their interactions with data to drive astronomic acquisition prices. In 2016, LinkedIn was sold for \$26 billion to Microsoft, a 50 percent premium over the stock's previous close, despite being unprofitable.<sup>[2]</sup> In the same year, Unilever paid \$1 billion for then-unprofitable former startup Dollar Shave Club, as it provided "unique consumer and data insights."<sup>[3]</sup> At the start of 2017, Cisco agreed to purchase AppDynamics for \$3.7 billion, explaining that AppDynamics had the ability to take "complex, siloed data" and "translate this data into business insights."<sup>[4]</sup><sup>[5]</sup> Per its own prospectus filed for a potential initial public offering, AppDynamics lost \$95 million during the first nine months of 2016.<sup>[6]</sup>



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To assist companies and would-be acquirers in creating and evaluating data-based moats, this article introduces the concept of "data dexterity" as the actual creator of competitive advantage based on data. This article will explain what data dexterity is, how companies can create data dexterity for themselves, and how acquirers can evaluate whether a potential target possesses data dexterity, as outlined below:

1. An effective moat based on data is provided by the company's own "data dexterity." Data dexterity is achieved when an identified data interaction meets three characteristics. First, the data interaction must drive commercial value. Second, there must be a barrier to the competition emulating the interaction. Third, the data interaction must not create unacceptable business risks.
2. Companies can apply these three underlying characteristics of data dexterity to create a data-based moat applicable to their industry.
3. Companies that wish to acquire other companies with moats based on data being a competitive advantage should, as a standard part of due diligence, evaluate the target company's data dexterity by analyzing whether one or more of the company's data interactions possess the three characteristics.

### What is "Data Dexterity"?

Data dexterity is a company's ability to interact with data in a way its competitors cannot. Every data interaction that demonstrates data dexterity will possess three characteristics. First, the data interaction must drive significant commercial value. Second, there must be a barrier to emulation by the competition. Third, the data interaction cannot create unacceptable risks of legal, financial

or reputational harm. Unless all three of these characteristics are present, the data interaction cannot serve to provide an effective data moat against competitors in a sustainable manner.

Consider a hypothetical company that becomes known for collecting data on the electronic media consumption by children. No other company in the industry is able to obtain such relevant, detailed and up-to-date information. The monetization options are endless and render the company a market darling, driving commercial value. No one in the industry knows how this company is able to do this, providing a barrier to emulation by the competition. Now imagine that it comes to light the company has been violating the Children's Online Privacy Protection Act the entire time. After this news breaks, instead of a competitive advantage, the company's collection of this information becomes a massive liability, potentially ending its ability to operate and making the accumulated data potentially unusable. This sort of risk is clearly unacceptable to a company that wishes to remain in business. For data dexterity to exist, all three characteristics must be met.

To observe how data dexterity exists in practice, an analysis of the data interactions of LinkedIn, Dollar Shave Club and AppDynamics are provided below in light of the three characteristics.

LinkedIn provides a way for users to network with others, seek employment opportunities and more. By far the most expensive of the three acquisitions, LinkedIn likely possesses data dexterity in the data interactions that comprise its collection, use and analysis of data. Its collection of extensive user data drives commercial value by providing it access to a valuable data set. Other entities cannot emulate this data, as users are only willing to provide this data due to the services LinkedIn provides, which are difficult to emulate, at least in part because their provision is dependent on the network effect of a large number of like-minded users. LinkedIn's use and analysis of the data it collects drives commercial value by allowing it to provide valuable insight to its users as well as partnering entities, such as those that pay to post jobs on the platform. As before, LinkedIn's competitors would likely find these data interactions difficult to emulate, due to the network effect, as well as LinkedIn's expertise in data analysis. The third characteristic, lack of unacceptable risk, is difficult to evaluate externally, yet appears to exist as LinkedIn still possesses user trust, demonstrated by the continued willingness of users to engage with the site over a significant period of operation.

Dollar Shave Club possesses data dexterity in its collection of user data. It created innovative viral advertisements that became wildly popular and enabled it to collect a database of young consumers willing to try a new product in a space long dominated by incumbents, driving commercial value. Dollar Shave Club's unique ability to create such popular advertisements served as a barrier to emulation by competitors. Externally, the lack of unacceptable risk appears to exist based on continued user engagement and the lack of negative data events.

AppDynamics possesses data dexterity through its ability to analyze information technology data and drive commercial value by taking "complex, siloed data" and "translat[ing] this data into business insights."<sup>[7]</sup> A barrier to emulation exists as competitors likely do not possess the knowledge to perform similar analysis. Externally, no unacceptable risks created by this data interaction have been exposed.

## **How To Improve Your Company's Data Dexterity**

Companies can improve their data dexterity by applying the three characteristics discussed above to their data interactions. This will require examining existing data practices to understand how the company interacts with data currently, and documenting this by creating a matrix of data interactions and corresponding interaction owners. While this may seem simple, many entities are unaware of different mechanisms through which they collect, use and analyze data. The support of corporate decision makers in understanding these processes at an organizational level is critical. Companies cannot improve what has not been identified.

After the company has understood and documented its data interactions, it must ensure that each of them satisfies the third characteristic of data dexterity, no creation of unacceptable risk. This is accomplished by benchmarking the interactions against applicable regulatory requirements and best practices. For example, if an entity is engaging with collection of data from end consumers, an appropriate privacy policy that complies with applicable state and federal law will be

necessary. Other laws may require safeguarding certain information in defined ways — for example, California’s Security of Personal Information Law provided by Civil Code § 1798.81.5, and Massachusetts 201 C.M.R. 17.00. Violations of applicable laws or standards destroy a company’s reputation and cause others to cease future interactions with the company. Global operations require an analysis of global data protection laws to determine whether certain data sets were legally collected and transferred to databases located elsewhere. A key example is preparation for Europe’s upcoming General Data Protection Regulation and its higher threshold for data subject consent.[8] No amount of driving commercial value or barriers to emulation can fix this.

After ensuring that its data interactions do not create unacceptable risks, the company can begin engineering its interactions to meet the remaining two characteristics — driving commercial value and a barrier to emulation by the competition. The company should review the previously created data interactions matrix, and ask the process owners to explain how these processes drive value and what barriers to emulation exist or could be created. It is likely that this will be an iterative process with additional opportunities for data interaction owners to understand how their workflows interact with those of other owners, as well what approaches are already in use in the industry. As we saw previously, a company need not necessarily possess best in class data dexterity in each of its data interactions to create an effective moat. Often, the key data dexterity aspect will be tied to a core competency of the organization, like Dollar Shave Club’s viral marketing efforts through social media, or AppDynamics’ sophisticated analysis of information technology data.

## **How To Evaluate A Target’s Data Dexterity**

Potential acquirers that wish to understand and evaluate a target’s data-based moat(s) should review the target’s data interactions in light of the three data dexterity characteristics. Before engaging with a company in an acquisition discussion, the acquirer will want to consider what about the company’s existing data interactions drives commercial value while remaining resistant to emulation. The acquirer should keep in mind that multiple moats may be worth more than the so-called sum of their parts, as the creation of a substitute good or service would require emulation by a single entity of each of the separate data-based moats.

After engaging with a specific company in an acquisition discussion, the acquirer will want to pay particular attention to evaluating whether the data interactions that hopefully provide the data-based moats have created any unacceptable legal, financial or reputational risks during the ensuing diligence process. This sort of analysis is particularly difficult to perform from an external perspective, as it will depend on the internal data governance in place and the absence of undesirable activities that cannot be effectively ascertained without inside information.

If diligence during the deal reveals that the company does not understand its own data processes and lacks an effective compliance program for dealing with regulatory requirements and best practices, it’s likely that data dexterity has not been a priority for the company. While this could signal that this is an area that is ripe for improvement, the acquirer should be aware that providing this level of institution knowledge to the company will not be inexpensive, and may reflect the attitude of senior leadership as it relates to these critical issues.

## **Conclusion**

As we have seen, possession of one or more data-based moats can provide an effective incentive for an acquirer to purchase a target at a handsome valuation despite lack of profitability. These data-based moats are created through one or more data interactions that possess the three characteristics of data dexterity: (1) driving commercial value, (2) a barrier to emulation by competition, (3) and the lack of unacceptable risks. Companies that wish to create their own data-based moats should engineer one or more their data interactions to conform to these characteristics. Potential acquirers should use the first two characteristics to identify potential targets, and pay particular attention to the third characteristic during the acquisition agreement diligence process, as it is difficult to determine without external information.

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[1] <http://www.businessinsider.com/buffett-on-moats-2016-4>

[2] <https://www.wsj.com/articles/microsoft-to-acquire-linkedin-in-deal-valued-at-26-2-billion-1465821523>

[3] <https://www.wsj.com/articles/unilever-buys-dollar-shave-club-1468987836>

[4] <https://www.wsj.com/articles/cisco-to-buy-appdynamics-for-3-7-billion-1485307482>

[5] <http://blogs.cisco.com/news/cisco-announces-enterprise-news>

[6] <https://www.sec.gov/Archives/edgar/data/1435043/000119312516805559/d209425ds1.htm>

[7] <http://blogs.cisco.com/news/cisco-announces-enterprise-news>

[8] <https://www.privacyandsecuritymatters.com/2015/12/the-general-data-protection-regulation-in-bullet-points/>

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