



# Seizing China's new digital opportunity

**The rise of digital technology has become a global business issue. The global managing director of McKinsey & Company discusses some of the big and potentially bright implications for Chinese enterprises.**

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Over the past year, I've met one-on-one with more than 300 CEOs, including 60 in Asia. For most of them, digital technology is now a top-two agenda item for the year ahead. As one executive noted, "Technology is changing five times faster than management." That's exactly right, and it underscores the mix of excitement and anxiety I hear in these conversations. Business leaders have no doubt that the opportunities are enormous. Their big concerns are exactly how—and how quickly—they can prepare their organizations for what is becoming a shift of seismic proportions.

Every day we see how digital technologies are both creating value and driving industry disruption. For example, customers in South Korea can now shop while waiting for their subway trains by using a Tesco mobile app to scan the Quick Response (QR) codes from

the grocery giant's billboards and then get the goods delivered to their homes. Alongside creating new customer services, business processes can be optimized and automated. One bank found that 50 percent of its workforce could be replaced by software over time. And supply chains can be taken to new levels of efficiency using remote sensor networks coupled with sophisticated analysis and prediction techniques.

Digital continues to lower barriers to entry. Online consumer-payment solutions such as Square—a mobile app and device that enables merchants to accept payments—are challenging traditional merchant acceptance solutions. Digital technology also changes the basis of competition by allowing companies from adjacent sectors to compete. For example, motor manufacturers are planning to enter the

## Takeaways

In China, the consumer economy has already gone digital—but the corporate side has lagged behind, and many companies are still trying to catch up with technology trends.

Players there must now pursue rapid change, not only by making investments but also by transforming processes and business models.

The experience of leading multinationals suggests that five basic steps will be necessary: decide the direction, revisit the portfolio, build a technology firm inside, find the investment sweet spot, and increase corporate clock speed.

insurance market as data from in-car “black boxes” provide a competitive edge in pricing.

In China, of course, the consumer economy has already gone digital in a big way. As of December 2011, China had 513 million Internet users, compared with 245 million in the United States. In a recent first-of-its-kind survey of the Chinese “i-consumer,” McKinsey found that the country has by far the world’s most active social-media population, with 91 percent of respondents saying they visited a social-media site in the previous six months. More consumers in China than anywhere else say they are more likely to consider buying a product if a friend or acquaintance recommends it on a social-media site.

Where China lags is on the corporate side. Despite pure digital success stories such as Alibaba and Tencent, most big Chinese enterprises are still playing catch-up when it comes to technology. According to McKinsey’s latest survey of Chinese CIOs, the typical Chinese company spends 2 percent of revenue on IT, in comparison with the 4 percent that international counterparts customarily spend. While respondents predict their IT spending will climb to 3 percent of revenue by 2015, up from 1.5 percent at the beginning of the decade, that still leaves a large gap.

I believe real change in China needs to come faster—and be accompanied not just by more investment but by real business-process and business-model transformation. Building more capable digital enterprises will help China’s companies close their productivity gap versus the leading multinationals, a must if they are to remain competitive as their labor-cost advantage erodes. It will also help them scale rapidly at a time when finding qualified talent

is a key bottleneck. If Chinese enterprises really embrace this imperative, going digital may even allow them to “leapfrog” their Western competitors’ efforts to reengineer processes and improve productivity in much the same way that Chinese telecommunications famously skipped the stage of fixed-line voice telephony and went straight from greenfield to mobile.

What will it take? A few leading international corporations are already going all in. General Electric, for example, is building apps ranging from industry-specific monitoring and diagnostic tools to business-intelligence resources. It is also embedding digital innovations in its “ecomagination” products to make them more energy efficient. Internally, GE is pushing hard to complete its digital transformation by integrating enterprise-resource-planning, product-life-cycle-management, and customer-relationship-management systems in a fundamentally new way.

While such a sweeping commitment may not be the right path for all Chinese enterprises today, it’s clear that most of them need to continue to rapidly upgrade their digital capabilities. Our experience working with leading multinationals suggests that at least five basic steps are required.

### 1. Decide your digital direction

Every enterprise needs to start with a clear stance on its core digital strategy. It can choose to defend, attack, or become an innovator.

Defense is as important as attack. Digital creates threats to revenue as it tends to transfer value to the end customer—due to better price transparency, for example—and also to

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attackers. One global telco estimates that it faces opportunities to increase profits by around 20 percent but a downside in excess of 50 percent. Defenders limit digital downsides, for instance, by increasing customer service in physical channels. Attackers see digital as a competitive differentiator and invest to outperform. Innovators see opportunities in entirely new business models. Bankinter in Spain has invested heavily in digital channels from the start and was the first bank to use video chat for advising customers; it is now creating a seamless experience across online and offline channels. UK online portal Funding Circle is bypassing banks entirely through peer-to-peer lending.

To gauge progress, enterprises are introducing digital scorecards that track performance on metrics such as percentage of sales through digital channels or percentage of transactions requiring no human intervention.

### 2. Revisit the portfolio

A vital part of a digital strategy is to understand the relative attractiveness of portfolio businesses in a digital future and to restructure accordingly. For example, retailers with large physical networks but poor online capabilities now look challenged in an increasingly digital environment. By contrast, after years of being a less attractive part of the equation, logistics businesses that deliver parcels are growing

rapidly due to online shopping. It may make sense to add new businesses to the portfolio to extract counterintuitive synergies. A US insurer, for instance, has acquired a security-system provider because it can use the data from the security systems to improve insurance pricing.

### 3. Build a technology firm inside

Digital success requires focused leadership and a ring-fenced operating model in order to breed innovation and insulate rare technology talent from dilution in the wider corporate culture. Roles like data scientist and user-experience manager didn't exist a few years ago. Such skills are in high demand, and the individuals possessing them can take their pick of employers. Ring-fenced operating models come in different guises. A European telecommunications company has set up a stand-alone business, and one global bank has created a center of excellence. Regardless of the precise model, strong leadership with both technology and business experience is a must.

Fifty years ago, the emergence of M&A led to the creation of the CFO. We believe the digital explosion may now require a chief digital officer (CDO) in a role distinct from the CIO. The CDO could add value by being responsible for the financial results of digital businesses, realizing new digital opportunities, understanding the

impact of technology and influencing corporate strategy accordingly, and building digital skills and culture across the enterprise.

#### 4. Find the investment sweet spot

Leading digital companies achieve a higher return on digital investments than on other capital investments and successfully manage the risks associated with technology projects. They do this in three ways. First, they find the investment sweet spot. Small digital experiments are effective in testing new customer propositions but don't move the needle on business performance. Large projects often deliver too late in fast-moving markets. Successful companies experiment widely, and they rapidly scale up successes. Second, they use "agile" project techniques to drive tangible change that delivers measurable business performance every month—or even more frequently. Finally, they centralize decisions on technology spending to maximize reuse and avoid creating new legacy systems.

#### 5. Increase the corporate clock speed

Digital increases the pace of innovation by allowing new customer products and services to be developed and deployed in days instead of months or years. To keep pace with all this



innovation, corporate processes, such as budgeting and planning, need to move to “digital time.” Some corporations are moving from an annual to a monthly reallocation of investment spending.



Getting this right requires careful execution and a deep understanding of each company's external context, industry dynamics, and corporate culture. There is no one-size-fits-all model. But there is also no longer an option to ignore this imperative. It's time for business leaders in China to join the global movement to radically reshape and upgrade their core operations and strategies by building more truly digital enterprises. ○