

The background of the entire page is a complex network diagram. It consists of numerous circular nodes of varying sizes, some in white and some in shades of blue. These nodes are interconnected by a dense web of thin, light blue lines, creating a sense of global connectivity and digital networks.

McKinsey&Company

McKinsey Digital

Building up your digital quotient: How to harness digital to accelerate business performance

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Introduction

A fast-food restaurant operating in more than 100 countries had invested heavily in online marketing and interactive technologies to create a richer in-store experience. But they weren't seeing the results they wanted. While certain geographies introduced popular new features such as digital playgrounds or payment kiosks, these innovations were often highly tailored to the local market, so they could not be scaled. In other areas that could be more centrally managed, such as menu redesign and mobile payments, the chain—beleaguered by old processes, a disjointed organizational structure, and too few resources with the know-how to deliver relevant digital solutions quickly—lagged direct competitors by as much as six months when it came to rolling out new initiatives. Those challenges in tandem with a complex digital strategy made it hard for management to understand and prioritize which digital capabilities mattered and which ones to prioritize.

Many organizations are in the same boat. They have experimented with digital but are keenly aware that they're missing out on the chance to harvest extraordinary returns. Winning digital companies are capable of delivering both rapid results and sustained performance. They generate revenue growth rates that are ~10 percent higher, and they are 20-30 percent more profitable than the industry average.

Most other companies are left scratching their heads, wondering why they can't achieve those results. The sweep of digital, the number of initiatives involved, and the enormous challenge of transforming any large-scale business make it hard for executives to know where they lag and where they lead relative to their market and peers. As a result, many feel as though they're shooting in the dark. They're asking: How do I organize for digital? How do I adjust my strategy, and how do I scale?

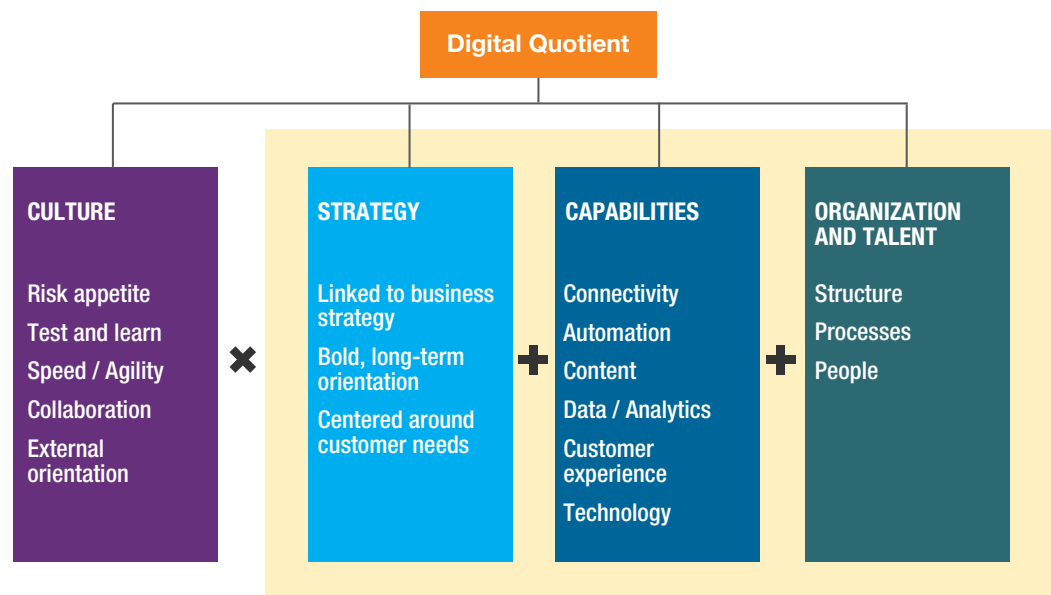
Defining “digital”

Digital is a combination of technologies and capabilities that enable organizations to automate processes, connect with customers, make better decisions, and innovate to build business value.

Building a company's Digital Quotient™

Exhibit 1

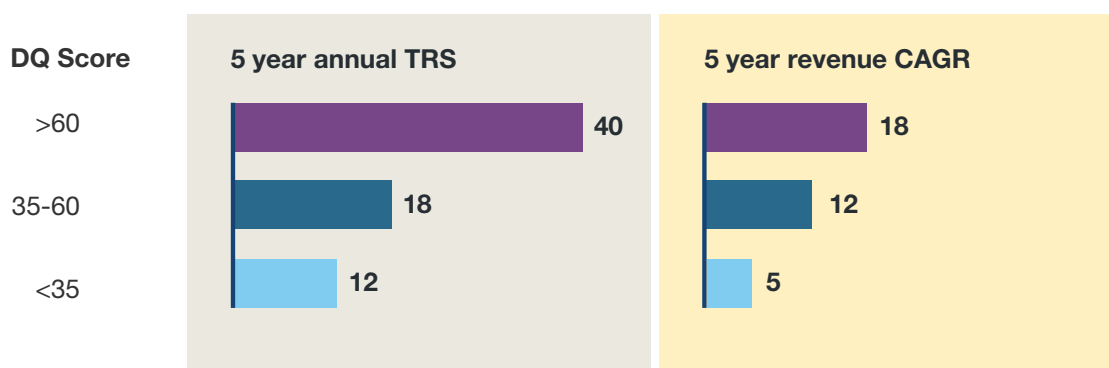
Digital leaders exhibit strength across four outcomes



To help companies address these questions, we spent the past several years developing a systematic methodology to measure an organization's digital maturity. We call it Digital Quotient, or DQ¹. Our analysis of companies with a high DQ revealed specific attributes and management practices grouped into four areas: culture, strategy, capabilities, and the organizational operating model (See Exhibit 1). Quantitative analyses based on our client work reveal DQ scores to be tightly linked to leading measures of digital and financial success, including the five-year annual total return to shareholders (TRS) and share of online and mobile sales relative to total sales (See Exhibit 2).

Exhibit 2

A clear correlation between a company's DQ and its financial performance



SOURCE: McKinsey Digital Quotient analysis of 34 publicly-traded companies

This DQ score provides business companies with a rich benchmark that allows organizations to understand to a fine degree what “good looks like” across internal functions as well as globally and across industries. In addition, we’ve found that having this “snapshot” assessment of a company’s digital maturity and isolating what attributes are most necessary produce a number of invaluable benefits for leadership. It provides companies with a vocabulary and framework for discussing, thinking through, and planning a digital agenda; it helps align leadership around goals and priorities (even helping to define what “digital” means – something that is surprisingly unclear to many leaders); it helps companies gauge where they are on their digital transformation so that they have a much clearer view into the ROI of their digital investments; and it provides important focus on where to make surgical investments that will have the most impact and combats the tendency of many companies to respond to the digital challenge by trying to do “everything at once” or making the wrong choices about where to invest their energies.

The DQ analysis underscored a critical point that expertise in technology is not the primary barometer of a company’s digital maturity. What really mattered are the behaviors of the management team. What follows is an overview of the most important factors, management practices, and outcomes that determine a company’s digital maturity:

¹ DQ is a quantitative measure of a company’s digital maturity, based on the specific management practices most correlated with positive digital and financial performance. DQ isolates the subset of management practices that most contribute to financial and market success. It was developed based on the practices of leading digital organizations and “alpha tested” with more than 100 thought leaders and 200 companies worldwide, including Google, AOL, Nickelodeon, Starwood, and Twitter. The framework is grounded in McKinsey’s Organizational Health Index (OHI) program—a widely regarded framework for assessing the key determinants of organizational performance. To learn more, please visit dq.mckinsey.com.

Culture

Culture has a multiplier effect. A good one significantly enhances growth and momentum, while a poor one stunts everything. Digital leaders have markedly different cultural attributes in five key areas.

1. Appetite for risk

Where 84 percent of companies in McKinsey's DQ benchmark indicate their culture is risk averse, the mentality of companies like Google and Amazon is, "We think big and are not afraid to fail." Google, for instance, goes after initiatives they believe will have a "10X impact." In an interview with Wired, Google CEO Larry Page said, "A 10 percent improvement means that you're basically doing the same thing as everybody else. . . . That's why most companies decay slowly over time."² That doesn't mean taking blind risks. These companies do rigorous analysis of risk and reward, but if the data points to a big and achievable opportunity, companies with high DQ scores jump in with both feet.



Tanguy Catlin
Partner

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This approach to risk taking requires boldness. For instance, when Amazon CEO Jeff Bezos saw that customers were more inclined to purchase when they could touch and feel the product, he launched Amazon's virtual "Search Inside the Book," a feature that allows consumers to flip through certain sections of a book online. That effort required digitizing over 120,000 books page by page—a gargantuan task; but launching at scale was the only way the company would be able to tell if the initiative would work. In an interview with Fast Company, the marketing executive responsible for the rollout said, "There's a leap of faith. Jeff [Bezos] is willing to take those risks."³

2. Test & learn

Instead of waiting for "perfect," digital leaders learn, track, and react by putting something in the market, gauging interest, collecting consumer feedback, and driving continuous improvement. Rigorous data monitoring helps teams quickly refine or jettison new initiatives so that they can "fail often" and "succeed early." Leaders typically allocate more than 10 percent of their marketing budget toward new digital initiatives, and they build in reinforcement mechanisms. Even if some of those ideas prove flops, those that stick, like Post-It Notes and Gmail, more than make up for the cost of experimentation.

Nordstrom's Innovation Lab, for example, launches customer-facing initiatives in a series of one-week experiments. To build the app that makes it easier for customers to shop for sunglasses, the innovation team set up temporary camp in the retailer's flagship Seattle store, mocked up paper prototypes, and rounded up shoppers to tap through the paper model as they would a live version. Customers shared feedback on the types of features they found most helpful and pointed out problematic or unintuitive elements in the prototype. Coders used that feedback to make real-time adjustments, then released the live version for customers to test-drive on the spot. After a week of continual tweaking and re-releasing, the app was ready for sales associates.⁴

3. Speed & agility

While many companies understand the value of speed and agility, digital champions are built to act that way. Amazon's "two-pizza teams" (small groups capable of surviving on two pizzas per day), for example, were intended to foster greater autonomy and faster turnaround times.⁵ Liberated from hierarchy and large-team paralysis, these pizza teams have created some of Amazon's most creative offerings at a breakneck pace, including Amazon Prime, which was launched in just 60 days.

"Digital-first" companies don't own a monopoly on speed and agility. Take Valerus, a Texas-based company that installs and services equipment for the natural gas industry. It needed to expand quickly into

² "Google's Larry Page on Why Moon Shots Matter," S. Levy, Wired, Jan 17, 2013, <http://www.wired.com/2013/01/ff-qa-larry-page/all/>

³ "Inside the Mind of Jeff Bezos," A. Deutschman, Fast Company, August 2004, <http://www.fastcompany.com/50541/inside-mind-jeff-bezos>

⁴ Nordstrom Innovation Lab: Sunglass iPad app case study, <https://www.youtube.com/watch?v=szr0ezLyQHY&noredirect=1>

⁵ "Inside Amazon's idea machine: How Bezos decodes customers," George Anders, Forbes, April 4, 2012 <http://www.forbes.com/sites/georgeanders/2012/04/04/inside-amazon/>

“Digital leaders place a premium on internal collaboration”

foreign marketing (five continents in all) to keep up with their customers. The company’s IT organization couldn’t keep up, and was putting the entire business at risk. The team ended up creating a quick-ramp version of the company’s enterprise systems using cloud computing and virtualized desktops. The company can now build a fully functioning office to support new business in less than 72 hours.⁶

4. Internal collaboration

The single strongest predictor of group effectiveness is the amount of help colleagues extend to each other and the reciprocity that encourages. After 9/11, for instance, a team of Harvard psychologists worked with the US government to figure out how to make intelligence units perform better. They found that the highest-performing teams invested significant time helping, coaching, and consulting with their colleagues while low-performing teams did not.⁷ Unfortunately, fewer than 30 percent of all companies in our DQ benchmark take that approach. Digital leaders, by contrast, place a premium on internal collaboration, creating processes and teams that integrate various functions across the business and developing incentives for sharing.

5. External orientation

Digital leaders know what they’re good at, what others might be better at, and how to partner to close those gaps. They are keenly aware of what’s going on in the marketplace, constantly evaluating threats and opportunities, and they stay close to their customers. Netflix, for instance, turned to crowd sourcing and created the “Netflix Prize” as an open competition for their customers to develop the popular algorithm the company now uses to recommend movies and predict user ratings.

Strategy

“Only 13 percent of companies have a digital strategy that is systematically linked to their corporate strategy”

Our benchmark found only 13 percent of companies have a digital strategy that is systematically linked to their corporate strategy. By contrast, digital leaders integrate both. They lay out a coherent digital strategy based on a deep understanding of their customers, and they act on a handful of priorities. That strategic approach is anchored on three precepts:

1. Reinvention

Digital leaders recognize that digitization is redefining the boundary of the typical strategy. They think less in terms of traditional linear value and more in terms of value networks and fluid partnerships between diverse organizations. Whereas conventional business models are often based on developing proprietary assets, visionary digital players see much greater long-term growth potential in cooperative business models.

Mobile operators in Japan, for instance, upended standard telecom practice by taking this more inclusive approach and providing customers with flat, low data-access fees and opening up content rights to a wide cadre of participants. Better, richer content encouraged many to upgrade their data plans—which, in turn, increased average rates per user.

2. Focus on customer journeys

The modern journey customers take to buy something or accomplish a task is a multichannel and highly iterative process where the experience often matters as much as the product itself. Understanding that journey—and identifying where the opportunities to influence the customer are—is fundamental to any successful strategy. McKinsey analysis finds that companies acting on journey insights have typically seen a 15-20 percent reduction in repeat service visits, a 10-20 percent boost in cross-selling, and a drop of 10-25 basis points in churn. Yet only 11 percent of companies we polled align their digital strategy with the customer lifecycle journey.

6 “Top CIOs Use IT to Speed Up the Business,” Kim S. Nash, CIO Magazine, July, 2013. <http://www.cio.com/article/2384189/cio-role/top-cios-use-it-to-speed-up-the-business.html>

7 “Givers take all: the hidden dimension of corporate culture,” Adam Grant, McKinsey Quarterly, April 2013. http://www.mckinsey.com/insights/organization/givers_take_all_the_hidden_dimension_of_corporate_culture

“Companies with high DQs integrate structured data, such as demographics and purchase history, and unstructured data, such as social media and voice analytics, quickly and dynamically.”

Analysis at one cable television company, for instance, revealed that improving two journeys—onboarding and problem resolution—could help address nagging customer retention and loyalty issues. That insight informed the company’s strategy and prompted marketing to partner with IT and the call center to address key service trouble spots. To bring improvements to market faster, such as a new self-service account-opening program and a live customer service chat room, they created a “learning lab” that operated semi-independently. Those changes led to a significant increase in customer satisfaction rates.

3. Strategy by “experimentation”

Companies need a clear long-term strategy that identifies market opportunities, trends, and threats to value. But digital allows companies to test and refine that strategy quickly and cheaply, which makes medium-term planning (one to three years) increasingly obsolete. This approach releases teams from getting bogged down in over-planning and allows them to test the viability of a market, product, or segment in near real time. Limited releases, small campaigns to compare markets, and prototyping with early adopters are all valuable techniques that favor testing strategies in the market over complex and time-consuming plans.

Capabilities

Most companies have major gaps in their digital infrastructure. What separates the small number of high DQ scorers in this area (about 10 percent of those surveyed) is their competency in using digital to drive greater customer engagement and cost performance in four areas:

1. Data-empowered decision making

Digital leaders use data to make better decisions. However, just 25 percent of the companies we analyzed use data effectively to improve business performance. Companies with high DQs integrate structured data, such as demographics and purchase history, and unstructured data, such as social media and voice analytics, quickly and dynamically. That allows them to anticipate emerging patterns in customer behavior and tailor interactions to make them more relevant. Digital champions recognize it is not enough for analytics teams to be “builders” of models. They must also be “architects” and “general contractors” who can quickly assess what resources are available inside and outside the business and bring them to bear on a given issue. They invest heavily in top analytic talent as well as the right mix of business and other partners to extract insights and execute on them quickly.

For example, Reckitt Benckiser, maker of popular cold and flu remedies, used search data from WebMD, a medical website with ~32 million monthly visitors, to track the course of a given illness and anticipate where outbreaks were likely to occur. They then released targeted geo-specific and symptom-specific advertising and promotions in those markets, including free home delivery. Reckitt grew cough-cold product sales by 22 percent over just one four-week period in heavily affected markets like Boston and grew sales nationally by 8 percent over the same period.⁸

2. Connectivity

Digital leaders embrace technologies (such as apps, personalization, and social media) that strengthen customer engagement and allow employees to establish deeper connections between customers and brands to create more rewarding experiences. Those connections also inform product development. Burberry’s “Art of the Trench” campaign, for example,⁹ encouraged customers to upload photos of themselves in trench coats. Fellow shoppers and fashion mavens then commented on them and “liked” and shared the photos on Facebook, email, and other social media outlets. Users could also click through to the Burberry site to shop and buy. This approach, along with other innovations, helped Burberry triple its annual global revenue growth.

8 “Reckitt targets flu sufferers online,” E Steel, Financial Times, November 5, 2012, and “Flu gives Reckitt, Johnson & Johnson a shot in the arm,” J. Neff, AdAge, January 14, 2013.

9 “Burberry checks out crowdsourcing with ‘The Art of the Trench,’” M Bunz, The Guardian, November 9, 2009 and “Digging Trenchcoats: What makes Burberry our boldest brand?” H Walker, The Independent, February 23, 2013.

“While executive leadership is important, midlevel talent is most critical.”

3. Automation

Top-performing digital players focus their automation efforts on one well-defined process at a time, which they iterate in a series of test-and-optimize releases. Successful process-automation efforts start by designing the future state for each process without regard for current constraints—say, shortening turnaround time from days to minutes. Once that future state has been described, relevant constraints, such as legal protocols, can be reintroduced.

Using this approach a European bank succeeded in automating its account-opening process, replacing a procedure that used to take two-to-three days with one that took less than 10 minutes. They also automated elements of the mortgage-application process by connecting an online calculator to the bank’s credit-scoring models, which provided customers with a preliminary offer in less than a minute. This approach not only cut costs significantly but also improved customer satisfaction.¹⁰

4. Two-speed IT

Digital champions have the ability to operate both a specialized, high-speed IT capability designed to deliver rapid results and a legacy capability optimized to support traditional business operations.

The customer-facing technology needs to be modular and flexible to move quickly—to develop new “micro-services” that can be developed and deployed in days, for example, or to release dynamic and personalized web pages to customers in seconds. The core IT infrastructure, on the other hand, is responsible for managing transactional and support systems that must be designed for stability and resiliency. The priority is high-quality data management and built-in security to maintain the reliability of core business services.

One UK financial institution used this two-speed approach to improve its online retail-banking service. The bank opened a new development office with a start-up culture where the team used an agile work process to rapidly test and optimize new products. To support this capability for the long term, the company simultaneously evolved its service architecture so the bank could accelerate the release of new customer-facing functionality.¹¹

Organization and Talent

Executing on digital requires that organizations have the right people, processes, and structure. Here, too, digital leaders do things differently.

1. Talent connections

High-DQ companies have frequently installed a digital leader (one who combines business and marketing savvy with technological expertise) with real authority and responsibilities as a formal member of the company’s executive team. But while executive leadership is important, midlevel talent is most critical. These people are the “boots on the ground” who can make or break digital initiatives and are ultimately responsible for bringing products, services, and offers to market. While finding that talent is hard, digital leaders such as eBay and CapitalOne frequently pluck talent from disparate sectors, because they understand that digital competency matters more than sector knowledge in the early stages of transformation. That approach contrasts with the fact that only 35 percent of digital talent in companies we analyzed have outside digital experience.

10 “Accelerating the digitization of business processes,” S. Markovith, P. Willmott, McKinsey on Business Technology, No. 34, Summer 2014. http://www.mckinsey.com/insights/business_technology/accelerating_the_digitization_of_business_processes

11 “Reinventing IT to support digitization,” H. Andersson, P. Tuddenham, McKinsey, May 2014. http://www.mckinsey.com/insights/business_technology/reinventing_it_to_support_digitization

High-DQ companies are also creative about training and nurturing talent. A number of years ago, for example, P&G launched an employee swap with Google to shore up its search-engine optimization skills while the Internet company got a deeper understanding of marketing.¹² Such opportunities build competency but also expand thinking in terms of methods and possibilities. Digital talent must also be nurtured differently, with the right incentives and clear career paths. When done well, nurturing good talent attracts more talent, allowing digital leaders to build quickly on the initial foundation to secure a stable of digital leaders; that critical mass, in turn, serves to draw in similar candidates.

2. Real-time processes

Digital champions track and communicate digital key performance indicators (KPIs) frequently—in some cases on a real-time basis. They measure those KPIs against their digital priorities and make sure senior management is involved in reviewing and managing performance. When Starbucks rolled out a new point-of-sale system, managers videotaped transactions and interviewed employees to fine-tune the check-out process. That feedback allowed them to trim 10 seconds off the average sales transaction, saving customers 900,000 hours of line time a year¹³ and allowing employees to process sales more quickly.

3. Nontraditional structures

While there is no one answer that works for all companies, high-DQ businesses are deliberate about building out and supporting an organizational structure around their digital capabilities based on where they are in their digital transformation. Starbucks and Capital One created separate venture-capital incubators. Others, such as Wells Fargo, TD Ameritrade, and Johnson & Johnson's consumer business, have installed Centers of Excellence (COE) and Chief Digital Officers (CDOs). Still others, like Burberry, operate governing councils charged with thinking "big" and ensuring senior leadership buy-in. These structures often change over time as companies evolve. What might start out as a new competency to be incubated, such as social media, eventually matures and is integrated into the business.

How to improve your DQ

Digital maturity is a journey, requiring sustained commitment from company leadership and sustained investment in people, capabilities, technology, and cultural change. Getting started entails being honest about where the organization is, clear about its long-term digital play, and open to iterating and refining along the way. For companies interested in making that leap, consider this three-phased approach:

1. Agree on where you really are in your digital transformation

Attaining consensus at the management level about the organization's present level of digital readiness, the desired future positioning, and the critical gaps to be overcome is essential. In our experience, that requires an objective, empirical, and detailed set of insights into a company's digital capabilities. The management of one Fortune 100 company, for instance, was surprised to find wide disparities among its executive team, with some functions scoring much higher than others. The reason was a lack of agreement about what it meant to "go digital," since management had never aligned on a shared definition of digital strategy and objectives. In response, management created a digital council led by representatives from each core function and charged it with articulating a companywide digital strategy and addressing critical weaknesses identified by the assessment, such as IT modernization and automation.

12 "A new odd couple: Google, P&G swap workers to spur innovation," E. Byron, Wall Street Journal, November, 19, 2008. <http://online.wsj.com/articles/SB122705787917439625>

13 "How Starbucks has gone digital," Interview with Adam Brotman and Curt Garner, MIT Sloan Management Review, April 2013. <http://sloanreview.mit.edu/article/how-starbucks-has-gone-digital/>

“Prioritize the handful of business opportunities most worth pursuing (no more than three to five) and shine a light on the investments needed to put the right capabilities and infrastructure in place.”

2. Prioritize those areas likely to generate the greatest value

Assessing the value-at-stake from digital requires taking both a top- and bottom-line perspective. It also requires factoring in the opportunity cost and market risk of not pursuing digital avenues. That review can allow management to prioritize the handful of business opportunities most worth pursuing (no more than three to five) and shine a light on the investments needed to put the right capabilities and infrastructure in place—along with the cultural change needed to stay the course. One global financial institution found that some of the most significant potential value from digital lay less in launching new revenue-generating services than in improving back-office automation. By digitizing a handful of core supporting processes end-to-end, it was able to significantly reduce both cost and cycle times, steps that ultimately improved the quality of their clients’ experience.

3. Focus on rapidly scaling – not just launching – priority initiatives

The most successful digital transformations are defined by the number of digital initiatives an organization can scale rapidly, not by the number of initiatives it launches. That mindset is important in informing the right organizational supports. The same goes for scaling resources. Leaders create opportunities for digital talent to move across the enterprise and transfer skills and experience to others. That allows the business to grow digital talent organically and multiply the number of complementary digital initiatives it can support. An objective skills inventory can help provide a check list of elements that need to be in place: Is the team cross-functional? Are the right skills represented? Are there clear and appropriate KPIs, etc.? One global financial institution decided to deploy a small cross-functional team empowered with greater decision-making authority in one of its core product lines. Within a matter of weeks, the team developed and launched an app that radically simplified the process of opening a new account. That innovation was quickly deemed best-practice, and the team was asked to partner with colleagues in larger domestic markets to replicate and roll out similar apps.

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Becoming digital to the core doesn’t happen overnight. But focusing on building up a company’s DQ will help shorten that process and increase the chances of success by providing a clear vision based on facts for building the DNA of a digital leader.

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