Turnaround artists: How companies can catch up to the digital revolution

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Latecomers can succeed at digitization if they take these five steps.

As Michael Busch, the CEO of German bookseller Thalia, looked across the Atlantic at the U.S. book market in the mid-2000s, he had a dispiriting preview of what might happen when the full effect of the digital revolution hit his own shores. Even then, Amazon was taking significant market share in Germany. The picture looked bleak.

Rather than wait for the full force of the looming crisis to hit, Busch jumpstarted a rapid turnaround program that significantly ratcheted up his company's digital capabilities. Working with a network of partners, rolling out bold innovations at speed, and instilling a new culture that favored action over perfection, Thalia launched a number of significant initiatives, including the rollout of an e-reader called Tolino. By 2013, it had reversed its lagging market share to overtake Amazon.

'A crisis is a terrible thing to waste.'

That quote is from Paul Romer, the Stanford economist, in 2004. He was referring to the increasing competition America was facing from the rising education rates in other countries. But it's a useful way to think about digital transformations as well.

Thalia was able to use the looming digital crisis as a catalyst to spur the organization to change before the situation was dire. The reality is that for most large companies today, it's not a question of *if* digital will upend their business but *when* (see Exhibit 1). In fact, there is a lot more digitization still to come. McKinsey research finds that industries, on average, are less than 40 percent digitized[1] (for more on how digital has affected industries over time, see sidebar, "Turning point of the three waves of digitization").

As the pace of change and disruption increases, companies can ill afford to wait or be seduced into thinking that they'll have enough time to respond when a real challenge hits—or that half measures will suffice to stave off the challenge. History shows that this approach just hasn't worked.

In fact, the opposite is true. Companies that act now, deliberately and at speed, can shape their own futures and build real value.

Having a "crisis" mind-set—even if there isn't a crisis at hand—can simultaneously force important decisions, drive activity across many fronts, and radically accelerate the pace of change. We call this a Digital Turnaround & Transformation (DTT) approach.

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1 Jacques Bughin, Laura LaBerge, and Anette Mellbye, "The case for digital reinvention," *McKinsey Quarterly*, February 2017.

Turning point of the three waves of digitization

Wave 1 industries tend to be more technology intensive and have products that are more vulnerable to being reproduced and continually refined using digital tools and platforms. Such industries experienced the fastest rates of disruption and the steepest go-to-market impacts.

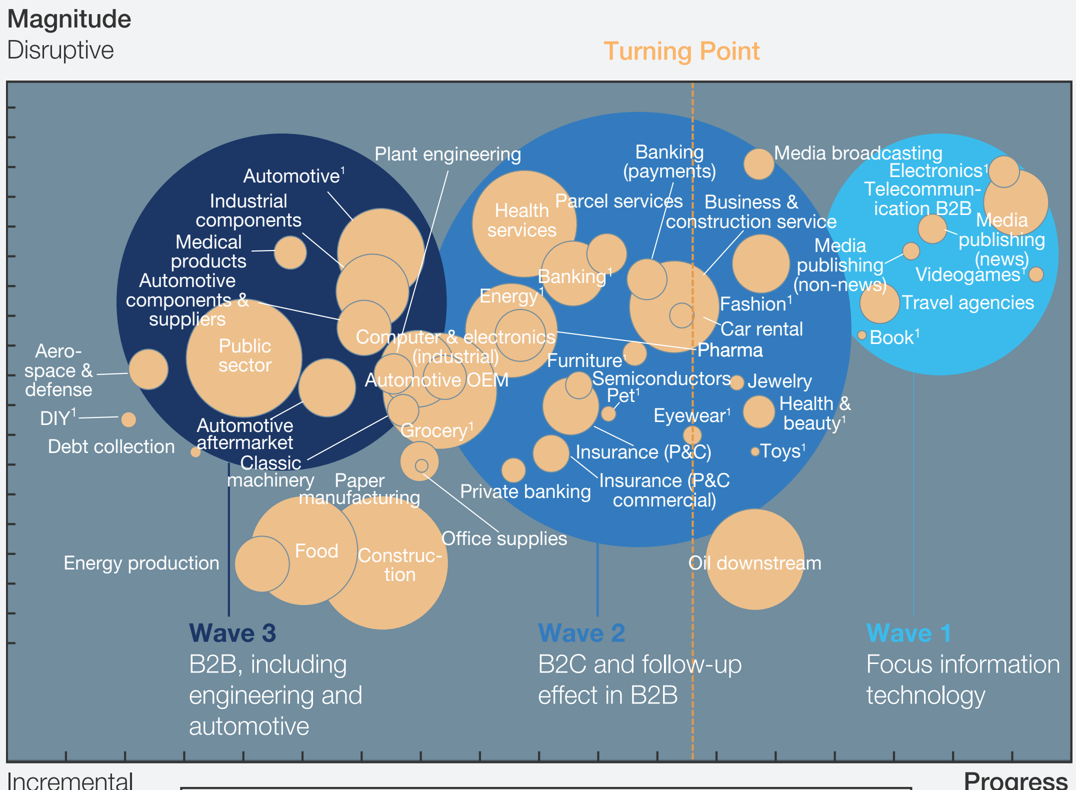
Wave 2 consists of service-based businesses and consumer companies, such as retail banking, insurance, consulting, and healthcare. The complex organizational infrastructures and product portfolios that characterize this wave mean disruption moves at a slower pace.

Wave 3 includes sectors with the most complicated supply chains, such as automotive, retail, industrial components, or where core processes and products still require significant manual involvement, such as grocery retailing. Although full-scale disruption is still a few years out, companies with digitally optimized supply chains are likely to benefit disproportionately. McKinsey research finds that nearly three-quarters of the total revenue and EBIT growth gains from digitization will come from their superior supply-chain performance.[1]

1 Jacques Bughin, Laura LaBerge, and Anette Mellbye, "The case for digital reinvention," *McKinsey Quarterly*, February 2017.

Exhibit 1

Digitization takes place in 3 waves. An industry’s position within the development progress depends on the maturity of its applicable technologies.



Relevant for positioning across progress of digitization:
1) Maturity of applicable new technology 2) Complexity of technology, size and character of installed base

1 Retail
SOURCE: McKinsey Digital Footprint

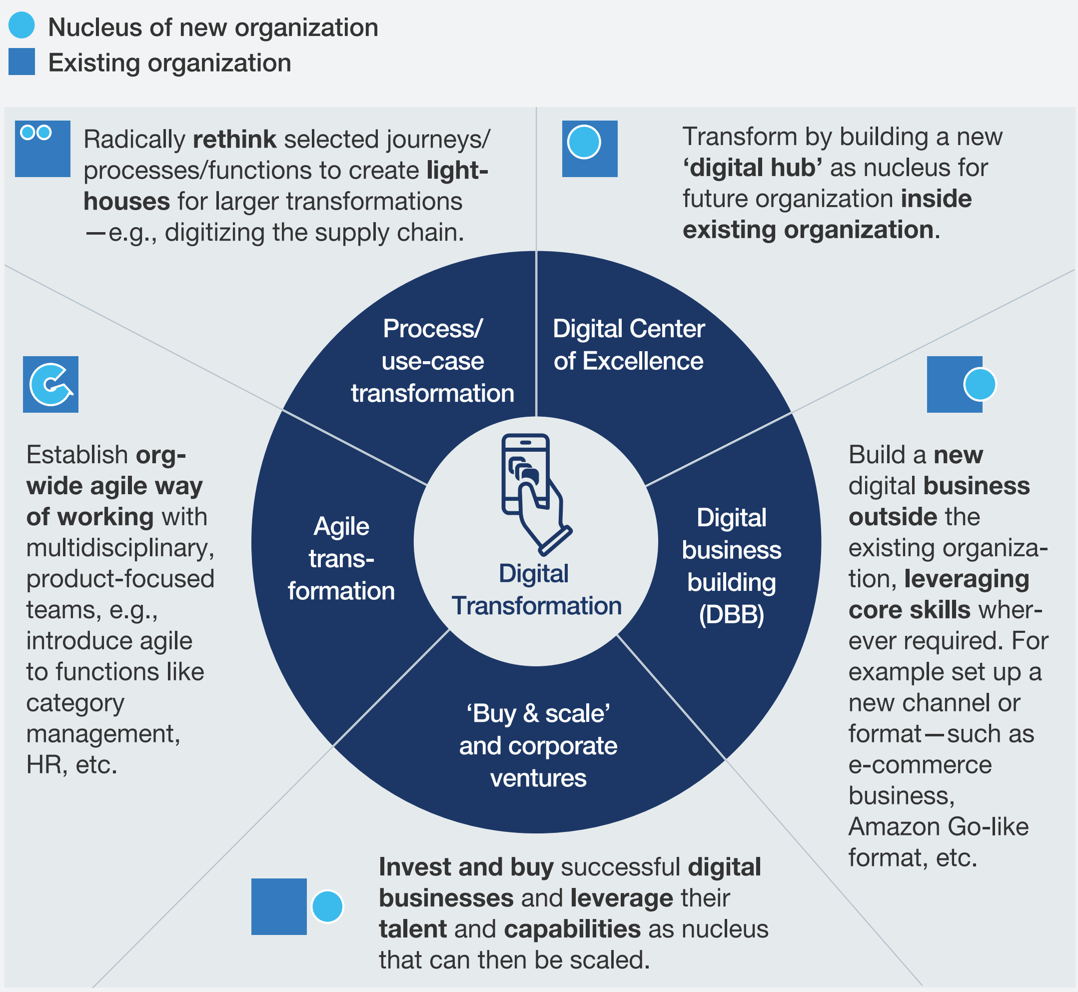
To digitize effectively, act like it’s a turnaround

Crisis mode is certainly a high-pressure environment, but it should be free from any sense of panic. Many companies we’ve worked with, in fact, find this restructuring process energizing and liberating.

Just as in a corporate restructuring program, however, digital transformations require choices about what sort of change the company should pursue. In our experience, there are five main options, each one requiring a specific approach and set of activities, each with its own costs and benefits (see Exhibit 2).

Exhibit 2

A combination of several transformation 'pathways' can ensure a successful digital transformation



SOURCE: Digital McKinsey

Which option a company selects depends on various conditions, such as marketplace dynamics, existing capabilities, and leadership conviction. In practice, companies can choose a number of options. For example, a company can establish a Digital Center of Excellence to create a critical mass of digital expertise, then direct those resources to work on transforming a set of customer journeys or processes. Or they may buy a start-up and use that business's talent and processes to jumpstart an organization-wide program to develop agile, cross-functional teams working on specific products. Whichever option or set of options a business chooses for its digital transformation, the company needs to pursue it with the vigor of a restructuring program.

Our experience shows that most effective digital turnaround and transformation (DTT) programs follow a well-proven five-step process:

1. Break the compromise. The temptation with any transformation effort is to play it safe and make incremental changes to the business. But incrementalism is the death of a rapid turnaround. Digital is by its nature disruptive, so the transformation needs to be disruptive as well. Successful programs require leaders to be bold and think big. In fact, McKinsey research shows that digitization will take a significant bite out of revenues for companies that stay idle, while those that are willing to disrupt themselves through bold action can drive significant growth (see Exhibit 3).

   Mathias Döpfner, CEO of the German publishing company Axel Springer, embodied this boldness in his turnaround effort. Sensing that digital would completely disrupt the business, he set a target of 50 percent of sales coming from digital in five years and recast his company's mission to become the "leading digital publisher" in the world. Digital activities now generate more than 60 percent of Axel Springer's revenues and just over 70 percent of its operating profit.[2]

   That boldness plays out in how the scope of the DTT program is defined and driven. In most transformations, scope might start out being bold but is often watered down during the alignment process. In a true DTT program, the entire business is in scope.

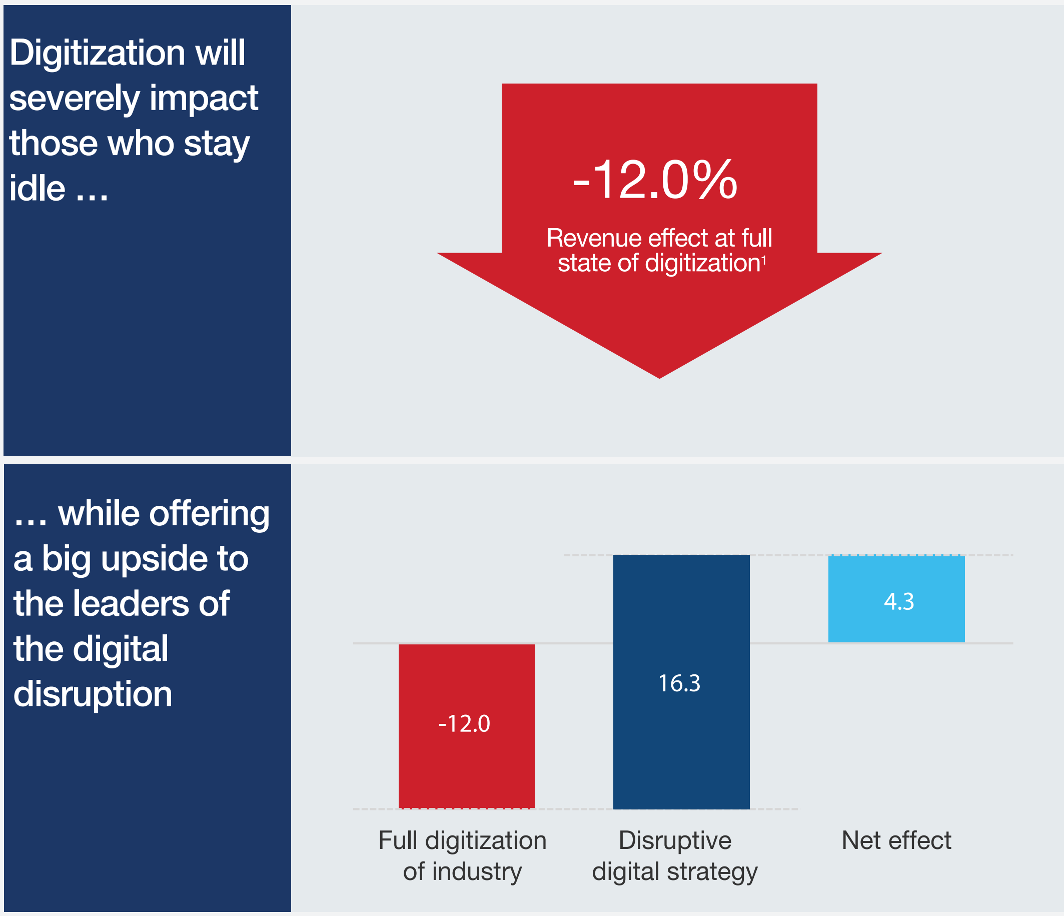
   The pace of the DTT effort also reflects this bold stance by embracing a clear bias for action over analysis. A digital-turnaround program in particular emphasizes putting many experiments in the field on a constant basis to learn what works rather than developing 'bulletproof' plans. That applies particularly to IT, where DTT programs focus on as many as 30 detailed KPIs. That level of granularity is necessary to address the particular complexity in transforming IT to enable the rest of the business to digitize. Because there are so many experiments going on, a turnaround will have a 3–5:1 failure-to-success ratio. Maintaining momentum, therefore, means having a sufficient number of experiments in

2 "An Old-Media Empire, Axel Springer Reboots for the Digital Age," *The New York Times*, Dec. 20, 2015.

Exhibit 3

Facts speak for themselves: Only companies that disrupt themselves will stay ahead in a digitizing world

% of revenue, at full state of digitization, by industry, estimated[1]



1 Estimated effect via regression on revenue growth of level of total types of disruption

SOURCE: MGI; McKinsey Digital Global Survey

the pipeline.

Nowhere is that bias for action more visible than in the way successful businesses make decisions. Meetings are frequent but short (sometimes just 15 minutes) and have the express purpose of resolving a specific issue. One CEO of a European retail company set the goal that a decision had to be made within 30 minutes of a meeting's start. The mentality is that a bad decision is better than no decision at all.

2. Bring in the digital muscle. Rapid transformations are complex and require specific skills. Getting moving quickly and effectively generally requires an injection of specialized talent. In many cases, that starts with bringing in a chief digital officer (CDO). While the CDO should have a substantial digital skill set (e.g., cloud, cybersecurity, advanced analytics) the crucial capability needed is around change management. In a rapid transformation program, the CDO needs to be the primary agent and driver of change by putting in place new performance metrics, creating a culture that rewards different behaviors, harnessing influencers in the business to drive the change, and role modeling new ways of working. The role also has extensive *business* responsibility. Driving change is good, but it needs to result in new revenue, and a good CDO has explicit accountability on that score.

   Importantly, CDOs must have substantive budgets and decision-making rights. They generally report to the CEO and, in some cases, also join the board. The CEO needs to assign senior leaders to the CDO's team who have deep functional knowledge—for example, of transferring sensitive IT systems to the cloud, or building new compensation structures—and experience in leading change. Their seniority is an important point, because it greatly increases the likelihood that leaders in the business will take their advice and guidance seriously.

   There are cases when a CDO isn't the right answer. Sometimes the CEO or a 'council' of leaders acts as the main driver of change. In each case, though, the drivers of a transformation take a highly visible role, set clear aspirations, and put in place the mechanisms and capabilities to support change across the business.

3. Activate many fronts. A significant difference between a DTT program and more traditional transformation approaches is in the scale of the activity. DTT efforts happen across many fronts at the same time. McKinsey research shows that winning companies not only invest more in digital, but invest across more dimensions of the business.[3]

   A light-bulb company took this kind of multifront action when it decided to switch to making LEDs. That required building out new semiconductor technology to create the LEDs, as well as developing a different way of selling that included more reliance on digital tools, such as better search and comparison on a website and automated reordering. That in turn required finding new people with the right skills and creating a new digital department that functioned next to existing IT.

   In another example, Telefonica, a large telecoms company, decided that to accelerate its digital transformation, it needed to set up a new IoT business. This new business unit set up shop in its own space so it could make decisions quickly, including signing up OEM customers and ecosystem vendor partners. They hired a workforce of about 35 people (including vendors and support) with strong IoT, cloud, API, and app skills. At the same time, they built a working prototype of the IoT platform in about 100 days.

3 Jacques Bughin, Laura LaBerge, and Anette Mellbye, "The case for digital reinvention," *McKinsey Quarterly*, February 2017.

This multifront approach may sound like a recipe for chaos, especially with the high volume of experiments required, and that can certainly be the outcome if it's not effectively managed. We've found that it's essential to put in place a management tool that can track the many 'minitransformations' happening across the organization. To be useful, this tool needs to provide sufficient transparency so that the CDO can track progress at a meaningful level of detail. It should include tasks, people who are accountable, milestones, and timing. This tool should also help decision makers spot where progress is falling behind, determine what dependencies need to be addressed and when, and make the right allocations of people and spend to keep the momentum moving forward.

4. Establish a digital control tower. Where a traditional digital transformation might establish a central team to roll out needed changes, companies operating with a turnaround mind-set create a dedicated Transformation Office or TO. Managed by the CDO, the TO has a broad remit and significant decision-making authority. It manages traditional change efforts, such as planning and coordinating digital initiatives, centralizing management, and maintaining tight execution discipline. Where a TO is really different from traditional transformation-management teams is in its adoption of a private-equity management approach. Experiments are evaluated frequently. Poor performers are quickly defunded, but additional funding is released for successful experiments that meet their milestones.

   At one multinational telco, multidisciplinary teams representing a mix of seniority and skill sets from across the business took ownership for specific crosscutting reforms. To keep things moving, TO teams met in daily and weekly huddles where they reviewed progress and resolved the most pressing issues. Business leaders committed to removing organizational blockers, such as working with legal to streamline approvals, helping teams navigate interdependencies, and setting new stretch goals. In this way, the TO ensured changes were managed end to end with the full involvement of the business, increasing transparency and accountability across all layers.

5. Make the change personal. In a turnaround, the need for change is clear. What's often less clear to employees is what the change means for them and if they're going to like the end result. To guard against 'tissue rejection'—the legacy organization resisting the change—leaders at a few companies have created personal 'change stories.' These are short briefs describing the change they want to happen.

   A general manager, for example, might articulate where he wants the business to be in a year and what he thinks is needed to get there. He also writes out what he expects from his direct reports and what they can expect from him. They then pass this down to the next level of the organization, where people build on that story by including more details and translating those into specifics actions they'll take to drive the change. This relatively simple step helps to ready people for change, and makes them more amenable to working with a troop of outside experts.

In addition, senior leadership and managers need to actively communicate so that employees understand what the change means for them. When backed with opportunities for employees to play a key role in shaping the change—for instance, by being part of an empowered, autonomous TO team charged with designing a superior customer journey—buy-in is easier to cultivate.

Incentives need to recognize the altered environment and reward employees accordingly, such as with outsize payouts for outsize performance. Soft rewards also help. Recognizing a team's work in a visible way, such as at a company event, or sending a personalized note from leadership can be big morale boosters.

Sustaining a transformation mind-set

After months of exhaustive effort, a company reaches its transformation goals, celebrates the hard-won achievement—then, bit by bit, settles back into old routines. Competing in the digital economy, however, doesn't allow for that kind of complacency. Organizations must continually innovate and refine their digital capabilities to maintain high performance One way to spur that focus is to reinforce intelligence gathering abilities to watch for early indicators on how markets are moving. By discovering how digitization is altering the fundamental economics of different industry models, executives can better isolate where disruption is most likely to occur. They continually scan the market and invest time in examining how digitization can reshape the competition and where future growth will come from.

Predicting exactly how a market will shake out is impossible, but our transformation work shows that companies that lay the groundwork now, by investing in their analytics capabilities and embracing work practices that support continual test-and-learn development are more likely to spot threats, anticipate opportunities and be quicker to innovate around them.

One way to sustain the momentum is to make the TO mind-set the de facto way of working, applying the same crossfunctional teaming model and performance discipline to other parts of the business. When multidisciplinary teams are empowered to deliver on specific customer and business goals, they have a stake in the outcome. That helps foster a culture of innovation and personal accountability that can embed the behavioral and process changes needed.

All this takes enormous commitment and a certain amount of humility. While most companies know that digitization will bring significant changes to their business, many don't realize how fast those changes can come and how quickly they can reshape the operating landscape and value chain. Taking an outside-in view, creating a responsive execution engine, and backing it with the right performance discipline can help business leaders spread that commitment across the organization, ensure fresh perspectives, and generate more rapid returns.

By the time disruptive shifts take hold, companies can find themselves on the back foot, scrambling to stave off obsolescence in parts of the business and bring needed innovations to market quickly enough. But our client work finds that an aggressive transformation that focuses on helping companies digitize at scale and better track how their industry is likely to be reshaped by digitization, can allow even latecomers to rebound successfully.

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