A CEO guide for avoiding the ten traps that derail digital transformations

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Transforming your business has risks. Successful leaders know how to spot them and avoid them.

Business leaders are in a high-stakes game. Many have embarked on programs to reinvent their businesses. The rewards for success are enormous, while the consequences of failure are drastic, even lethal.

They could do worse than look to a quote from one of the most successful race-car drivers in history, Mario Andretti: “If everything seems under control, you’re not going fast enough.”

While Andretti’s guidance might seem unnerving at first, it is appropriate for leaders navigating the digital world. No race—or transformation—is risk free, of course, but having the courage to make decisions that push the limits of the organization is a necessity.

A clear understanding of what really matters to the success of a change program and what doesn’t, however, can make all the difference. For this reason, we analyzed dozens of both successful and less successful digital transformations to get at the root causes of where they go wrong. This analysis has yielded ten important traps that businesses frequently fall into during a digital transformation. Often overlooked or misunderstood, these traps boil down to culture, discipline, and mind-set issues. Here is what CEOs can do to overcome them and de-risk their programs so that businesses can capture the full benefits of digital.

Ten traps of a digital transformation

1. Excessive caution

Paradoxical though it may sound, we believe companies need to take more risk, not less. Many senior executives look back on their transformation programs[1] and wish they'd been bolder. In today's environment, making incremental changes is like rearranging the deck chairs on the *Titanic*.

Data tell the same story. Recent McKinsey research reveals that the companies that do best follow bold and disruptive strategies.[2] They make big bets on new technologies and business models, champion a test-and-learn culture where every failure is an opportunity to improve, and launch change programs that transform their whole business.

But taking on more risk doesn't mean being more risky. Making reckless moves, ignoring common sense, and losing sight of where the value is can undo bold initiatives.

1 Peter Dahlström, Liz Ericson, Somesh Khanna, and Jürgen Meffert, "From disrupted to disruptor: Reinventing your business by transforming the core," McKinsey.com, February 2017.

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

2. Fear of the unknown

When information is in short supply, people fall back on experience and gut feeling. Though there's no such thing as cast-iron certainty in a digital transformation, developing a comprehensive fact base can do much to dispel people's understandable fears.

The best companies start by identifying where value is created and destroyed,[3] and they don't confine their analysis to their own sector and competitors. This external analysis should be matched with a deep and comprehensive internal assessment. That starts with a thorough evaluation of a company's assets—brands, capital, data, customers, products, people—and capability gaps. The best companies then also develop an objective picture of their digital quotient,[4] the elements of their business that add the most value, and the structural disadvantages they face.

Dispelling the unknown extends as well to painting a compelling picture for the entire business of what the future could look like. Experimenting with hackathons and war gaming also helps not only to develop innovative new models but also to make them more tangible, so that leadership can align around them.

This extends to use of the overused term "digital transformation," which is often not well understood by leadership or employees. Leaders can address this by thoroughly defining and explaining what the digital transformation *really* means—for example, improving customer experience to become the number-one service in the category or radically improving productivity across the supply chain.

3 Angus Dawson, Martin Hirt, and Jay Scanlan, "The economic essentials of digital strategy," *McKinsey Quarterly*, March 2016.

4 Tanguy Catlin, Jay Scanlan, and Paul Willmott, "Raising your Digital Quotient," *McKinsey Quarterly*, June 2015.

3. Lack of focus

Many companies have adopted a "let a hundred flowers bloom" philosophy that encourages broad experimentation. Such an approach generates excitement and learning, but it can also be self-defeating if not carefully managed. Running too many competing initiatives dissipates management focus and starves promising ideas of the resources they need for a successful scale-up.

We have a rule of thumb that a successful scaled-up digital initiative at a company with more than $5 billion in revenues needs funding to the tune of $10 million to $30 million per year, and a major digital transformation across multiple business units at a global company might cost as much $100 million. To avoid spreading their efforts too thin, smart digital leaders prune their portfolios regularly and ruthlessly. Subscale investment is no way to compete against venture-fund-backed companies.

Focusing on the right kind of initiatives is equally important. Too often, businesses pour resources into programs that yield short-term gains but can't be scaled, aren't sustainable, and don't add value. To avoid this wasted energy, any digital transformation should start with understanding customer needs and build out solutions that not only address them but have the potential to generate the most impact.

4. Running out of money

Some digital transformations run into difficulties because costs rocket while savings or revenue growth take longer than expected. Leading companies start by targeting quick wins to unlock value so that the effort funds itself, often within the first three months. In fact, this approach can be so effective that the most successful companies generate more savings or revenues than are needed to fund a transformation.

Banking these savings and revenues can often happen using the tools and data already to hand coupled with a willingness to do things differently. Take the three-person team that carried out a microsegmentation of the customer base at a US telecom company. Their effort improved the efficiency of the company's targeting by more than 40 percent while halving its digital-marketing spend. Similarly, an online retailer upped conversion rates by 35 percent simply by having one person optimize page-loading times again and again until they shrank from 16 seconds to six.

Often these opportunities can be identified as early as a week into a project. Evaluating the customer decision journey is a good place to start. In consumer sectors like banking and telecoms, the joining and onboarding processes for new customers often offer plenty of opportunities for significant improvement.

5. Lack of talent

Most companies embarking on digital transformations underestimate how long it takes to build capabilities. They know they need digital talent, but not what kind or how much. A digital transformation at a large company can require as many as 150 full-time employees in the first year. Hiring a chief digital officer[5] is a good start but is not enough.

Any effective talent search should begin with identifying the problems that need to be solved. This helps clarify the skill sets you need. After a preliminary analysis, for example, one company determined that it needed 11 people with specific skill sets—"leaders" and "doers"—to complete a core project as part of a transformation. It found the right people at a leading tech company and paid a 100 percent premium to hire them. Later in the transformation, the next 50 people came at just a 20 percent premium because they were eager to work with the first hires. In less than nine months, the team generated $1.4 billion in incremental annualized revenues, a massive payoff for what had originally seemed a disproportionate investment.

Creating a start-up-like working environment with informal spaces where people can gather and share ideas can help attract the right talent. Developing a mechanism for integrating these external hires is also crucial. We've seen some large companies hire lots of digital talent, put them in a start-up environment, and then more or less forget about them. Left to their own devices, new people will start to work on their stuff, not yours.

5 Tuck Rickards, Kate Smaje, and Vic Sohoni, "'Transformer in chief': The new chief digital officer," McKinsey.com, September 2015.

6. Lack of discipline

Agility and speed are second nature to a digital organization, but energy can turn to chaos if it isn't channeled purposefully. Leaders need to be systematic about identifying and capturing business value, which begins with creating transparency into, and useful metrics to track, the progress of digital initiatives.

Many companies focus on output-based KPIs such as EBITDA growth, digital revenues as a percentage of total revenues, or reduction in capex. But such broad metrics don't isolate the factors that contribute to a given result. It's more productive to develop a set of simple input metrics tracking elements such as SEO conversion and app traffic, while making it clear who owns each item and is accountable for the result.

Another way to inject discipline is to invest like a venture-capital firm. Hold frequent check-ins with explicit expectations and clear governance; don't release the next tranche of finance until the project reaches milestones or meets KPIs; and show no mercy in killing off underperforming efforts. The best companies ensure that simple governance, escalation, and response procedures are in place, as well as mechanisms to allow course correction when experiments miss the mark (which many of them inevitably do).

Discipline should not be confused with rigidity. Having a flexible resourcing model to move people and funds, for example, to promising developments and address key issues quickly is necessary.

7. Failure to learn

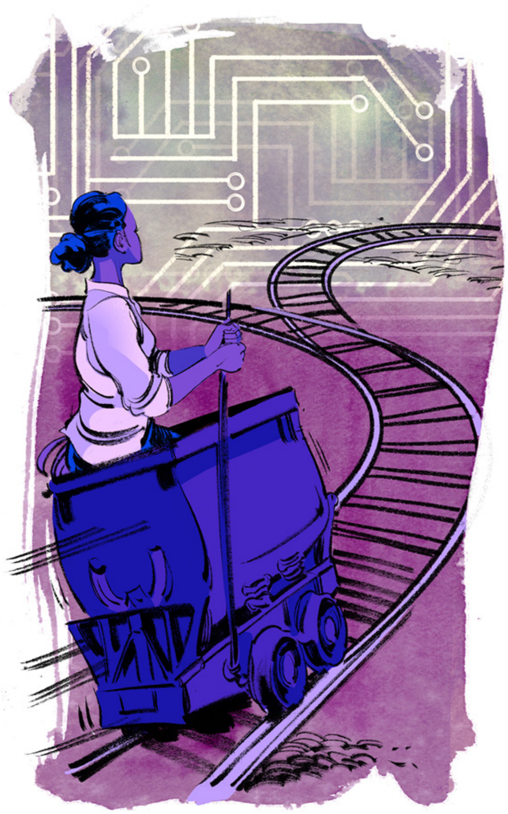
A surefire way to sink a transformation is to stop learning. Successful companies reward experimentation because learning from mistakes helps a company get it right the next time, which in turn fosters more creativity. A review of teams at Google found that when employees felt they could take risks without being shamed or criticized for failure, they did better work.[6]

6 Charles Duhigg, "What Google learned from its quest to build the perfect team," *The New York Times Magazine*, February 28, 2016.

Effective learning, however, doesn't just happen on its own. Companies need to invest in systems to capture lessons and learn from them. Amazon has invested in systems designed to make learning as transparent as possible, with dashboards showing what tests are running, who is doing them, and how customers are responding. The best-performing and longest-running tests are crowned "King of the Hill."

Where tech is concerned, some companies are keeping tested and approved code in a software-development repository like GitHub, which enables later developers to learn from others, capitalize on their successes, and put code into new solutions without further testing.

Organizations that embrace learning typically develop inexpensive prototypes, test them with customers, and repeatedly refine them until they reach a minimum viable product (MVP). They seek feedback on new features from small groups of customers through simple surveys or by gauging their responses to specific elements such as the wording or layout of a web page. One business that used to have conversion rates of 22 percent has now hit 29 percent—yielding growth of 5 percent—through this kind of test-and-learn process.



8. Change fatigue

Companies can often summon the resources and energy to pull off a few experiments with new approaches. But sustaining the momentum of a major change effort against the gravitational pull of the legacy organization[7] is a challenge of a different order. No transformation is immune to change fatigue, but certain steps can help stave it off.

Teams can become overwhelmed by the sheer scale and complexity of the change. Effective leaders, therefore, design small projects with frequent milestones so that teams feel a sense of accomplishment. They also focus on keeping things simple, for example by limiting the number of KPIs. One consumer business chose three: amount and source of traffic to digital assets, quality of traffic, and conversion rates.

Business leaders can "grease the skids" of the process by sequencing tasks thoughtfully to build on one another.[8] Some businesses, for example,

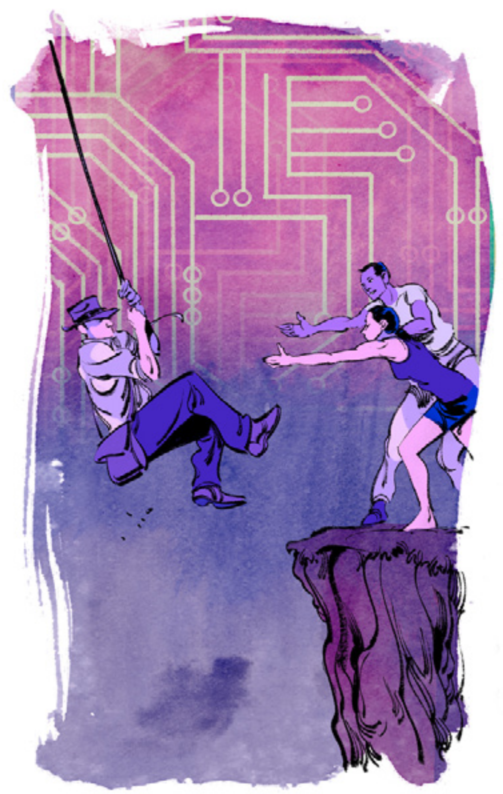
7 Jurgen Meffert and Anand Swaminathan, "How to break through the gravitational pull of your legacy organization," McKinsey.com, October 2017.

8 Driek Desmet, Shahar Markovitch, and Christopher Paquette,"Speed and scale: Unlocking digital value in customer journeys," McKinsey.com, November 2015.

develop "horizontal" components such as business-process management layers or central administration platforms that can be shared across multiple initiatives to accelerate future projects.

Leaders should also address turnover in their senior ranks. This effect undermines continuity and leads to cynicism among workers on the ground. While senior-level turnover is a fact of life for most businesses, companies have managed to create continuity in their change programs by recruiting a dozen or so influential middle managers as evangelists for change. By elevating their profiles in the business, giving them real responsibilities, such as leading agile teams, and rewarding them generously for their efforts, leaders can build continuity at the level of the business where the work gets done.

9. Going it alone



If the old world was about keeping things proprietary and closed off, the new world is about engaging with an ecosystem of partners and vendors. This approach can help accelerate access to markets, talent, capabilities, and technologies. Agile businesses build digital capacity at speed by using existing resources, such as open-source software, that can be customized to their needs. Working thoughtfully with vendors or partners to access new capabilities can jumpstart activity, and help businesses get smart quickly about how to "do digital."

In this new world of ecosystems,[9] success relies on having a detailed understanding of the capabilities and advantages you already have and the ones you need. Investing in a strategy around APIs (the links that allow disparate systems to "talk" to each other)[10] is crucial so that businesses develop the means to integrate with many different partners, vendors, and platforms. Leading companies are also building out ecosystem relationship-management capabilities, from negotiating teams who track potential partners to people dedicated to managing partner and developer communities.

9 Venkat Alturi, Miklós Dietz, and Nikolaus Henke, "Competing in a world of sectors without borders," *McKinsey Quarterly*, July 2017.

10 Keerthi Iyengar, Somesh Khanna, Srinivas Ramadath, and Daniel Stephens, "What it really takes to capture the value of APIs," McKinsey.com, September 2017.

10 . Going too slowly

However quickly you think you are going, chances are it isn't fast enough. Speed is of the essence when it comes to reacting to market changes and capturing revenue opportunities before competitors do.

One way to gain speed is to automate time-consuming processes and tasks. For instance, adopting "test-driven development"—writing automated tests for code before writing the code itself—can greatly accelerate development. One international hotel company consolidated its sales and catering systems by moving to a single version-control repository, integrating code twice a day, and insisting that developers write automated tests for new changes in their code. As a result, the company reduced its time to market with new software by 25 percent.[11]

With speed in mind, a team of developers at another company adopted a collaborative tool to track performance across sales, apps, and service. Every ten minutes the tool spits out new metrics—sales, cash or credit, numbers engaged, size of basket—and the team can see at a glance how the system is performing. An alert channel enables project leaders to identify whether an issue is new or known, big or small, so that they can plan how best to deal with it. The focus is on reacting quickly rather than making sure everything is "perfect."

The most effective businesses ingrain speed by making agile a way of life. They use short development cycles to address specific needs, try out rough-and-ready fixes repeatedly with customers, and produce "good enough" solutions. In marketing, for example, agile organizations[12] can test multiple new ideas and run hundreds of campaigns simultaneously and get ideas into the field in days rather than weeks or months.

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To build real value, business leaders need to take risks. But those who succeed will be the ones who understand how to manage the risks that matter and avoid the traps that can scuttle a transformation—all while pushing their organizations to the limit.

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11 Satty Bhens, Ling Lau, and Shahar Markovitch, "Finding the speed to innovate," McKinsey.com, April, 2015.

12 David Edelman, Jason Heller, and Steven Spittaels, "Agile marketing: A step-by-step guide," McKinsey.com, Novermber 2016.