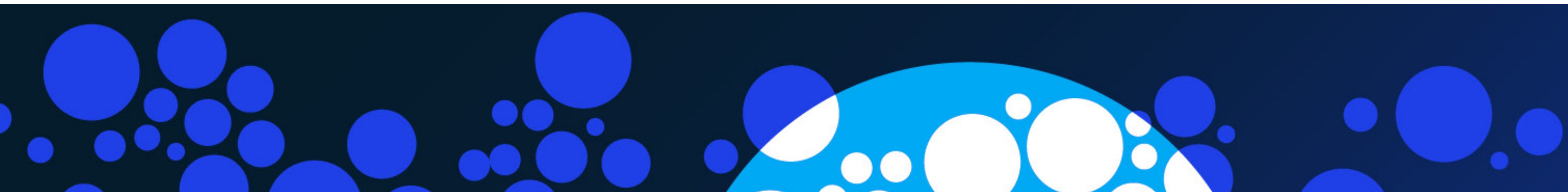
McKinsey Digital

Mastering the duality of digital: How companies withstand disruption

McKinsey research shows that established companies win by addressing digital strategy's dual imperatives: building new digital businesses while digitizing legacy operations.



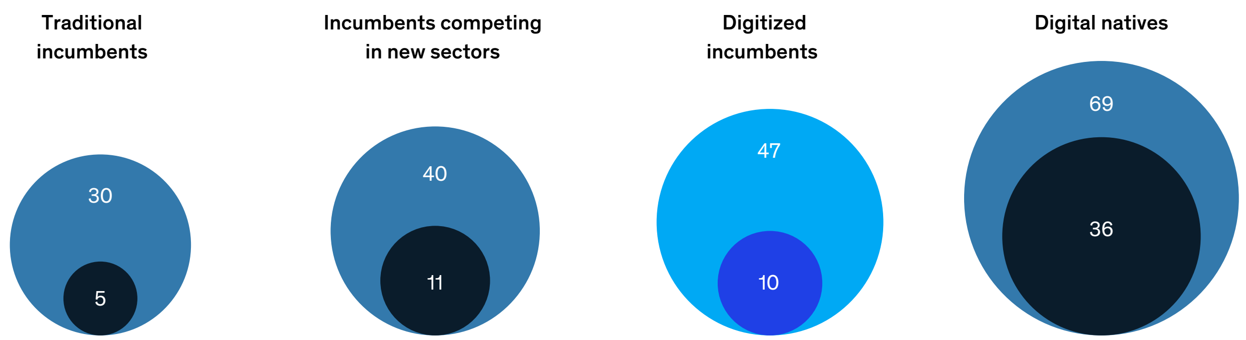
September 2019

For established companies in an increasingly digital world, making incremental changes to long-standing business models isn't enough to succeed. To sustain growth in the face of disruptive threats from digital challengers, incumbent companies must overcome two challenges at the same time: innovating with new digital businesses while also digitizing core holdings. The findings of multiple McKinsey Global Surveys on digitization show the defining elements of strategies and operating models that are built for this duality of digital.

It pays to master the duality of digital

Balancing the dual imperatives of digital can be difficult but exceptionally rewarding. According to respondents to a McKinsey survey on digital strategy, digitized incumbents—companies that are more than 20 percent digital and are launching new digital businesses while transforming the core—are twice as likely as traditional incumbents to experience organic revenue growth of 25 percent or higher (see sidebar, "The digital landscape").[1]

Companies with organic revenue growth over 25% (inner circle) and over 10% (outer circle), by company type,
% of respondents



The digital landscape

This article refers in several places to four kinds of companies:

Digital natives

Digitized incumbents are incumbent businesses competing substantially in new ways through digitization (that is, more than 20 percent of the business is digital).

Incumbents competing in new sectors are incumbent businesses moving into other industries through digital moves or initiatives.

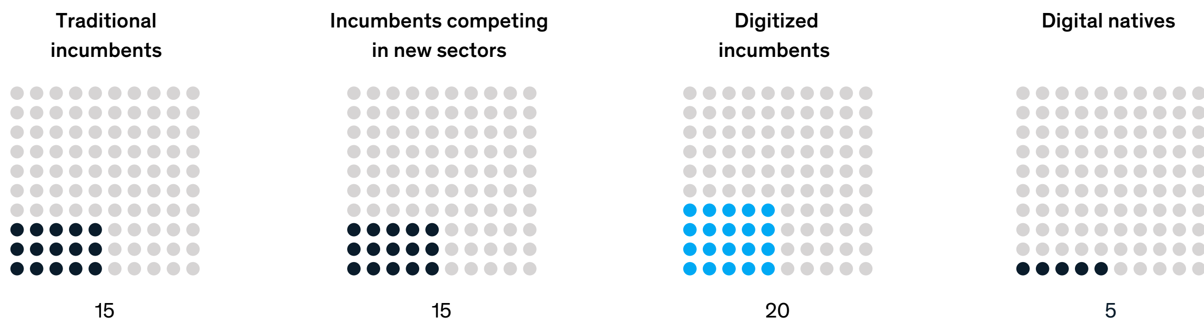
Traditional incumbents are incumbent companies competing primarily in traditional ways (that is, more than 80 percent of their business isn't digital).

We also refer to other kinds of companies (such as top economic performers), and define those as well.

[1] "How digital reinventors are pulling away from the pack," October 2017, McKinsey.com.

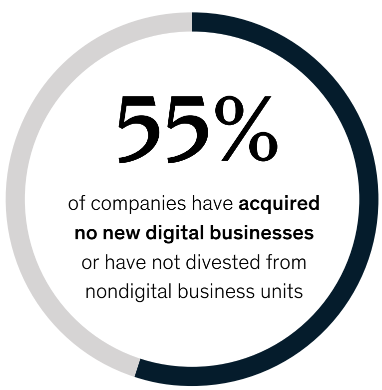
What's more, respondents at digitized incumbents say that their organizations have a strong position in terms of market share. Digitized incumbents command a 20 percent share, on average, of their core markets. That is five percentage points more than what respondents at traditional incumbents report, and four times what respondents at digital natives do.[2]

Median share of core market, by company type, %

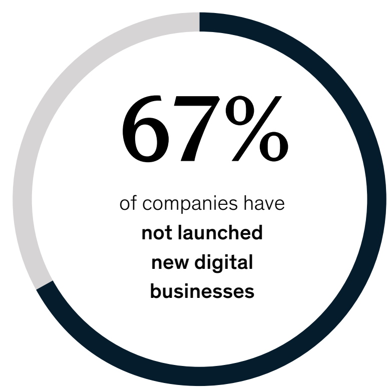


As appealing as these advantages may appear, the typical response to digital is underwhelming.

More than half of all respondents say that their companies have made no changes to their business portfolios because of digitization …



… and two-thirds say that their companies have not launched new digital businesses.



Three bold moves help winners create digital businesses

The best economic performers—that is, companies with organic revenue growth of 25 percent or higher during the past three years—are more likely than other companies to work on creating new digital businesses, according to a separate survey.[3] While not all digitized incumbents are top economic performers, they are much more likely to be in that elite group than traditional incumbents are.

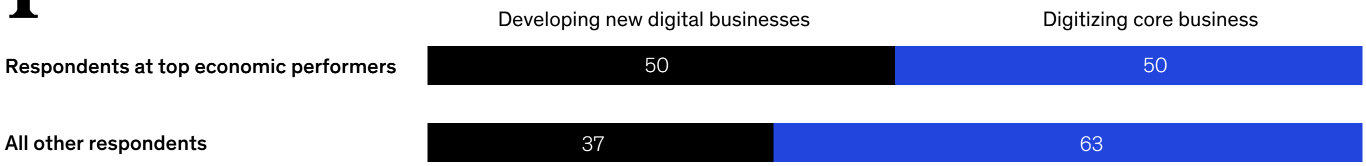
Three bold strategic moves, all geared to building digital businesses, distinguish the top economic performers from all other companies.[4]

The first move is allocating digital capital. Respondents at top economic performers say that their companies divide this capital equally between digitizing their core businesses and developing new digital businesses. Other companies put more money into digitizing legacy operations.

---

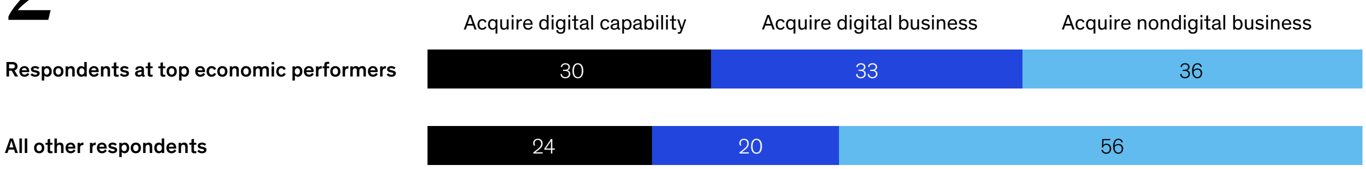
[2] Ibid.
[3] "A winning operating model for digital strategy," January 2019, McKinsey.com.
[4] Ibid.

1 Organizations' digital-capital allocation in past 3 years, by objective, %



The second bold move is centering M&A on digital opportunities. According to respondents, top economic performers dedicate most of their M&A investments—63 percent—to acquiring digital businesses and capabilities. By contrast, other companies focus their M&A on nondigital ventures.

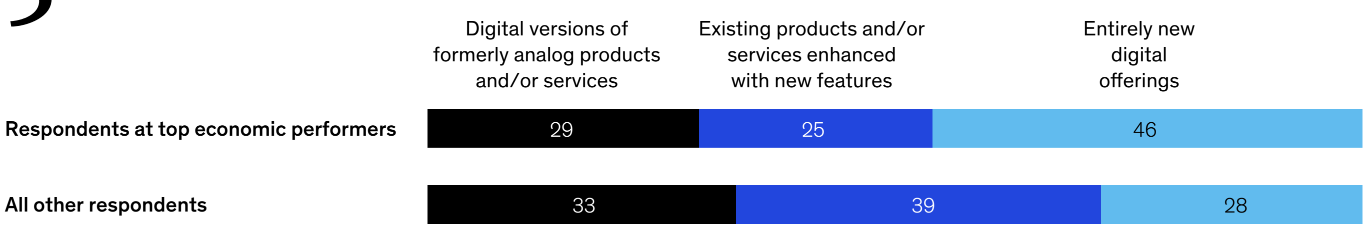
2 Organizations' M&A investments in past 3 years, by type of activity, %[1]



[1]Figures may not sum to 100%, because of rounding.

The top performers' third bold move is to emphasize innovation when they develop their digital-product portfolios. Respondents at these companies say that new digital offerings account for nearly half of their digital products and services. At other companies, new digital offerings make up less than one-third of the digital menu.

3 Organizations' digital offerings, by category, %



From a financial standpoint, putting extra effort and expense into business and product innovation makes sense. Other McKinsey analysis shows that investments in these digital plays yield twice the returns of investments in digitizing core businesses.[5]

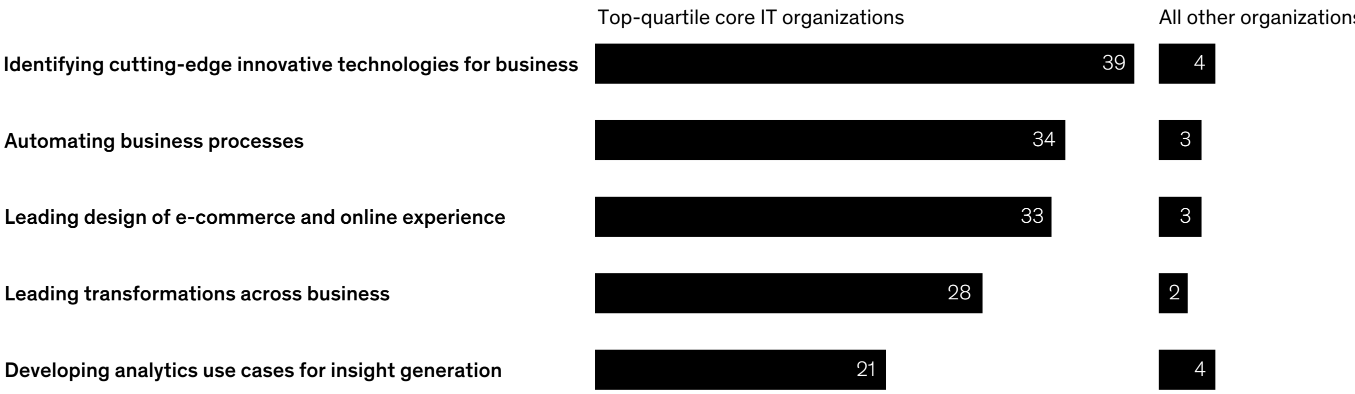
Digitizing the core means transforming processes as well as technology

But make no mistake: digitizing the core business is crucial, even though the direct financial returns are comparatively modest. Most companies can't simply walk away from a core business. They need to digitize it even as they innovate with new models.[6]

[5] Jacques Bughin, Tanguy Catlin, Martin Hirt, and Paul Willmott, "Why digital strategies fail," *McKinsey Quarterly*, January 2018, McKinsey.com.
[6] Ibid.

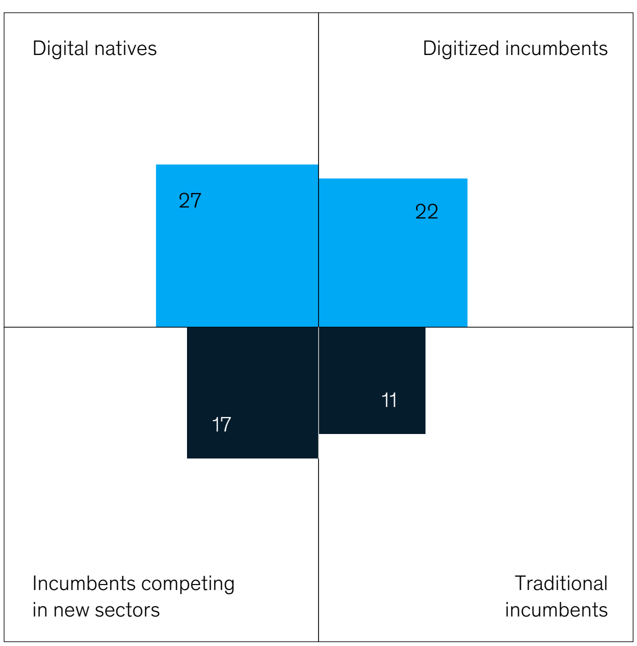
When companies digitize the core business, our research shows, strong IT capabilities help enormously. According to respondents in a survey on the IT function's effectiveness, companies with top performance on core IT tasks have made more progress than other companies in becoming fully digital and mastering key digital activities.[7]

IT effectiveness by activity, % of respondents

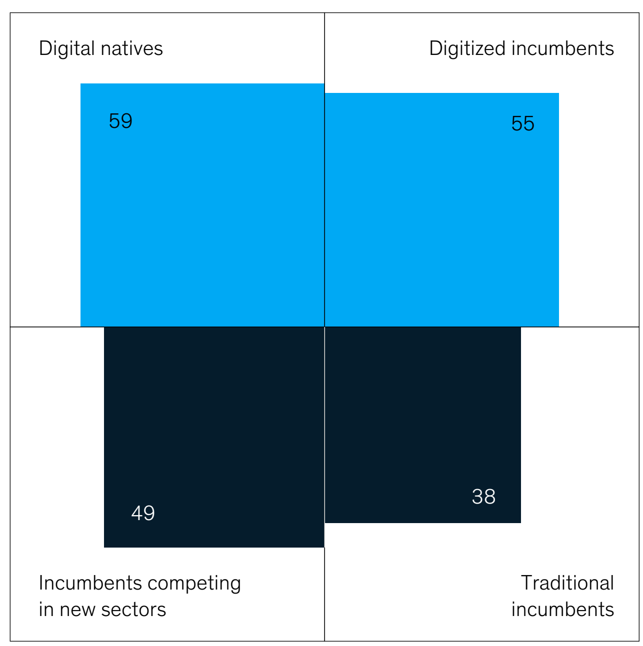


Respondents at digitized incumbents are also more likely than their counterparts at traditional companies to report using basic and advanced digital technologies across the enterprise.[8]

Artificial-intelligence tool use at scale, % of respondents



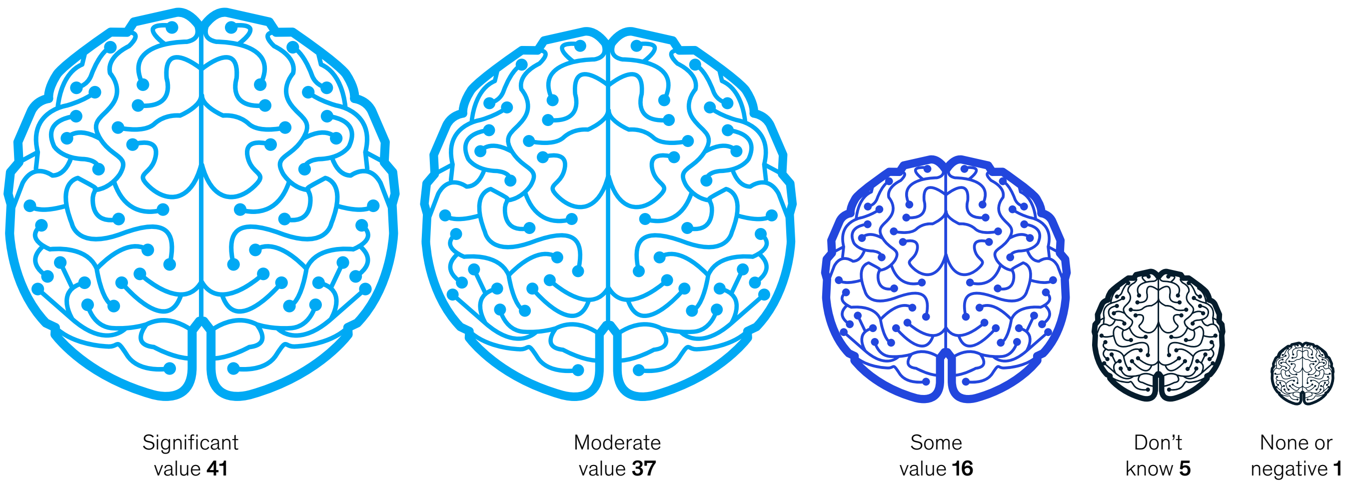
Mobile-internet use at scale, % of respondents



[7] "Can IT rise to the digital challenge?," October 2018, McKinsey.com.
[8] "How digital reinventors are pulling away from the pack," October 2017, McKinsey.com.

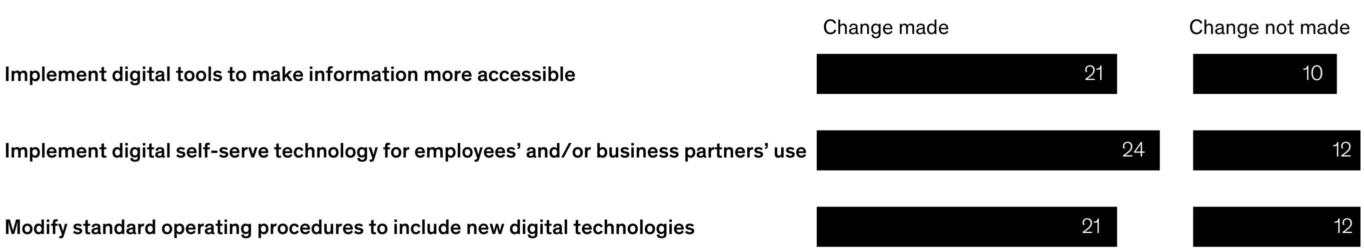
Survey results on the use of artificial intelligence (AI) further illustrate what businesses can achieve by deploying advanced technologies. Among respondents at companies that have embedded or piloted AI in one or more functions or business units, 78 percent say that it has created significant or moderate value.[9]

Value created by embedding or piloting artificial intelligence in business function, % of respondents



To capture the benefit of digital technologies, companies must integrate them into day-to-day processes. In a survey on success factors for digital transformations, some respondents reported that their companies made the use of digital tools a new organizational norm during the transformation. These respondents were more likely than others to say that the transformation had been a success: in other words, that it had brought about sustained improvements in performance.[10]

Digital-transformation success rates by structural change, % of respondents



[9] "AI adoption advances, but foundational barriers remain," November 2018, McKinsey.com.
[10] "Unlocking success in digital transformations," October 2018, McKinsey.com.

The pace and degree of disruption can vary greatly from one established company to another, and even among the businesses in a company's portfolio. To respond to these conditions, incumbents must mount a well-calibrated, dual effort to create new models and digitize current businesses. Executives can begin plotting a course forward by assessing where their companies fall along the digital spectrum.[11]

[11] Jacques Bughin, Tanguy Catlin, Martin Hirt, and Paul Willmott, "Why digital strategies fail," *McKinsey Quarterly*, January 2018, McKinsey.com.