



The seven decisions that matter in a digital transformation: A CEO's guide to reinvention

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A successful digital transformation requires making trade-off decisions. Here's how successful CEOs guide their business's reinvention.

Being the CEO of a large company facing digital disruption can seem like being a gambler at a roulette table. You know you need to place bets to win, but you have no idea where to put your chips.

Of course, digital transformations aren't games of chance. But they do require big and bold commitments in the midst of uncertainty to reinvent the business rather than just improve it.

Many of the digital initiatives large incumbents have already tried to date have tended to operate at the margins of the business. Innovation labs or apps can be useful for learning

and can even provide a boost to the company. Meanwhile, the legacy business remains in place, largely unperturbed.

Without a transformation of the core—the value proposition, people, processes, and technologies that are the lifeblood of the business—any digital initiative is likely to be a short-term fix. The legacy organization will inevitably exert a gravitational pull that drives a reversion to established practices. Reinvention of a business is, by its nature, bold. But it's one thing to be bold; it's another to be thoughtfully bold. A digital reinvention requires the CEO to make tough decisions, which involve hard trade-offs that it is tempting to ignore, defer, or rush into. Yet knowing which decisions to prioritize and how to implement them can make the difference between a successful transformation effort and one that struggles.

These decisions occur in the four phases of a successful digital transformation program:

- Discovering the ambition for the business based on where value is migrating
- Designing a transformation program that targets profitable customer journeys
- Delivering the change through an ecosystem of partners
- De-risking the transformation process to maximize the chances of success

In each of these areas, the CEO has a lot of things to do, from modeling new behavior to driving a change in culture to executing strategy.¹ But this article focuses on some of the big decisions CEOs need to make, and how they can go about making them. Based on our experience with dozens of digital transformations, we believe these seven decisions are the most important ones.

DISCOVER—Set the ambition for the business.

Decision 1: Where the business should go

Few decisions are more momentous than choosing the business direction. While the almost existential nature of this decision can seem overwhelming, most incumbents don't have a choice, since they are already facing disruptions that can threaten their long-term viability.

Data and analysis, as well as a disciplined framework for thinking through options, provide a helpful structure for making the decision. As a starting point, we recommend a thoughtful review of the market and business based on those stalwarts of economic analysis, supply and demand.²

¹ Carolyn B. Aiken and Scott P. Keller, "The CEO's role in leading transformation," McKinsey & Company, February 2007, is a seminal piece on transformations. The points made in it remain true in the digital age.

² Angus Dawson, Martin Hirt, and Jay Scanlan, "Economic essentials of digital strategy," *McKinsey Quarterly*, March 2016.

It's important that any analysis be dynamic and forward-looking, based on an understanding of how digital technology could lead to changes in the future.

Almost every notable digital innovation we've seen has been based on using connectivity and data to transform the customer experience or to reshape products and services by allowing customers to interact with them in new ways. So that's a good basis for thinking through the possibilities. Incumbents can also look to approaches used by digital innovators—both within and outside their sectors—to spur fresh thinking.³

While analysis is crucial, it is no substitute for imagination. C.S. Lewis called imagination “the organ of meaning,” and CEOs need to tap into it. One approach might be to imagine how the industry would work if it were completely digitized.⁴ Often, a creative leap is needed to identify how the firm might serve customers in new ways across their entire journey. We have found 24-hour hackathons with senior leaders to be a very effective way to break through old thinking and encourage executives to adopt completely new ways of doing things.⁵

GE is an example of an incumbent that envisioned how its industry would evolve and acted in response. CEO Jeff Immelt noted that “15 percent or 20 percent of the S&P 500 valuation is consumer Internet stocks that didn't exist 15 or 20 years ago. The consumer companies got none of that ... If you look out 10 or 15 years ... that same value is going to be created in the industrial Internet.”⁶ Based on this insight, GE launched GE Digital, a software and analytics group that works closely with all the company's business units, and Predix, a branded digital platform that invites developers to build new applications using GE data.

DESIGN—Create a plan for the digital transformation.

Decision 2: Who will lead the effort

A program that will deliver the needed degree of transformation is not something CEOs can delegate; they must lead the charge themselves.

Some CEOs, like Daniel Gilbert, cofounder of Quicken Loans, serve as the public face of the company's digital-transformation program. Gilbert was the primary evangelist for Quicken's Rocket Mortgage initiative, touting it as the “mortgage industry's iPhone moment.”⁷

3 Ibid. Innovators have used a range of approaches, including rethinking the nature of customer demand, tapping into previously underutilized sources of supply, launching wholly new value propositions based on reimagined business systems, or leveraging new digital platforms.

4 Chris Bradley and Clayton O'Toole, “An incumbent's guide to digital disruption,” *McKinsey Quarterly*, May 2016, offers a structured framework for analyzing the potential impact of digital technologies on an industry.

5 Ferry Grijpink, Alan Lau, and Javier Vara, “Demystifying the hackathon,” McKinsey & Company, October 2015.

6 Interview: “GE's Jeff Immelt on digitizing in the industrial space,” McKinsey & Company, October 2015.

7 CNBC, “Get a mortgage 'Rocket' fast: Quicken Loans chairman,” January 2016; Matt Burns, “This could be the mortgage industry's iPhone moment,” Techcrunch, November 2015.

CEOs, however, can't do this on their own. Like the conductor of an orchestra, the CEO provides vision and ongoing direction. But a group of other senior leaders needs to drive the effort day-to-day. Thus a key decision for the CEO is selection of the members of the orchestra, based on the skills needed to be harmonious and effective.

One criterion for inclusion, naturally, has to be skill in and knowledge of digital. That's why some CEOs turn to a chief digital officer (CDO). Appointing a CDO is the right answer for many companies, but it's only part of the solution.

This decision needs to extend to putting in place the right team of people to drive the change. Since digital affects almost every aspect of the business and requires an unprecedented level of coordination across the entire organization, any leadership group has to include executives from multiple functions. While it can be important to have people who are visionary and inspiring, the team will also need respected executives with a deep understanding of the mechanics of the business, as well as expertise in change management. In addition, the CEO should select leaders who embody and will forward the key values of a digital culture: customer-centricity, a collaborative mind-set, and a tolerance for risk.

This leadership team doesn't need to be large. In fact, it can be quite small, as long as its members, and the people working with them, have the requisite skills. At Starbucks, for example, Howard Schultz had the CIO and CDO guide a decade-long digitization effort that has driven widespread adoption of mobile payments at North American stores, tightly coupled with the company's customer-loyalty program.⁸ At a European energy company, it was a COO, CMO, and CSO (chief sales officer) who led the charge.

Decision 3: How to “sell” the vision to key stakeholders

Any change effort requires active communication of the vision and an explanation of why it's necessary. For this reason, the CEO needs to decide not only what to say but also how—and how long—to communicate.

One approach is to think of the change program as a product and brand it. When Angela Ahrendts took over as CEO of Burberry, she launched a bold Art of the Trench campaign and an aggressive move into digital, which signaled her high level of ambition and rejuvenated the organization. In early 2014, Ralph Hamers, CEO of ING Group, announced his vision for the company, called Think Forward, Act Now. Its goal was to deliver a differentiating customer experience through faster innovation and better use of analytics. Late in 2016, Hamers updated the vision with Accelerating Think Forward, which focused on mobile banking.⁹

⁸ “How Starbucks Has Gone Digital,” *Sloan Management Review*, April 2013.

⁹ “ING strategy update: Accelerating Think Forward,” *ING Newsroom*, October 3, 2016, 7:30 CET.

It's crucial to decide when to communicate and with whom. The CEO should focus first on winning over influencers both inside and outside the company, then on propagating the change to their networks. CEOs also need to adopt a campaign mentality. This means delivering crisp and clear messages, in a steady cadence, using all relevant formats and channels. It's an influencing program, so messages need to be tailored to each audience—from employees to the board to shareholders.

A bold, long-term orientation, well communicated to all key stakeholders, can be a crucial counterbalance against pressures to hit short-term financial targets once the transformation program begins.

Decision 4: Where to position the firm within the digital ecosystem

New companies are able to challenge established businesses because an ecosystem of relatively cheap and plentiful resources—from technologies to platforms to vendors—is in place. This has been a boon to disruptive attackers, but the same resources can be used by incumbents, too.

CEOs need to figure out which capabilities, skills, and technologies available in the ecosystem complement and support their business's strategic ambitions. How much to rely on these relationships and how to structure them are also crucial decisions. Making them requires a clear sense of how to secure the company's most valuable assets, such as relationships with customers or data.

Michael Busch, the CEO of Thalia, Germany's leading bookstore, systematically evaluated the entire supply chain before launching his company's digital book offering. He created a network of alliances with other book retailers and partnered with Deutsche Telekom, which provided the technology and digital distribution backbone. He did not, however, make any agreements that separated Thalia from its customers, which it saw as its core value.

Over the past decade, BBVA Compass, a Spanish bank with a growing global presence, has aggressively remade itself into a digital organization.¹⁰ In 2016, it launched an API marketplace, which allows fintech start-ups to build apps that interface with BBVA's back-end systems. This arrangement channels the energy and creativity of entrepreneurs while ensuring that BBVA retains a leadership position within the ecosystem.

Decision 5: How to decide during the transformation

As boxer Mike Tyson once said, echoing Joe Louis, "Everyone has a plan 'til they get punched in the mouth."¹¹ No matter how well a transformation effort is designed, there will be surprises

¹⁰ "Francisco González on reinventing finance in the digital age," *Wired UK*, July 2015.

¹¹ <http://www.mightyfighter.com/top-30-greatest-mike-tyson-quotes/>

and unforeseen developments. To deal with this reality, the CEO and top team need to decide on governance and escalation rules to allow for inevitable course corrections.

Frequent check-ins—at least weekly—with senior leaders should be planned to gauge whether the digitization effort is on course and institute changes if it is not. That sounds like a lot, but devoting even one hour a week to a program that transforms the company is just 1 to 2 percent of a CEO's time. The challenge is to book this time and stick to it.

To support this approach, the CEO needs a dashboard developed to track progress on key initiatives that reflect the ambitions of the transformation. A digital transformation is a long-term effort, and as a result, yardsticks that focus on the short term, like ROI, can be misleading. Nontraditional metrics that evaluate digital adoption, such as new registrations on digital channels or digital-engagement levels, are better gauges of the progress of a digital transformation.¹²

DELIVER—Execute the transformation plan, allowing for ongoing adaptation and adjustment.

Decision 6: How to allocate funds rapidly and dynamically

The key lever CEOs and senior teams have to drive a digital transformation is resource allocation. This isn't just about making sure resources get to the right places, a decision CEOs already make as part of their everyday work. With a digital transformation, the CEO needs to decide what the allocation process should be and at what tempo it should operate.

Our research shows that raising a company's Digital Quotient, or DQ®, requires targeted allocation of both capital and operating expenditures.¹³ The CEO and top team should act like venture capitalists by following a digital initiative's progress closely, pulling the plug for projects that lag expectations, and investing more in those that do well.

This requires speeding up budgeting processes, which at large companies tend to follow annual cycles. During a digital transformation, budgeting should shift from annual to quarterly or even monthly cycles.

Succeeding with a digital transformation often requires cutting budgets for legacy operations. In the midst of its transformation effort, a large bank realized that even after making massive investments in digital, branches still accounted for 90 percent of its operating expenses—and that 70 to 80 percent of the transactions done in branches could be executed digitally. In response, they shifted almost all future capital spending to digital, closed a number of branches, and

¹² Karel Dörner and Jürgen Meffert, "Nine questions to help you get your digital transformation right," McKinsey & Company, October 2015.

¹³ Tanguy Catlin, Jay Scanlan, and Paul Willmott, "Raising your digital quotient," *McKinsey Quarterly*, June 2015.

launched a program to migrate customers who relied on branches for routine services to ATMs or web/mobile channels.

DE-RISK—Increase the transformation’s prospects for success.

Decision 7: What to do when

More than 70 percent of transformation programs fail.¹⁴ While the decisions covered in this article go a long way toward improving the odds, loss of momentum can undo even the best transformation efforts. To forestall that possibility, CEOs should carefully decide how to sequence the transformation for quick wins that yield revenue payoffs and reduce costs, gains that can then be reinvested. One e-tailer, for example, unlocked \$300 million in just five months by prioritizing initiatives with the fastest payback. That turned into more than \$800 million within a year, thanks to momentum from the early windfall.

Effective sequencing requires clear criteria to evaluate the potential payoff of various parts of the transformation initiative. These should include a hard-nosed assessment of projected benefits, the time needed to capture them, dependencies, investments required, and impact on the overall transformation journey. Sequencing with an eye toward cumulative effect is also necessary, so the business builds towards a cohesive digital whole rather than a jumble of loosely affiliated programs, which can undermine the ultimate benefits of scale.



Digital is the defining challenge for today’s generation of CEOs. And the decisions they make will determine whether their businesses thrive or fade.

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¹⁴ “Survey: How to beat the transformation odds,” McKinsey & Company, April 2015.