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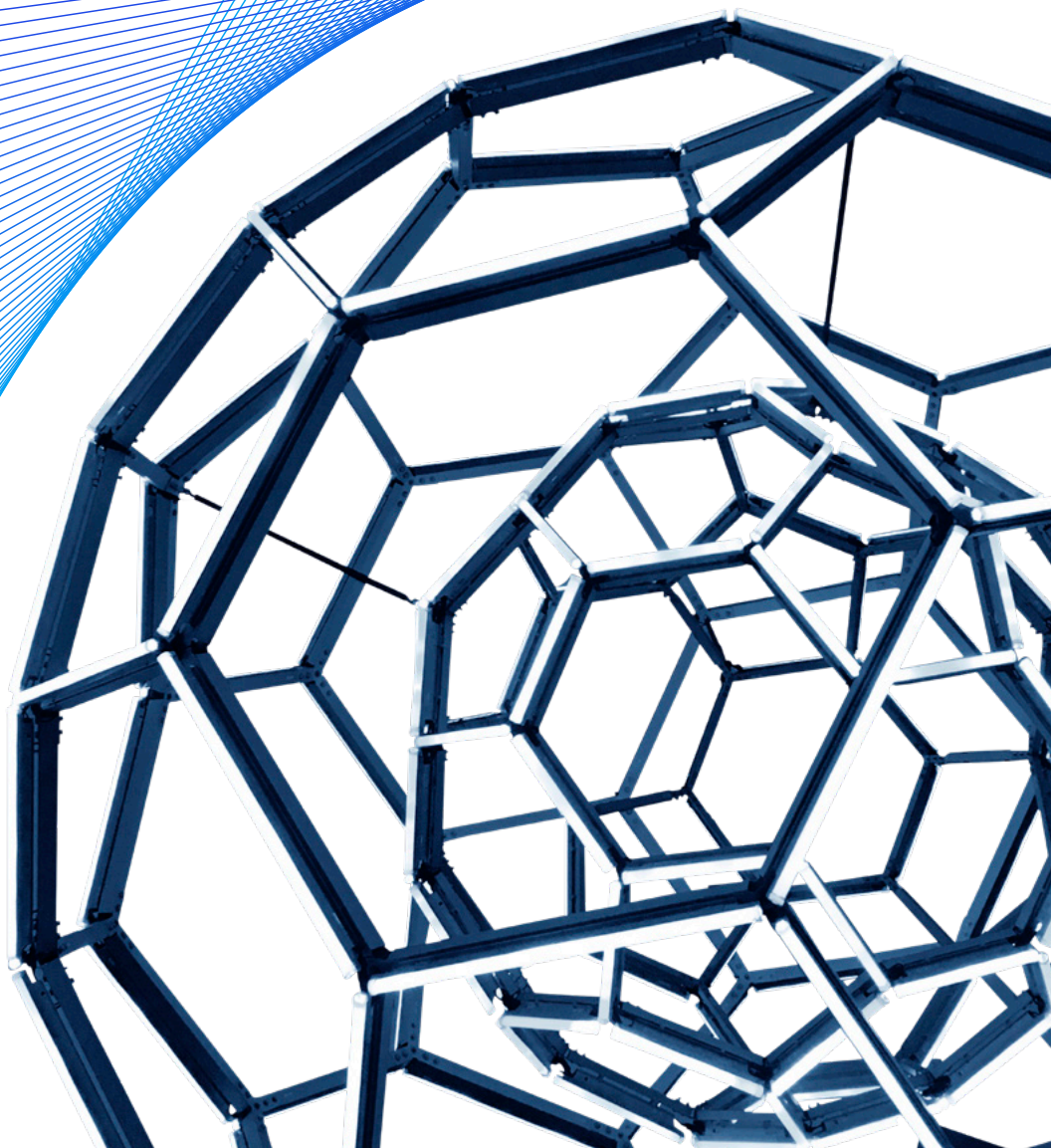
Volume II:

Turbocharging the next-generation operating model



April 2019

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Introduction

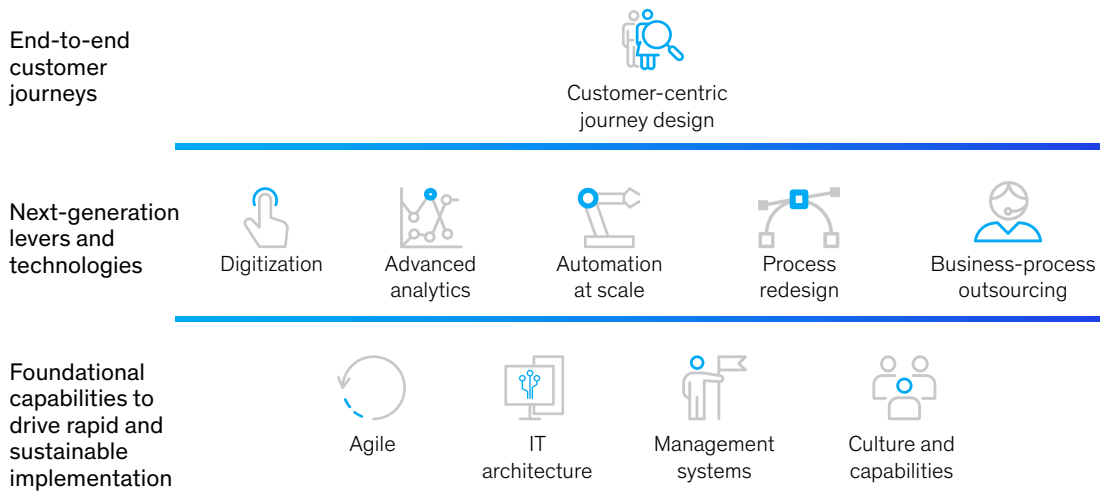
Companies are pushing hard to become digital. Many have embarked on aggressive programs to reinvent their operating models so that they can move and adapt quickly and capture value. But we've found that, in many cases, the reality doesn't match the aspiration. The transformations have either stalled or been caught in "pilot purgatory," where initial successes have proven too hard to scale.

With more companies embarking on creating their next-generation operating models,[1] however, lessons and best practices have started to emerge (exhibit). We have found, for example, that the most successful companies are pragmatic in how to get moving, tackle the talent challenges early in

[1] See Albert Bollard, Elixabete Larrea, Alex Singla, and Rohit Sood, "The next-generation operating model for the digital world," May 2017, McKinsey.com.

Exhibit

Best practices have emerged for next-generation operating models.



the process, and build teams that can manage the change from the front lines to the back office—and the effort is well worth it. Companies that have been successful in building out core elements of their next-gen operating model have seen step-change improvements on the order of 30 to 50 percent along key dimensions of costs and customer satisfaction, retention, and acquisition.

As we outlined in 2017, the transformation from how companies work today to how they will need to work tomorrow requires two significant shifts:

— from running uncoordinated improvement efforts within siloes to launching an integrated operational transformation program organized around customer journeys (the interactions a customer has with a company) and internal journeys (end-to-end processes inside the company)

— from using individual technologies and operations capabilities in a piecemeal way inside siloes to applying them to journeys in combination and in the right sequence, thereby achieving compound impact

Making these shifts is not easy. Pressing questions persist on a number of fronts:

End-to-end customer journeys

— Is the entire leadership team in my organization aligned on the top 20 end-to-end journeys?

— Is my organization tracking customer satisfaction at every interaction along the customer journey?

— Have we taken a zero-based design approach to the most critical customer journeys?

Next-generation levers and technologies

— Can we clearly articulate all the investments being made across next-gen levers (for example, process redesign, automation at scale, advanced analytics, digitization, business-process outsourcing) and their respective return on investment?

— Do we have an integrated road map for transforming the top 20 journeys across the enterprise using a complete set of levers?

Foundational capabilities

— Do we have an enterprise management system that integrates analog and digital processes seamlessly?

— Are there at least two examples of end-to-end journey transformations using cross-functional agile teams that we can use as a reference for the rest of the business?

— Have we successfully found a way to transform to next-gen operations that overcomes our legacy IT infrastructure?

— Do we have a clear road map for the future of talent in our organization, given the implications of automation on the workforce?

— What is the role of a CEO in leading the organization in a transformation to the next-gen operating model?

As might be expected, there are no easy answers to these questions. But in working with companies to answer them over the past year, we thought it would be helpful to reflect on and share what we've learned and bring in leaders from various companies to share their stories as well.

We look forward to the conversations in driving forward the next-generation operating model that creates sustainable value.

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Part

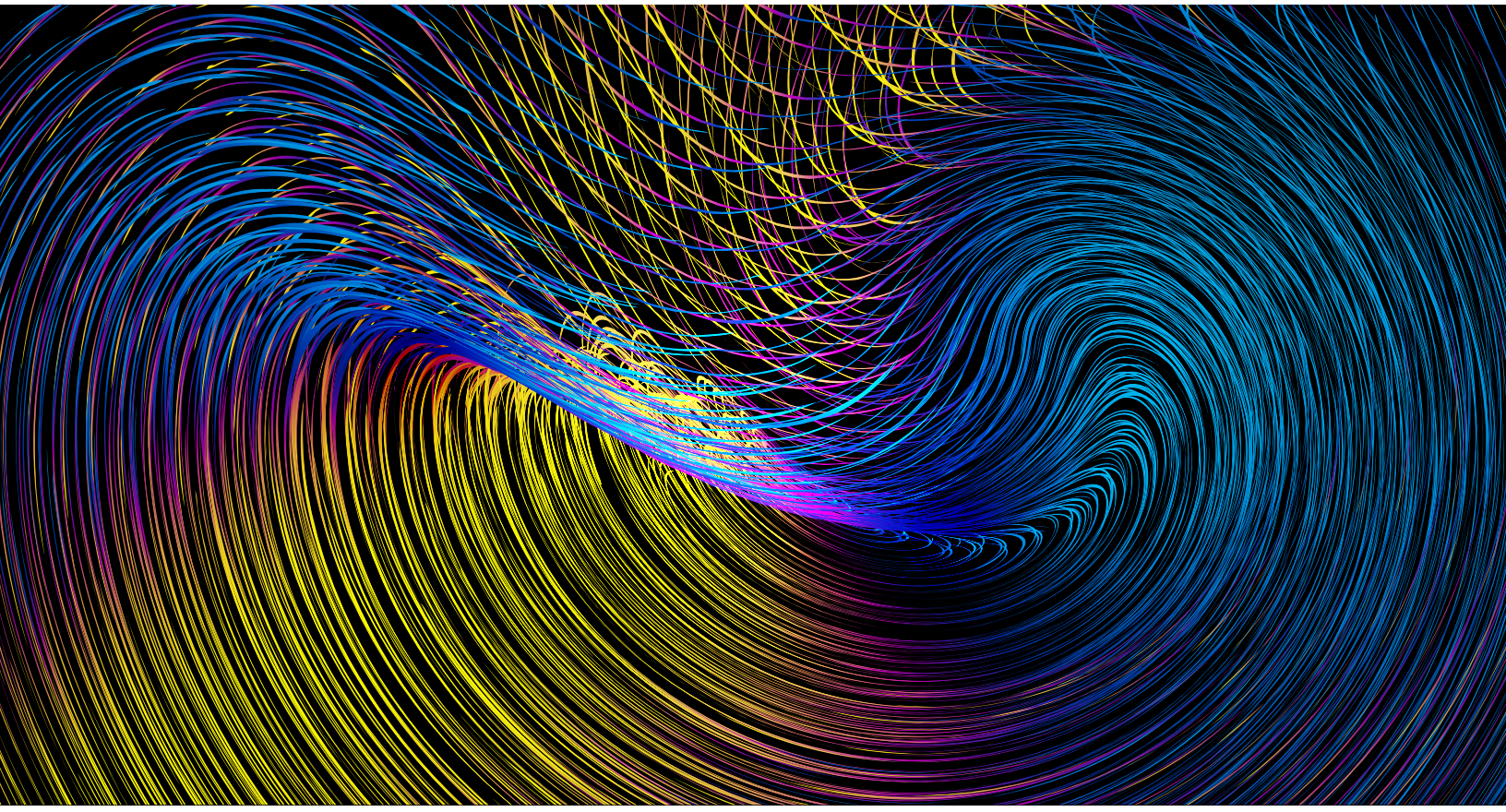
01

Core learnings

Six lessons on how to embrace the next-generation operating model

Realities on the ground highlight what's really needed to pull off the transformation.

by Tod Camara, Adele Hu, Alex Singla, Rohit Sood, and Jasper van Ouwerkerk



Companies that hope to compete in the digital world are coming to see that it requires a fundamentally new way of working. On the customer-experience side, digital natives have raised the bar considerably; for example, banks today benchmark their websites and apps against companies such as Amazon and Uber. Internally, despite big investments in digitization, process redesign, and automation, the efficiency ratio at most large companies has stalled. Their improvement initiatives reside in different pockets, such as a digital factory or automation center of excellence, and are seldom integrated.

A next-generation operating model (NGOM)[1] is needed to give companies the ability to move quickly and adapt to changing circumstances. The rewards for making the leap to the NGOM are significant: step-change improvements that produce 30 to 50 percent productivity gains, up to 80 percent reduction in turnaround time, up to 10 percent enhancement of customer experience, and 20 to 25 percent growth.

Last year, we identified the two key shifts that are necessary for companies to build the NGOM:

From uncoordinated improvement efforts within siloes . . . *To* an integrated transformation program organized around customer journeys (the interactions a customer has with a company) and internal journeys (end-to-end processes inside the company).

From using individual technologies and capabilities in a piecemeal way inside siloes . . . *To* applying them to journeys in combination and in the right sequence, thereby achieving compound impact.

Over the past couple of years, as we've worked with companies to develop their NGOM, six important lessons have emerged.

Lesson #1: Start by working on a high-impact end-to-end journey

Some companies start their digital operations transformation with small pilots that don't generate significant benefits. Others spend a lot of time analyzing which journey to tackle first. But there's no single right way to get started. The key is to identify a journey that's important and begin there.

There are two primary approaches for deciding where to begin:

— If a "burning platform" at the company is already in mind—an issue with potential to have a big impact on customer experience, new-customer acquisition, customer service, and/or cost/productivity—simply start there. Alternatively, identify no-regret areas (every company has a few) and pick one. Set up a cross-functional, agile team to tackle the chosen area.

— If there are several burning platforms, evaluate the potential of the next-gen levers across the most important customer journeys at the enterprise level. This will help prioritize and sequence journeys for the next two to three years after embarking on the transformation.

Whichever path is chosen, it's important to get started quickly in order to demonstrate the *from-to* path for the next-gen transformation and win over skeptics by showing the value the model can generate. We have found that it's generally better to take on customer-facing journeys before internal ones. If it's hard to get the buy-in needed to begin with a whole journey, it's possible to start smaller—inside a single business unit or geographic site—and later extend the effort to include the entire journey from end to end.

Companies have started with a range of high-impact journeys. A North American bank began with home-

[1] For a compendium of articles on the next-generation operating model, see "Building the next-generation operating model," May 2019, McKinsey.com. For an overview of the model, see Albert Bollard, Elixabete Larrea, Alex Singla, and Rohit Sood, "The next-generation operating model for the digital world," March 2017, McKinsey.com.

mortgage origination on an end-to-end basis. For a global property-and-casualty insurer, the starting point was policy services; for a credit-card issuer, it was customer acquisition; for a life insurance issuer, it was new-business origination; and for an airline company, it was the ticket and ancillaries sales journey. Companies in other industries have also applied the NGOM, starting with journeys such as production of steel or restocking of store shelves. Despite beginning in quite different places, all of these companies experienced comparable results along key dimensions that drive costs and revenue growth.

Lesson #2: Be systematic when prioritizing and sequencing improvement levers

The NGOM integrates multiple improvement levers—process redesign, digitization, automation, analytics, and outsourcing/offshoring—to achieve step-change improvements. Yet there can be complex interdependencies between levers. In some settings, for example, applying robotic process automation (RPA) before redesigning the process can be a waste of time. It's critical to understand the interdependencies and to be systematic in selecting the mix and sequence of levers.

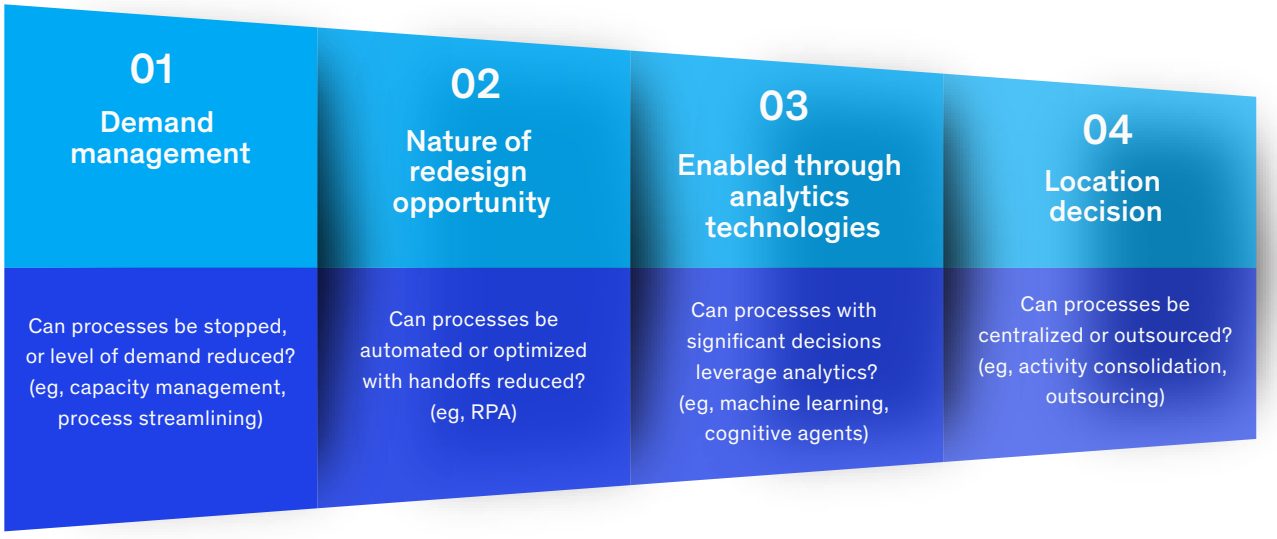
Use a structured process to understand the potential of the key levers and the dependencies between them. These can vary depending on such factors as the journey being addressed or location (exhibit).

A vehicle-leasing company recognized there were significant differences in the level of sophistication of its operations in different countries, which meant the applicability of levers varied widely. In one country, where capabilities are less mature, it

Exhibit

Understanding interdependencies between levers helps to achieve improvements.

Example of how a company goes through selection and sequencing of improvement levers



plans to implement a major process-redesign effort and then centralize key activities, all as a prelude to introducing automation. In another country, by contrast, where the processes are more mature, centralization will be the first step, followed by automation. Another strategy the company is keeping in mind is to favor early initiatives that can generate short-term return on investment.

Lesson #3: Apply the next-generation operating model across all steps of core journeys to get the most value

Often, companies start by applying the NGOM in a focused way—for example, to a customer-facing journey in the organization's front end. But achieving step-change improvements from the NGOM requires applying it from the point where the customer interacts with the brand all the way through to the back-end systems that support and deliver on that interaction. At most companies, 20 end-to-end journeys account for more than 70 percent of the costs and more than 80 percent of the customer experience. Transforming core journeys touches all parts of an organization and requires spanning "horizontally" to cut across silos and deliver step-change, multidimensional improvements.

We have observed two approaches that can extend the NGOM horizontally:

— The most common is to start at the front end, with the customer-facing aspects of a journey, and later extend the effort to internal processes housed in the back office.

— A more aggressive approach is to begin working horizontally from the outset, by assigning responsibility for all aspects of customer-facing journeys, and the key internal processes that support them, to cross-functional agile squads. In this approach, organizational change happens before journey transformation.

One other important way to realize true impact from end-to-end journey transformation is by creating a new role: the journey owner, who has the authority to call on resources from the multiple groups that must contribute to delivering on that journey. In a bank, these could include the front, middle, and back office, as well as IT, risk, and compliance. Because the end-to-end journey owner must engage with many parts of the organization, it is a challenging role and should be filled by a highly capable executive. The end-to-end journey owner should report to a C-level executive: chief digital officer, COO, or even the CEO.

A leading global financial-services company wanted to improve its customer-exception journey. To break down silos within the business, it started by standing up a cross-functional team with process redesign, agile, digital, and automation expertise and representation from compliance, legal, risk, and privacy. The team then focused on improving the entire customer journey. To enhance the customer experience, it tackled the front end by digitizing its customer self-service portal and improving existing interactive voice response (IVR). In parallel, it redesigned processes to drive efficiency in the back office, enabling future RPA opportunities. This "horizontal" approach, spanning multiple parts of the organization, is on pace to deliver close to a 20 percent reduction in cost of service delivery, a more than 35 percent improvement in work efficiency and quality of service, and a more than 20 percent gain in people-engagement scores.

Lesson #4: Start on the talent challenge immediately

Most companies do not fully grasp their talent challenge. Not only do they need new skilled people,

but they also need to reskill or redeploy existing staff, since certain improvement levers, such as RPA, will replace some jobs and transform many others.[2] Because these challenges don't appear immediately, companies tend not to focus on them until it's too late, at which point talent management becomes a bottleneck on their path toward the NGOM.

Organizations need to start preparing right away to get the talent needed for the future workforce. The first step is to assess future skill demand in key areas such as data science and agile, diagnose the current supply, and launch initiatives to fill the gap. This requires HR to work closely with the executives in charge of implementing the NGOM to gain a complete understanding of what the real skill needs are.

Reskilling and redeploying staff is a critical step in monetizing the value generated by the next-generation operating model.[3] For example, a data-entry analyst whose former work is automated could be upskilled to oversee RPA systems. It's worth noting that not everyone can be reskilled to the roles in greatest demand; a call-center rep can't be trained in a few months to become a data scientist or an agile scrum master.

A global bank set up a digital factory in a new facility in its home country's leading tech region, plus satellite digital factories in the tech centers of four countries where it had subsidiaries. It built out the offices so they resembled start-ups and established partnerships with university research centers and early-stage fintechs to create a collaborative environment that leveraged the new offices' locations inside larger tech ecosystems. Its recruiting materials emphasized that positions in the digital factory were anything but typical banking jobs.

Lesson #5: Don't let technology debt scare you off

Many companies are in technology debt and believe they cannot achieve the full potential of the NGOM without fully revamping their IT architecture and systems. But no matter what the condition of their current infrastructure, companies can take advantage of the NGOM by making incremental tech upgrades along their transformation journey and so accrue significant benefits without needing to wait for a full system upgrade.

Companies have followed two paths in addressing their technology debt:

— The first involves building individual databases and applications, driven by specific use cases, separate from the existing legacy infrastructure. This creates new capabilities, which can then connect back with legacy systems on a case-by-case basis, using application programming interfaces (APIs) and microservices.

— Cloud and open-source technologies now make it affordable to build entirely new infrastructure, on a limited scale, to meet the emerging needs of the NGOM, while continuing to run existing legacy systems in parallel. As this new, clean stack grows over time, it can increasingly be used in lieu of the legacy infrastructure.[4]

[2] Research by the McKinsey Global Institute notes that rather than replacing entire jobs wholesale, new technologies will more often be used to undertake some of the *activities* that are a part of current jobs. See James Manyika, Susan Lund, Michael Chui, Jacques Bughin, Jonathan Woetzel, Parul Batra, Ryan Ko, and Saurabh Sanghvi, "Jobs lost, jobs gained: What the future of work will mean for jobs, skills, and wages," McKinsey Global Institute, November 2017, on McKinsey.com.

[3] For more on value capture, see "Banks and the digital flywheel: An engine for ongoing value capture," on p. 12 of this compendium.

[4] For more on how new technologies are allowing companies to stand up clean stacks at modest cost, see Michael Bender, Nicolaus Henke, and Eric Lamarre, "The cornerstones of large-scale technology transformation," *McKinsey Quarterly*, October 2018, McKinsey.com.

A large financial-services firm launched an analytics initiative that relied on machine learning, along with associated digital tools and process redesign. When data from its digital customer-acquisition channels were fed into its existing infrastructure, the legacy systems effectively broke. In response, the company stood up new databases and analytics engines by deploying inexpensive cloud technologies and open-source tools. These systems worked well, and the company soon wanted to apply the new analytic models to its old data, which was housed in its legacy core. To make this work, the company wired the new systems and legacy core together with APIs and microservices. The company is now continuing along this path on a case-by-case basis, using the gains generated by earlier activities to pay for the next round of work.

Lesson #6: Keep evolving and adapting with continuous improvement

Our experience from transformation efforts has shown that the 80/20 rule applies. The initial big effort generates the majority of the value—the 80 percent. But the remaining 20 percent is still significant. Rather than stretch to "do it all" in one shot, find the 80/20 balance, and commit to continuous improvement to adapt and optimize the model.

To achieve the last 20 percent of value from the NGOM, a continuous-improvement mind-set should become the new "steady state." That means making agile practices a way of life, not a project methodology, one that continually generates new ideas, prototypes them quickly, tests them to obtain feedback, and then iterates based on that input. Even after primary customer-facing journeys have been reconfigured, sizable productivity gains can still be achieved by tackling legacy operations and corporate support functions such as finance and HR.[5] The NGOM is not static. It must continually evolve and adapt.

At regular intervals—every three years or so—it's also worth taking out a clean sheet of paper and reinventing with zero-based design.[6]

Conclusion: Embrace the journey

Adopting the next-generation operating model is a journey, and insights on how best to embrace it are evolving. We expect to learn more as the journey continues. But so far, these six lessons have consistently made a difference for the companies that applied them.

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The authors wish to thank Matthew Craddy, Somesh Khanna, Eric Lamarre, Elixabete Larrea, Chris McShea, and Debasish Patnaik for their contributions to this article.

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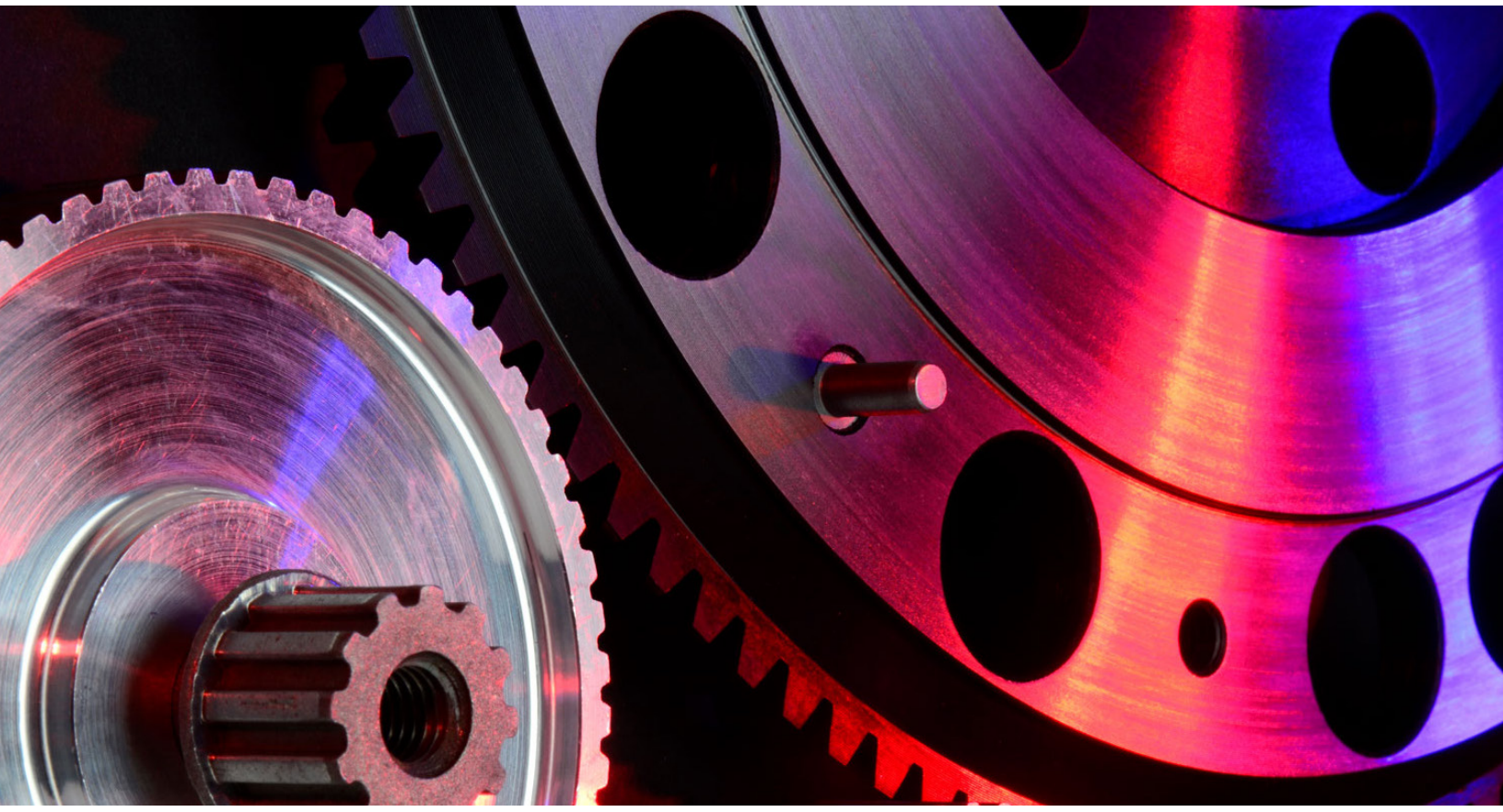
[5] For more on value capture, see "Banks and the digital flywheel: An engine for ongoing value capture," on p. 12 of this compendium.
[6] For more on what zero-based design is, and how it works, see "How to extract maximum value from a zero-based design approach to customer journeys," on p. 38 of this compendium.

Banks and the digital flywheel: An engine for ongoing value capture

A few banks are generating significant bottom-line impact from their digital investments. These leaders share a relentless focus on applying productivity gains as broadly as possible across the organization.

by Pooneh Baghai, Somesh Khanna, Eric Lamarre, Asheet Mehta, and Mateen Poonawala



For the past five years or more, banks have invested billions of dollars in efforts to digitize operations. However, some financial institutions are aware that their digital efforts are underperforming. Nearly 50 percent around the world say that their latest digital investments are failing to generate returns greater than the cost of capital (Exhibit 1). Few banks are generating $1 billion—or even $500 million—in annual bottom-line impact from their digital transformations.

We reflected on banks that are generating significant returns from digitization—call them the "benchmark banks"—to understand how they achieve what others cannot. We found that they share the following three relatively straightforward characteristics:

1. They consistently harvest the idle capacity that results from ongoing digitization and fund new initiatives with the savings.

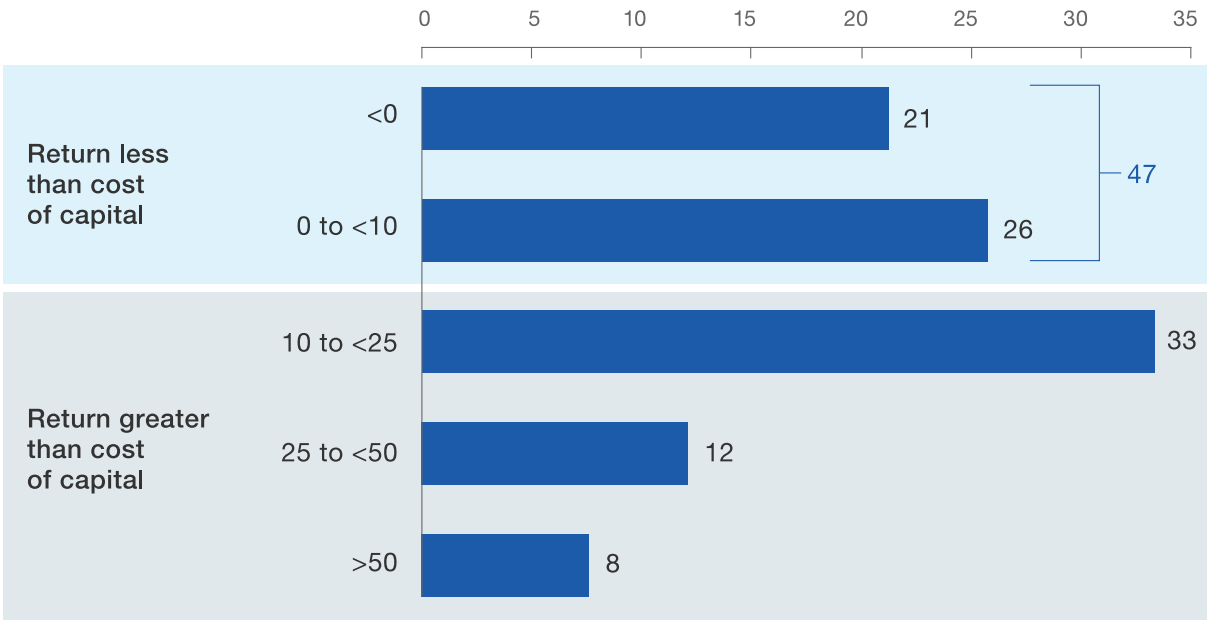
2. As they digitize the front-end customer experience, they capture the resulting productivity unlocked in their legacy operations.

3. They extend digitization beyond the customer experience and apply it to non-customer-facing operations, such as finance, HR, and other corporate functions.

Exhibit 1

Nearly 50 percent of financial institutions say that their latest digital investment is failing to generate returns greater than the cost of capital.

"Consider your organization's most recent digital initiative that relates to its most important strategic priority, and for which the outcome is largely known. Please give your best estimate of the initiative's return on invested capital."
Estimated ROIC,[1] %



[1]Financial-services responses only; financial institutions globally, n = 164.
Source: "The case for digital reinvention," Digital McKinsey survey, February 2017

Benchmark banks are further set apart by their relentlessness and discipline in applying these tactics, to the point where they cohere into an ongoing capability for capturing value from digitization. We think of this as the digital-economic version of a flywheel—the mechanical device that stores and distributes energy—in this case, to the tune of a potential $1 billion in recurring bottom-line impact or a ten-percentage-point improvement in cost-efficiency ratio[1] (Exhibit 2).

[1] For an illustrative bank with $10 billion in revenues and $5 billion in expenses.

Exhibit 2

Three turns of the digital-economic flywheel can lead to significant bottom-line impact.

For an illustrative bank with $10 billion in annual revenues and $5 billion in expenses

	Turn 1	Turn 2	Turn 3
	Harvest idle capacity resulting from ongoing digitization—and fund new initiatives with the savings	Capture productivity benefits in legacy operations as the front-end customer experience gets digitized	Extend digitization to non-customer-facing operations (eg, corporate functions)
Annual productivity opportunity, $ million	~150	~500	~350 $1 billion in cumulative annual run rate
What benchmark banks do (select examples)	Remove idle teller capacity in branches Close branches that are no longer attractive Redeploy sales staff to high-growth micromarkets Optimize managerial spans Reduce third-party spending through proactive demand management Tighten expense management	Deploy time-saving digital tools to free frontline capacity Digitize applications to improve completeness and to reduce reconciliations, mismatches, etc in legacy operations Streamline and digitize work flows Institute front-to-back work cells Cut spending on paper statements Accelerate transaction migration Optimize product portfolio Streamline roles and revisit compensation structure	Rationalize demand and ramp up digital self-service Streamline and automate repeatable, manual processing tasks (eg, in finance) Identify and eliminate shadow corporate functions in business units Centralize similar functions and optimize onshore-offshore mix Optimize outsourcing arrangements
Time to capture	~1 year	2–3 years	2–3 years

Harvest idle capacity from ongoing digitization and fund new initiatives with the savings

Digital initiatives are expensive. They require a cash outlay upfront, and returns—when they come at all—are typically deferred. Funding is usually the first challenge bank executives address before they kick off a digital transformation.

Benchmark banks start by self-funding—at least in part—their digital initiatives. Specifically, they go after productivity benefits already unlocked by digitization and latent in their system. For example, although branch usage in the United States decreased by 16 percent between 2011 and 2016,[2] not all banks reduced teller-staffing levels meaningfully. This productivity benefit—a by-product of customers' growing acceptance of digital channels—is sizable and ready to capture now. A North American bank recently discovered that 15 percent of its branch-teller workforce had become idle; by swiftly reducing teller-staffing levels networkwide, it freed up cash to fund future digital investments.

There are other, more traditional, nondigital opportunities, including tighter expense management, reduced third-party spend, and optimized spans and layers, to find digital investment dollars quickly. To be clear, these sources are unlikely to fund a bankwide digital transformation fully, but they can be meaningful sources of funding and quick ways to set the digital flywheel in motion.

Capture productivity in legacy operations unlocked by digitizing front-end customer experience

According to new McKinsey research, banks are predominantly applying digitization to the front-end customer experience through customer-facing tools, interfaces, and the like. Only 16 percent of banking executives consider productivity and cost reduction to be high priorities for their digital strategy (Exhibit 3).

Digitization of the front-end customer experience is, of course, an important part of any bank's offering today; but alone, it will not be a source of long-term competitive advantage.

Benchmark banks are taking a different approach. As they digitize the front-end customer experience, they consistently tap the productivity benefits unlocked in their legacy operations. In a recent example, a global bank had developed a new digital onboarding tool for online customers. Not satisfied with just customer-experience improvements, the bank looked for where else this tool could unlock productivity. It made a modified version of the tool available to its more than 4,000 sales advisors in branches and provided intensive coaching and frontline training to drive adoption. The result was a 25 percent lift in sales advisors' productivity.

Another bank, this one in Asia, invested heavily in bolstering its online capabilities but went a step further to maximize the returns: it instituted a "no tolerance" mind-set for paper statements. Within eight weeks, it signed up two million customers for e-statements, resulting in a 45 percent reduction in paper-statement spending.

A third benchmark financial institution redesigned its call center interactive-voice-response system with embedded digital tools to increase customer self-service. But it didn't stop there. As customers started resolving most simple inquiries unaided, the financial institution pivoted its back-office operations to complex inquiries. It streamlined the complex-inquiries workflow front to back, freeing up more than 40 percent productivity in addition to improving customer experience.[3]

[2] McKinsey US Consumer Financial Life Survey, 2009-16.
[3] See "Accelerating the shift to a next-generation operating model," on p. 18 of this compendium.

Exhibit 3

Banks are systematically digitizing the customer experience; productivity is not yet a priority.

[1]Financial-services responses only; financial institutions globally, n = 244. Figures may not sum to 100%, because of rounding.
Source: "The case for digital reinvention," Digital McKinsey survey, February 2017

Such improvements are not low-hanging fruit. These banks had to meaningfully reconfigure their ongoing digital efforts to go after the productivity benefits. They had to invest resources and take risks. But as they continued to pursue these opportunities, they became more disciplined in their execution and more confident about the ROI of their next digital investment.

Extend digitization beyond customer experience and apply it to non-customer-facing operations

A staggering 85 percent of executives at financial institutions say that their middle and back offices do not support the front office in meeting customer expectations.[4] Benchmark banks are challenging

[4] "Accelerating the pace and impact of digital transformation," *Harvard Business Review* and Genpact Research Institute, 2016.

this trend, using digitization to unlock significant productivity benefits. A North American bank identified more than 30 percent in productivity improvements in its finance function, powered by robotic process automation, natural-language processing, and machine learning. A global bank is using digitization to uncover and eliminate shadow HR functions in its business units.

More broadly, benchmark banks are taking a step back and rethinking the operating model for their non-customer-facing operations. What is the minimum efficient scale for digitally enabled corporate functions, such as finance and compliance?

How can HR redesign the employee onboarding journey for the digital age? These are critical design questions which will shape the future of productivity in middle- and back-office operations.

Organize to win

Banks that have seen significant returns from their digital investments use the commonsense strategies we previously detailed. But they also go a step further to work at consistently and repeatedly applying these capabilities. The result is a kind of muscle memory for getting the most out of their digital initiatives.

Benchmark banks share the following common organizational practices, in addition to the three strategies, to ensure success:

1. *Full-potential approach:* Arbitrary, annual cost-reduction targets of 3 to 5 percent are no longer applicable. So how should a bank set productivity levels for its individual units? Successful banks benchmark productivity based on facts and set aspirational targets so that every unit—front, middle, and back office—aims for top-quartile performance.
2. *Gold-standard scale out:* Benchmark banks deploy a robust test-and-learn methodology and construct intensive, full-scale pilots that test the true productivity potential of their efforts. They apply adult-learning principles to bring change to the front lines and set up mechanisms to ensure that pilot successes are sustained at scale.
3. *Productivity war room:* A transformation nerve center measures cost and productivity bankwide. It focuses on how digital initiatives in one area of the bank can unlock productivity in another. It challenges lines of business on their productivity aspirations and ensures that those benefits do not leak away. One bank's productivity war room was staffed with more than 30 highly skilled employees led by a senior leader who was assigned by the CEO.
4. *Flywheel mind-set:* Benchmark banks don't treat productivity as a one-time project. They think of it as an evolving capability—a flywheel that can be turned for the next ten years or more. And it shows in how they run the bank: business cases for digital investments have productivity benefits built in, employees are trained in productivity disciplines and reskilled as jobs evolve, and leaders all speak the productivity narrative and consistently model the right mind-sets and behaviors.

Banks that earn significant returns from their digital investments have a broader conception of what digitization can achieve. For these leaders, success is more than a slick, new customer interface or a one-time productivity boost. They recognize that real gains come from applying digitization as broadly as possible across the organization and from building an ongoing capability for capturing digital value.

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Accelerating the shift to a next-generation operating model

Digital-native companies have captured value by mastering the use of next-generation operating models. Now established companies must race to catch up.

by Albert Bollard, Ewan Duncan, Petko Rangelov, and Marta Rohr

© Unsplash

In the past 30 years, an array of digitally driven companies have captured enormous value at great cost to established businesses. Observers often attribute the success of these challengers to their innovative use and development of technologies, business models, and customer experiences. But this view overlooks an essential feature of many digital-native businesses: their next-generation operating models.[1] The next-generation operating model is defined by a continual effort to improve end-to-end customer journeys and business processes by applying advanced technologies and sophisticated operational methods in an integrated manner. The combination typically results in, or is built around, a business model that is new to the industry and allows the company to move, adapt, and scale quickly.

A next-generation operating model provides traditional companies with the agility and customer focus they need to fend off challenges from digital natives, as companies such as ING have demonstrated.[2] When making the transition to a next-generation operating model, speed is essential. McKinsey research shows that the digital first movers and fast followers in a market seize a decisive share of the available value, usually at the expense of slower-footed incumbents. And incumbents have only a narrow window of opportunity to get ahead of their competitors: once industries approach the 40-percent-digitization mark, digital attackers typically secure large market shares.[3]

For an established company, the shift to a next-generation operating model starts with a clear commitment from leadership and other enabling moves, such as the formation of a full-time, cross-functional team to manage the transition and the allocation of funds to pay for the effort.[4] Those elements enable the shift to take place, but they alone won't speed it up. In our experience, an incumbent company accelerates its implementation of the new operating model by enabling great customer journeys through three actions that need to be carried out at the same time: continually improving end-to-end customer journeys with a clean-sheet approach, integrating technology with operations by testing and learning, and establishing agile ways of working through teams focused on specific journeys.

An enterprise-wide focus on customer journeys is crucial because it allows the company to reorient itself toward customer needs, which can be distinctive sources of value and lie at the core of the operating model. Pursuing the three activities at once is important because companies can realize the full value of great customer journeys only if all three capabilities are firing (exhibit). In this article, we offer a closer look at these three actions and how executing all three together can help incumbents to stay in front of digital natives.

Continually improving end-to-end customer journeys with a clean-sheet approach

According to McKinsey research, the quality of the customer journeys that a company provides is much more closely correlated with business outcomes, such as churn, revenue, and repeat purchases, than the quality of individual customer touchpoints. Companies that provide the best journeys—entire sets of interactions that customers have when making purchases or receiving services from a company—also have stronger

[1] For more, see Albert Bollard, Elixabete Larrea, Alex Singla, and Rohit Sood, "The next-generation operating model for the digital world," March 2017, McKinsey.com.

[2] For more, see "ING's digital transformation," *McKinsey Quarterly*, January 2017, McKinsey.com.

[3] McKinsey measured industries' digitization levels in terms of the penetration of digital technologies across five dimensions: products and services, marketing and distribution channels, business processes, supply chains, and new entrants at the ecosystem level. For more, see Jacques Bughin, Laura LaBerge, and Nicolas van Zeebroeck, "When to shift your digital strategy into a higher gear," *McKinsey Quarterly*, August 2017, McKinsey.com, and Jacques Bughin and Nicolas van Zeebroeck, "The best response to digital disruption," *MIT Sloan Management Review*, Summer 2017.

[4] For more, see Joao Dias, David Hamilton, Christopher Paquette, and Rohit Sood, "How to start building your next-generation operating model," March 2017, McKinsey.com.

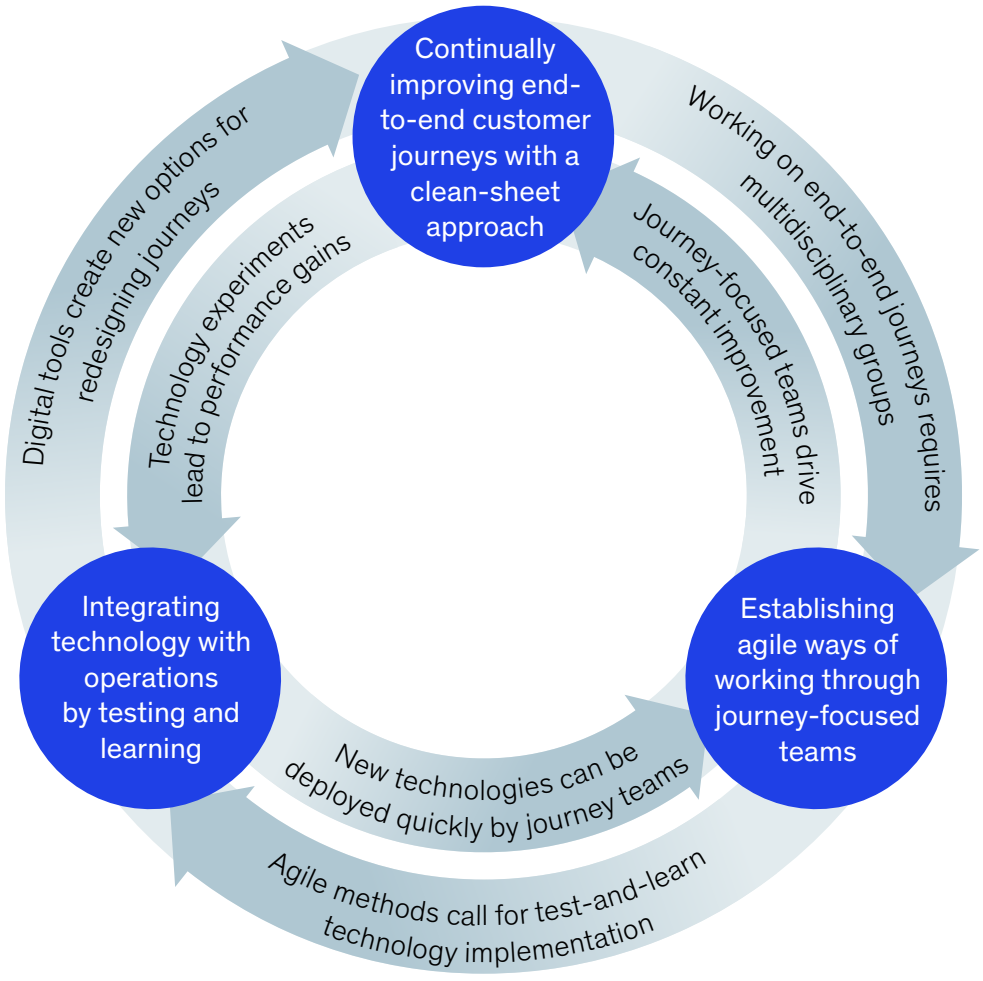
competitive advantages than those providing the best touchpoints (individual interactions).[5] Since digital-native companies have an inherent focus on customer journeys, optimizing end-to-end customer journeys is a core priority for incumbents that wish to speed up the transition to next-generation operating models.

The first step a company takes toward optimizing customer journeys is streamlining its product and service portfolio. It's not uncommon for this portfolio to expand over time, as a company identifies new opportunities and develops offerings to address them. But adding to lineups of products and services makes customer journeys increasingly

[5] For more, see Nicolas Maechler, Kevin Neher, and Robert Park, "From touchpoints to journeys: Seeing the world as customers do," March 2016, McKinsey.com.

Exhibit

Accelerating the shift to a next-generation operating model involves taking three mutually reinforcing actions at once.



complicated—and expensive—to support. It can also be off-putting to customers, who have to make sense of all the products and services that are on the company's menu. Shortening that menu will make customer journeys simpler and therefore easier to optimize.

In one case, a large telecom operator made its portfolio simpler for household customers by changing its digital-ordering journey. The company's website originally showed prospective customers several Internet-service packages, which they had to compare and choose from. Now the website asks each prospective customer a short series of questions about his or her needs, then offers just one service package. Streamlining the online-ordering journey doubled the conversion rate for online sales and led to a 50 percent increase in the website's share of sales.

Next, companies begin evaluating and pursuing opportunities to improve their customer journeys. The conventional approach is to determine which journeys matter most for value creation, identify the worst pain points through surveys and interviews, estimate the costs and effects of fixing those pain points, and activate a new journey only when all the major pain points have been corrected. While this approach is often effective, it is somewhat slower and more deliberate than is appropriate for a rapid transition to a next-generation operating model.

A different approach companies are taking is to "clean sheet" the future experience—to come up with a forward-looking concept that is unbound from all existing processes and systems and rapidly test it to determine whether it works well. With this approach, companies base their new experience designs on qualitative customer research. In a matter of days, they develop rough prototypes to try out with customers. Then they create digital prototypes, show them to customers, and make several rounds of refinements before launching the prototypes for live use. Many technology companies are comfortable with all the testing and learning that the clean-sheet approach involves, but the approach is different from traditional development methods.

The large telecom operator mentioned above used the clean-sheet approach to overhaul its customer journeys. It started by talking with customers about the most frustrating parts of their experiences dealing with the company. Next, it staged hackathons to create fresh prototypes for its customer journeys, which it showed to customers and adjusted according to their feedback. The company then developed digital prototypes based on its analog models, which it rolled out for testing with customers. Several cycles of revisions and tests brought the company to the point where it was ready to introduce the customer journeys for real-world use. But the testing and fine-tuning didn't stop there: the company continued to refine its customer journeys, putting out new versions on a weekly basis. It also modified its other processes to support the new customer journeys. The company was able to test the new journeys and prove their value in about five weeks—far less time than the normal IT release cycle of three to six months.

The telecom operator's approach to improving its customer journeys illustrates another important principle of the next-generation operating model, which is to start fixing pain points as soon as they are identified. The next-generation operating model involves devising solutions quickly, introducing them as soon as they are market ready—and promoting their accomplishments internally to show that the company has begun to move at a faster pace. The work of optimizing customer journeys then continues as an ongoing endeavor: correcting known problems, reevaluating journeys on a regular basis, and refocusing on new priorities as customer demands change. Other companies set up war rooms to analyze journeys and pursue continual improvements.

Integrating technology with operations by testing and learning

In a next-generation model, companies use advanced technologies to improve their behind- the-scenes business operations, for this generates cost savings that fund investments in better customer experiences. As they do when optimizing customer journeys, companies quicken the transition to a next-generation operating model by improving a few segments of their most important processes at a time, rather than tackling each process as a whole. This kind of fast-paced, progressive approach enables a company to achieve performance improvements much sooner than it would by remaking an entire process before putting it into action. In some cases, companies can attain substantial improvements within a matter of weeks.

Brief, rapid-change cycles are particularly helpful when considering the use of new technologies. Given the speed at which digital tools are advancing, it is seldom practical for a business to spend weeks evaluating its needs, comparing solutions, and creating a multiyear technology road map. Instead, next-generation companies find it more practical to select and quickly try out tools that could help resolve serious performance problems. Fortunately, the low cost and straightforward integration pathways for new technologies allow companies to stage and learn from technology experiments using small amounts of money and modest commitments of time from an IT function.

At the telecom operator we described earlier, sales agents had to enter some details of new customer orders into two IT systems because the systems had not been integrated. Switching between the systems and reentering order details prolonged the ordering process, which frequently caused prospective customers to abandon their orders before completion. When sales agents tried to compensate by working faster, they only made more errors. The company attacked these problems by redesigning and automating their order-entry process. Easy-to-use robotics applications allowed the company to automate the work of entering the same information into its two systems, thus enabling sales agents to complete customer orders in just 7 to 15 minutes, far less than the 30 to 45 minutes that the former ordering process took.

The performance improvement isn't the only significant aspect of this change; the manner in which it was attained is just as noteworthy. Installing the robotics applications was such a small job that the company's IT department probably would have put it on the back burner. But since setting up the applications was straightforward, the sales department could do it on its own and thus complete the installation and capture its benefits much earlier.

Managers use two simple criteria to quickly assess potential changes to business processes. The first criterion is customer benefit: companies favor changes that have clear potential to make customers' experiences better. (The link between customer experiences and business processes that support them is a further reason why companies need to work on both at once.) The second criterion is the potential benefit for the business. Managers and frontline workers typically know which activities within processes are especially slow, costly, or error prone, and they have performance data to prove it. In a next-generation operating model, companies prioritize changes according to the knowledge they already have rather than induce delays by preparing new assessments. Fixing the most troublesome activities quickly will produce noteworthy performance gains of the kind that generate savings and help validate a progressive approach to improvement.

A progressive approach to enhancing operations requires boldness and speed. Boldness means accepting that not every new process or technology that is put in place will immediately prove as valuable as expected. Speed means making adjustments quickly to produce greater

performance gains. Without boldness and speed, companies won't be able to validate and refine changes to their operations at the rate required to accelerate their shift to a next-generation model. Few traditional companies, however, are set up to carry out bold, rapid approaches to enhancing operations. Most will need to organize their working groups differently and bring in more technology talent, such as experience designers and engineers, full-stack architects, and product owners.

Establishing agile ways of working through teams focused on specific journeys

With its emphasis on continually improving journeys, the next-generation operating model calls for organizing teams and work groups according to different principles from those followed by most established businesses. The typical established company organizes people by function, line of business, or geographic region. Such structures slow the transition to a more digital way of working, which requires collaboration across different working groups. Companies can accelerate their shift to a next-generation operating model by assigning their employees to customer journeys or internal journeys (end-to-end processes, such as those involved in talent management, for which the "customers" are inside the company).

While just a few companies have reorganized themselves in this way, their experiences suggest that the benefits can be significant. ING, the Dutch financial-services giant, embarked on an extensive transformation after its leaders recognized the need to focus on customer journeys rather than products. It eliminated its hierarchical structure and installed a more flexible one in which many autonomous working groups, known as squads, are grouped into 13 functional tribes that share missions. Each squad is formed to achieve a client-related goal, with all members located in the same place to facilitate collaboration, and disbanded once the goal is achieved. ING's new structure has allowed the company to shorten the time-to-market for new products, increase employee engagement, and boost productivity.[6] It now stands out as a leading practitioner of the agile model. Other banks and technology-enabled service businesses have followed ING's lead, adopting some or all of its approaches to become more agile.

To speed their transition to a next-generation operating model, companies start by forming teams responsible for identifying, prioritizing, and making improvements to a few of their most important journeys. Each semiautonomous journey team comprises representatives from the business functions that are directly involved in a journey, so they can highlight pain points and devise ways of addressing them. Teams also include user-experience designers, software developers, and other IT specialists who can help come up with digital features that support new customer or operating requirements. Finally, each journey team is headed by a journey leader who has a diverse skill set: someone who is equally capable of understanding business objectives, overseeing technology-development efforts, and directing the day-to-day activities associated with a customer or internal journey.

One large insurance company initiated its transition to a next-generation operating model with a pilot effort focused on multiple journeys. The engine for its reorganization was a cross-functional "transformation lab" responsible for studying customer journeys, with special attention given to customer needs and pain points and to locating inefficiencies within its internal journeys. The lab then redesigned customer and internal journeys and conceived digital products to support them. Cross-functional teams of about 15 employees were formed to launch the journeys and participate in the creation of minimum viable software products that were improved in subsequent rounds of testing and development. Two months into its pilot of the next-generation operating model, the company saw

[6] For more, see "ING's agile transformation," *McKinsey Quarterly*, January 2017, McKinsey.com.

productivity gains of 30 to 50 percent, higher levels of employee engagement, a 50 percent reduction in the time required to bring new customers on board, and substantial cost savings.

A major factor enabling the success of the insurance company's operating-model pilot was its move toward agile methods for software development, in which IT specialists use short, high-speed cycles of prototyping and real-world deployment to test and refine software. Agile methods are all but essential, because they are compatible with bold experimentation and rapid, continuous improvement. That said, many companies have IT systems that aren't suited to agile development. At such companies, a two-speed IT architecture enables agile development while preserving the stability of the legacy systems. A two-speed IT architecture puts software that needs to be updated frequently on different platforms than the legacy systems, so that software can be modified without throwing legacy systems into flux.

Next-generation operating models provide traditional companies with big improvements in cost, effectiveness, and customer experience that help them compete with digital-native competitors. Speed is of the essence, for first and second movers capture most of the value. To race ahead of the pack, traditional companies must take action in three areas: continually improving end-to-end customer journeys with a clean-sheet approach, integrating technology with operations by testing and learning, and establishing agile ways of working through journey-focused teams.

Working on all three areas at once, rather than one or two at a time, is crucial because each area supports the other two. To optimize customer journeys, companies must make their operations more efficient and responsive. The ability to make improvements quickly requires integrated teams that understand all facets of customer journeys and business operations and are comfortable pursuing incremental gains on a continual basis. By modifying their customer journeys, business operations, and working methods simultaneously, incumbents move quickly toward the next-generation operating model that will enable them to withstand disruption and expand their shares of the value in their markets.

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Unlocking success in digital transformations

Digital transformations are even more difficult than traditional change efforts to pull off. But the results from the most effective transformations point to five factors for success.

As digital technologies dramatically reshape industry after industry, many companies are pursuing large-scale change efforts to capture the benefits of these trends or simply to keep up with competitors. In a new McKinsey Global Survey on digital transformations, more than eight in ten respondents say their organizations have undertaken such efforts in the past five years.[1] Yet success in these transformations is proving to be elusive. While our earlier research has found that fewer than one-third of organizational transformations succeed at improving a company's performance and sustaining those gains,[2] the latest results find that the success rate of digital transformations is even lower.

The results from respondents who do report success point to 21 best practices, all of which make a digital transformation more likely to succeed. These characteristics fall into five categories: leadership, capability building, empowering workers, upgrading tools, and communication. These categories suggest where and how companies can start to improve their chances of successfully making digital changes to their business.

Transformations are hard, and digital ones are harder

Years of research on transformations has shown that the success rate for these efforts is consistently low: less than 30 percent succeed.[3] This year's results suggest that digital transformations are even more difficult. Only 16 percent of respondents say their organizations' digital transformations have successfully improved performance and also equipped them to sustain changes in the long term. An additional 7 percent say that performance improved but that those improvements were not sustained.

Even digitally savvy industries,[4] such as high tech, media, and telecom, are struggling. Among these industries, the success rate does not exceed 26 percent. But in more traditional industries, such as oil and gas, automotive, infrastructure, and pharmaceuticals, digital transformations are even more challenging: success rates fall between 4 and 11 percent.

Success rates also vary by company size. At organizations with fewer than 100 employees, respondents are 2.7 times more likely to report a successful digital transformation than are those from organizations with more than 50,000 employees.

The anatomy of digital transformations

Whether a change effort has succeeded or not, the results point to a few shared traits of today's digital transformations. For one, organizations tend to look inward when making such changes. The most commonly cited objective for digital transformations is digitizing the organization's operating model, cited by 68 percent of respondents. Less than half say their objective is either launching new products or services or interacting with external partners through digital channels. Digital transformations also tend to be wide in scope. Eight in ten respondents say their recent change efforts involved either multiple functions or business units or the whole enterprise. Additionally, the adoption of technologies plays an important role across digital transformations. On average, respondents say their organizations are using four of 11 technologies we asked about, with traditional web tools cited most often and used in the vast majority of these efforts.

At the same time, the results from successful transformations show that these organizations deploy more technologies than others do (Exhibit 1). This might seem counterintuitive, given that a broader suite of technologies could result in more complex execution of transformation initiatives and,

[1] The online survey was in the field from January 16–26, 2018, and garnered responses from 1,793 participants representing the full range of regions, industries, company sizes, functional specialties, and tenures. Of them, 1,521 have been part of at least one digital transformation in the past five years at either their current or previous organizations. To adjust for differences in response rates, the data are weighted by the contribution of each respondent's nation to global GDP.

[2] "How to beat the transformation odds," April 2015, McKinsey.com; "The people power of transformations," February 2017, McKinsey.com.

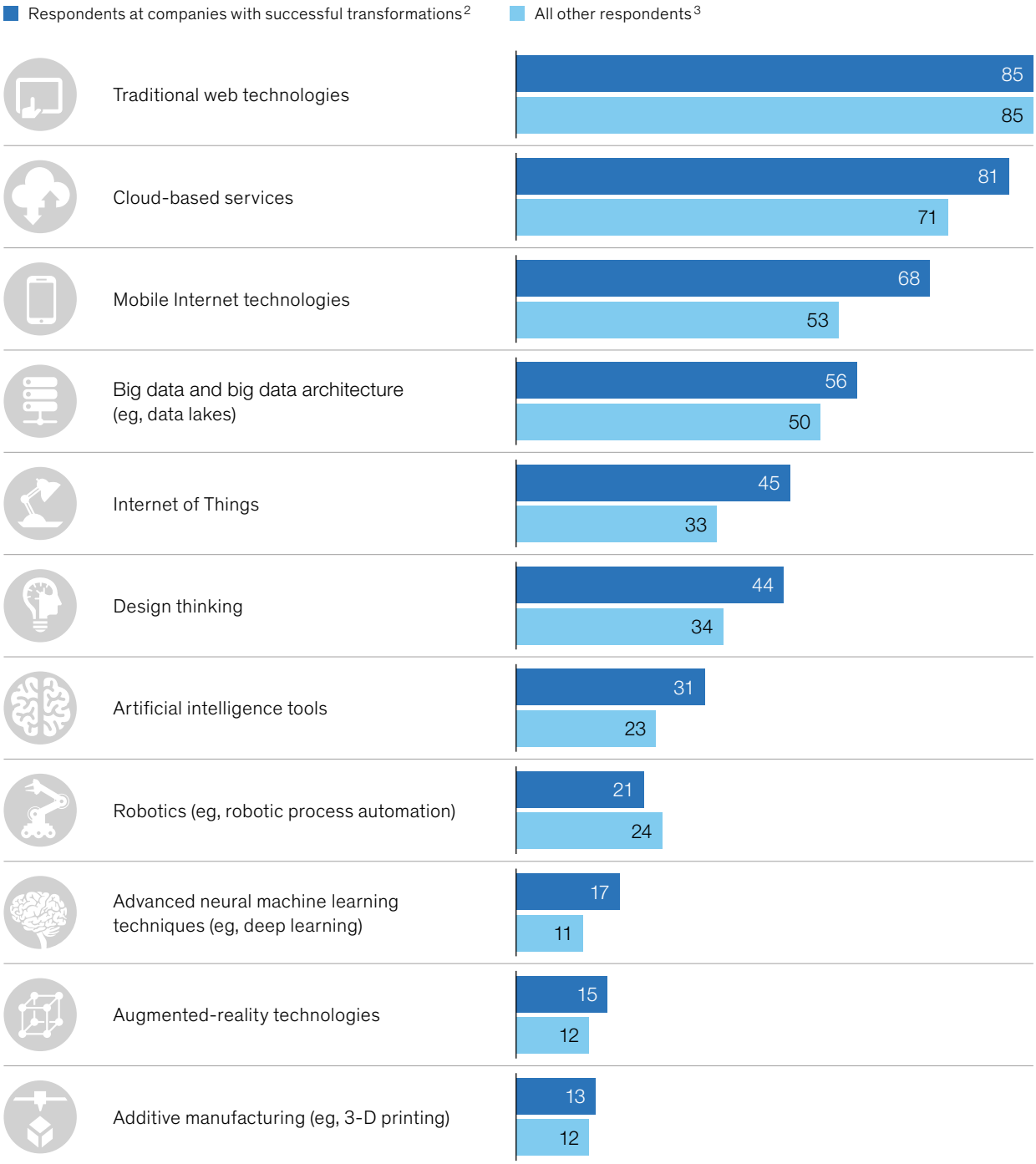
[3] We define a successful transformation as one that, according to respondents, was very or completely successful at both improving performance and equipping the organization to sustain improvements over time. In our 2016 survey, the rate of success was 20 percent; in 2014, 26 percent; and in 2012, 20 percent.

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

Exhibit 1

Organizations with successful transformations deploy more technologies than others do.

Digital technologies, tools, and methods currently used by organizations, % of respondents[1]



[1] Respondents who answered "other" or "don't know" are not shown.
[2] Respondents who say their organizations' transformations were very or completely successful at both improving performance and equipping the organizations to sustain improvements over time, n = 263.
[3] n = 1,258.

Sidebar

Twenty-one keys to success

Out of 83 practices that were tested in the survey,[1] the following are those that best explain the success of an organization's digital transformation:

1. Implement digital tools to make information more accessible across the organization.
2. Engage initiative leaders (leaders of either digital or nondigital initiatives that are part of the transformation) to support the transformation.
3. Modify standard operating procedures to include new digital technologies.
4. Establish a clear change story (description of, and case for, the changes being made) for the digital transformation.
5. Add one or more people who are familiar or very familiar with digital technologies to the top team.
6. Leaders engaged in transformation-specific roles encourage employees to challenge old ways of working (processes and procedures).
7. Senior managers encourage employees to challenge old ways of working (processes and procedures).
8. Redefine individuals' roles and responsibilities so they align with the transformation's goals.
9. Provide employees with opportunities to generate ideas of where digitization might support the business.
10. Establish one or more practices related to new ways of working (such as continuous learning, open physical and virtual work environments, and role mobility).
11. Engage employees in integrator roles (employees who translate and integrate new digital methods and processes into existing ways of working to help connect traditional and digital parts of the business) to support the transformation.
12. Implement digital self-serve technology for employees' and business partners' use.
13. Engage the leader of a program-management office or transformation office (full-time leader of the team or office dedicated to transformation-related activities) to support the transformation.
14. Leaders in transformation-specific roles get more involved in developing the digital transformation's initiatives than they were in past change efforts.
15. Leaders in transformation-specific roles encourage their employees to experiment with new ideas (such as rapid prototyping and allowing employees to learn from their failures).
16. Senior managers get more involved in digital initiatives than they were in past change efforts.
17. Leaders in transformation-specific roles ensure collaboration between their units and others across the organization when employees are working on transformation initiatives.
18. Senior managers ensure collaboration between their units and others across the organization.
19. Engage technology-innovation managers (managers with specialized technical skills who lead work on digital innovations, such as development of new digital products or services) to support the transformation.
20. Senior managers encourage their employees to experiment with new ideas.
21. Senior managers foster a sense of urgency within their units for making the transformation's changes.

[1] The survey tested for best practices in a digital transformation by using different types and structures of questions. To make commensurate comparisons of each practice's impact on the likelihood of transformation success, Total Unduplicated Reach and Frequency (TURF) and Shapley value analyses were run. TURF analysis was conducted among respondents reporting successful transformations to identify the most common combinations of the 83 practices tested in the survey. This analysis was carried out by determining the proportion of respondents agreeing with or selecting at least one practice, then calculating the incremental value of including or excluding each practice. Shapley value analysis was then applied to the TURF output to rank the practices by their average expected marginal contribution to the likelihood of a successful transformation. The 21 keys to transformation success are the practices with the highest Shapley values.

therefore, more opportunities to fail.[5] But the organizations with successful transformations are likelier than others to use more sophisticated technologies, such as artificial intelligence, the Internet of Things, and advanced neural machine learning techniques.

The keys to success

Having these technologies on hand is only one part of the story. The survey results indicate exactly how companies should make the technology-supported changes that differentiate successful digital transformations from the rest (Exhibit 2).

Our research points to a set of factors that might improve the chances of a transformation succeeding (see sidebar, "Twenty-one keys to success").[6] These factors fall into five categories:

— having the right digital-savvy leaders in place

— building capabilities for the workforce of the future

— empowering people to work in new ways

— giving day-to-day tools a digital upgrade

— communicating frequently via traditional and digital methods

Having the right digital-savvy leaders in place

Change takes place at all levels during a digital transformation, especially when it comes to talent and capabilities. Nearly 70 percent of all respondents say their organizations' top teams changed during the transformation—most commonly when new leaders familiar with digital technologies joined the management team.

Indeed, adding such a leader is one of the keys to transformation success. So is the engagement of transformation-specific roles—namely, leaders of individual initiatives and leaders of the program-management or transformation office who are dedicated full time to the change effort. Another key to success is leadership commitment. When people in key roles (both the senior leaders of the organization and those in transformation-specific roles) are more involved in a digital transformation than they were in past change efforts, a transformation's success is more likely.

Other results indicate that when companies achieve transformation success, they are more likely to have certain digital-savvy leaders in place. Fewer than one-third of all respondents say their organizations have engaged a chief digital officer (CDO) to support their transformations. But those that do are 1.6 times more likely than others to report a successful digital transformation.

Building capabilities for the workforce of the future

The survey results confirm that developing talent and skills throughout the organization, a fundamental action for traditional transformations,[7] is one of the most important factors for success in a digital change effort.[8] Of our 21 keys to success, three relate to the workforce's digital capabilities. First is redefining individuals' roles and responsibilities so they align with a transformation's goals, which can help clarify

[5] For more on the implementation of digital technologies and solutions, see "How the implementation of organizational change is evolving," February 2018, McKinsey.com.

[6] The survey tested for best practices in a digital transformation by using different types and structures of questions. To make commensurate comparisons of each practice's impact on the likelihood of transformation success, Total Unduplicated Reach and Frequency (TURF) and Shapley value analyses were run. TURF analysis was conducted among respondents reporting successful transformations to identify the most common combinations of the 83 practices tested in the survey. This analysis was carried out by determining the proportion of respondents agreeing with or selecting at least one practice, then calculating the incremental value of including or excluding each practice. Shapley value analysis was then applied to the TURF output to rank the practices by their average expected marginal contribution to the likelihood of a successful transformation. The 21 keys to transformation success are the practices with the highest Shapley values.

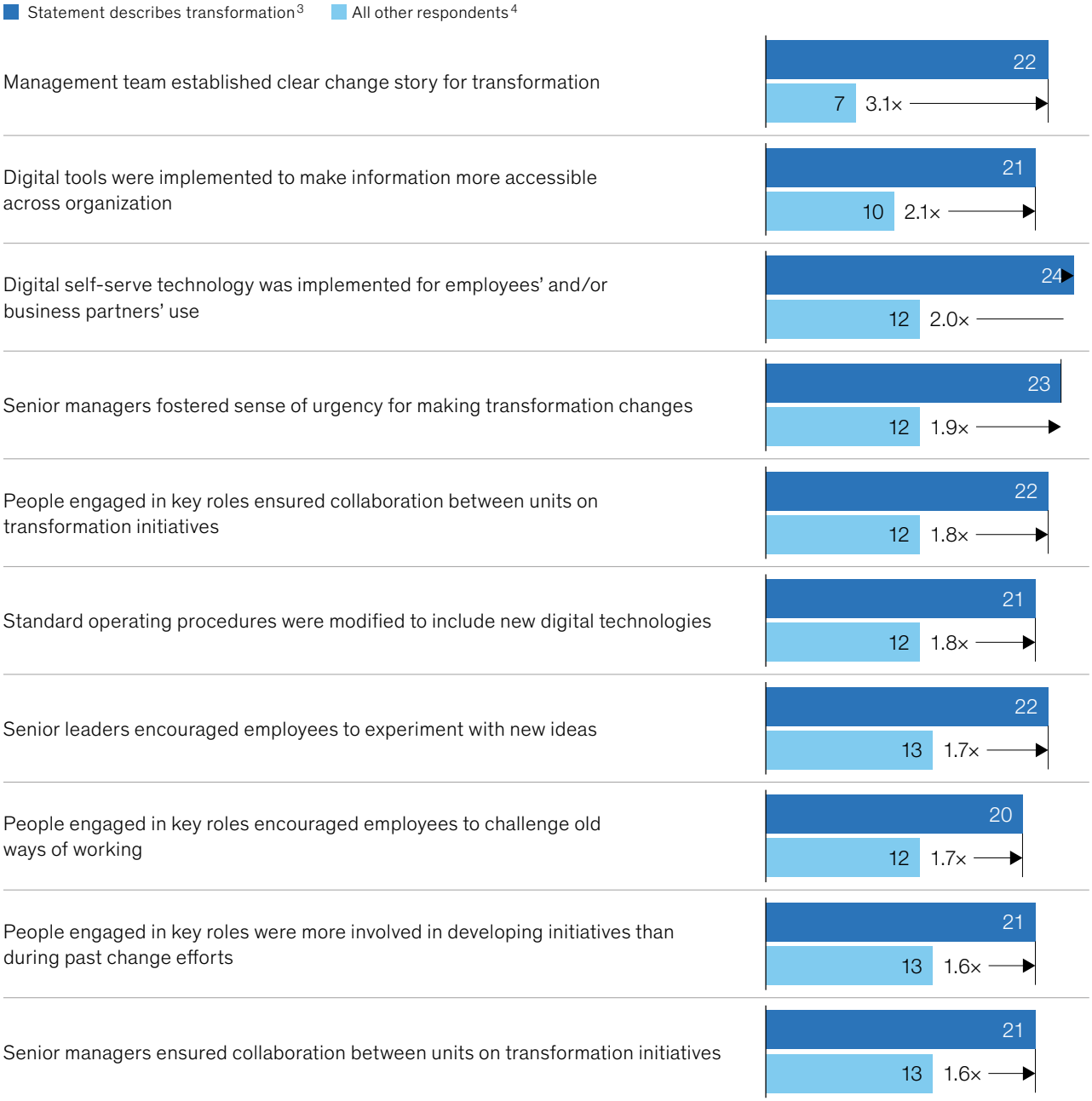
[7] Tessa Basford and Bill Schaninger, "The four building blocks of change," *McKinsey Quarterly*, April 2016, McKinsey.com.

[8] For more on technology's implications for talent and skills development, see James Manyika, "Technology, jobs, and the future of work," McKinsey Global Institute, May 2017, on McKinsey.com.

Exhibit 2

When key factors are in place, respondents are up to three times more likely to report successful digital transformations.

Success rate of digital transformations[1] by key factors,[2] % of respondents



[1] Respondents who report success say their organizations' transformations were very or completely successful at both improving performance and equipping the organizations to sustain improvements over time; n = 263.
[2] Out of 21 key factors of success, determined by Total Unduplicated Reach and Frequency (TURF) and Shapley analyses. These analyses were used to make commensurate comparisons of best practices within a digital transformation, which were tested by using different types and structures of questions.
[3] Includes respondents who either agreed (somewhat or strongly) that a given statement describes the transformation or selected a given practice as true of the transformation.
[4] Includes respondents who either disagreed (somewhat or strongly) that a given statement describes the transformation or did not select a given practice as true of the transformation.

the roles and capabilities the organization needs. Respondents are 1.5 times more likely to report a successful digital transformation when this practice is in place.

Two other keys relate to engaging the specific roles of integrators and technology-innovation managers, who bridge potential gaps between the traditional and digital parts of the business. People in these roles help foster stronger internal capabilities among colleagues. Integrators are employees who translate and integrate new digital methods and processes into existing ways of working. Because they typically have experience on the business side and also understand the technical aspects and business potential of digital technologies, integrators are well equipped to connect the traditional and digital parts of the business. For their part, technology-innovation managers possess specialized technical skills and lead work on a company's digital innovations.

Beyond these three keys for success, we found that companies with winning transformations have a better-funded and more robust approach to talent than others do. Transformation success is more than three times likelier when respondents say their organizations have invested the right amount in digital talent.

Success is also more likely when organizations scale up their workforce planning and talent development (Exhibit 3). For example, 27 percent of respondents report successful transformations when their companies set cross-functional or enterprise-wide hiring goals based on specific skill needs—nearly twice the share of respondents whose organizations do not.

During recruitment, using a wider range of approaches also supports success. Traditional recruiting tactics, such as public job postings and referrals from current employees, do not have a clear effect on success, but newer or more uncommon methods do. Success is at least twice as likely at organizations that run innovative recruiting campaigns (such as having recruits play games or find hidden messages in source code as part of the recruiting process) or host technology conferences or "hackathons."

Empowering people to work in new ways

Digital transformations require cultural and behavioral changes such as calculated risk taking, increased collaboration, and customer-centricity, as our previous research has shown.[9] In this survey, the results suggest two primary ways in which companies with successful transformations are empowering employees to embrace these changes.

The first is reinforcing new behaviors and ways of working through formal mechanisms, long proved as an action that supports organizational change. One related key to transformation success is establishing practices related to working in new ways. Respondents who say their organizations established at least one new way of working, such as continuous learning or open work environments, as part of their change efforts are more likely than others to report successful transformations. Another key is giving employees a say on where digitization could and should be adopted. When employees generate their own ideas about where digitization might support the business, respondents are 1.4 times more likely to report success.

A second approach to empowering workers is ensuring that people in key roles play parts in reinforcing change. Success depends on both senior leaders and those engaged during the transformation.[10] One related factor is encouraging

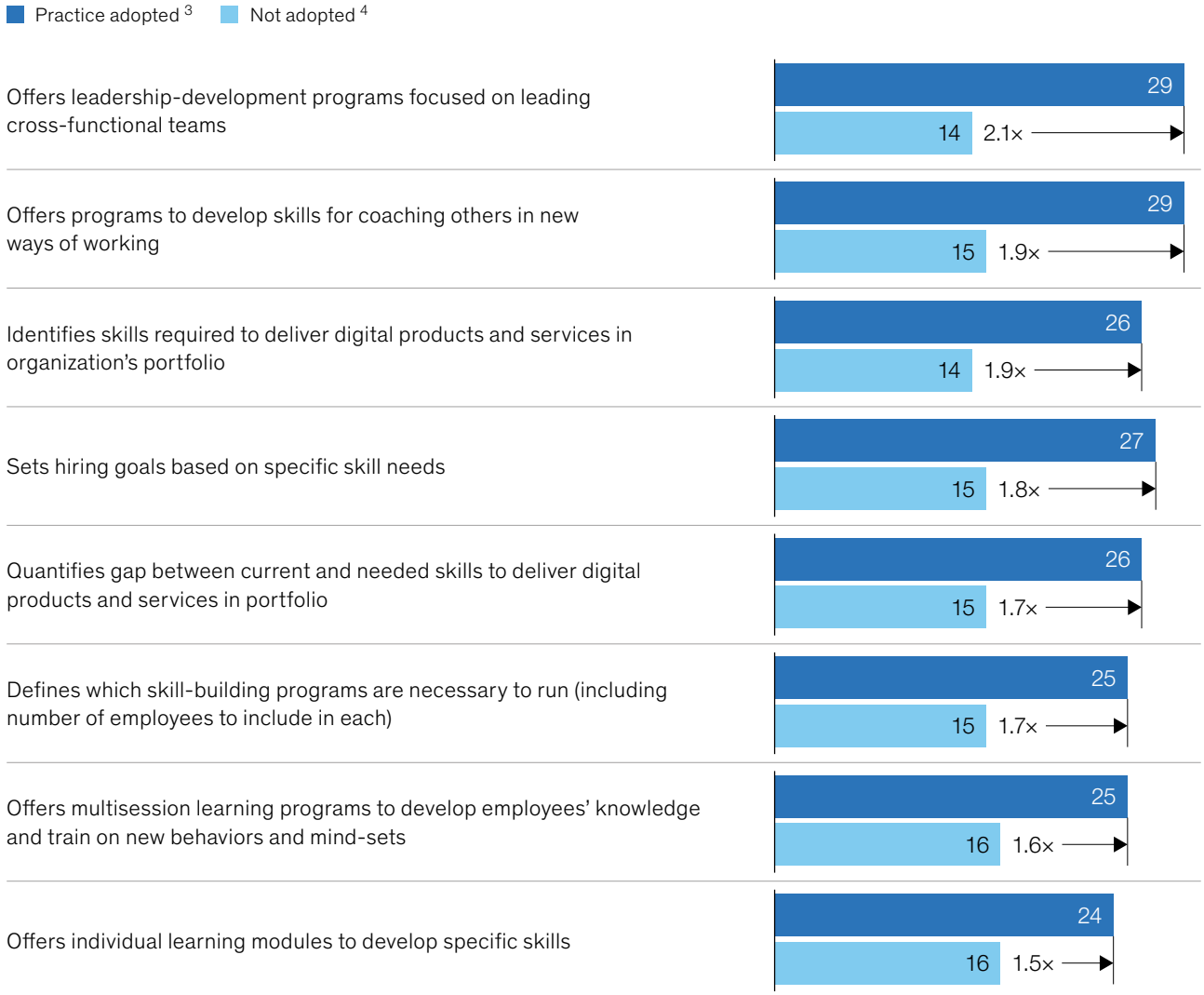
[9] Julie Goran, Laura LaBerge, and Ramesh Srinivasan, "Culture for a digital age," *McKinsey Quarterly*, July 2017, McKinsey.com.

[10] The survey asked which of the following roles were engaged by the organization to support the execution of the digital transformation: initiative leaders, integrator roles, leaders of the program-management or transformation office, technology-innovation managers, chief digital officers, and coaches.

Exhibit 3

At companies with enterprise-wide workforce-planning and talent-development practices, success is more likely.

Success rate of digital transformations[1] by adoption of organization-wide workforce and talent practices,[2] % of respondents



[1] Respondents who report success say their organizations' transformations were very or completely successful at both improving performance and equipping the organizations to sustain improvements over time; n = 263.
[2] Question was not asked of respondents who say their organizations significantly underinvested in digital talent during their transformations.
[3] Includes respondents who said that a given practice has been adopted in more than 1 function or business unit, or organization-wide, since the transformation began.
[4] Includes respondents who said that a given practice has not been adopted in more than 1 function or business unit, or organization-wide, since the transformation began.

employees to challenge old ways of working. Respondents who say their senior leaders and the people engaged in transformation-specific roles do this are more likely than their peers to report success (1.5 times more for senior leaders and 1.7 times more for those in key transformation roles). Another factor for success relates to risk taking. Success is more likely when senior leaders and leaders who are engaged in the transformation all encourage employees to experiment with new ideas—for example, through rapid prototyping and allowing employees to learn from their failures. A third key to success is people in key roles ensuring that their own units are collaborating with others when working on transformations. When respondents say their senior leaders and those in transformation-related roles have done so, they are 1.6 and 1.8 times, respectively, more likely than others to report success.

Giving day-to-day tools a digital upgrade

For organizations to empower employees to work in new ways, the survey findings show how, and by how much, digitizing tools and processes can support success. We asked respondents about seven structural changes their organizations had made since the transformations began (Exhibit 4). Three of these changes, each of which involves making the use of digital tools a new organizational norm, emerged as keys to success.

The first key is adopting digital tools to make information more accessible across the organization, which more than doubles the likelihood of a successful transformation. The second is implementing digital self-serve technologies for employees, business partners, or both groups to use; transformation success is twice as likely when organizations do so. A third key, focused on technology in company operations, is organizations modifying their standard operating procedures to include new technologies. Beyond these factors, an increase in data-based decision making and in the visible use of interactive tools can also more than double the likelihood of a transformation's success.

Communicating frequently via traditional and digital methods

As we have seen in traditional change efforts, clear communication is critical during a digital transformation. More specifically, one key to success is communicating a change story,[11] which helps employees understand where the organization is headed, why it is changing, and why the changes are important. At organizations that follow this practice, a successful transformation is more than three times more likely. A second key is senior leaders fostering a sense of urgency for making the transformation's changes within their units, a practice where good communication is central. Other results suggest that when communicating change stories, successful organizations tend to relay a richer story than others do. The elements with the greatest influence on success are clear targets for organizations' key performance indicators and clear communication of the transformation's timeline (Exhibit 5).

We also found that using remote and digital communications to convey the transformation's vision does a much better job of supporting success than in-person or traditional channels. When senior managers and initiative leaders use new digital channels to reach employees remotely, the rate of success is three times greater.

Looking ahead

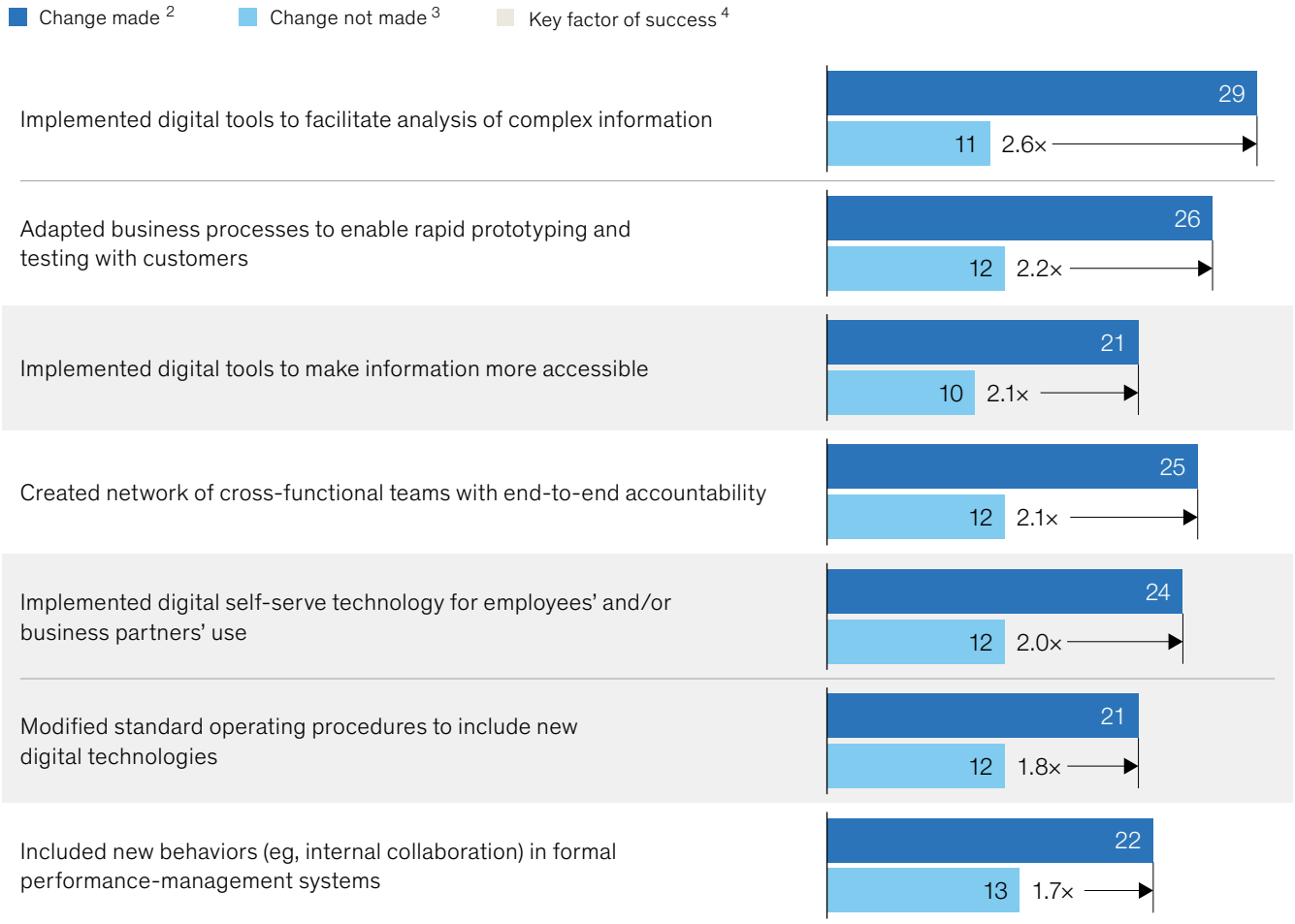
While respondents say that many digital transformations fall short in improving performance and equipping companies to sustain changes, lessons can be learned from those who report

[11] For more on change stories, see Carolyn Aiken and Scott Keller, "The irrational side of change management," *McKinsey Quarterly*, April 2009, McKinsey.com.

Exhibit 4

Respondents whose companies have made the use of digital tools a new organizational norm are more likely to report success.

Success rate of digital transformations[1] by structural changes made since transformations began, % of respondents

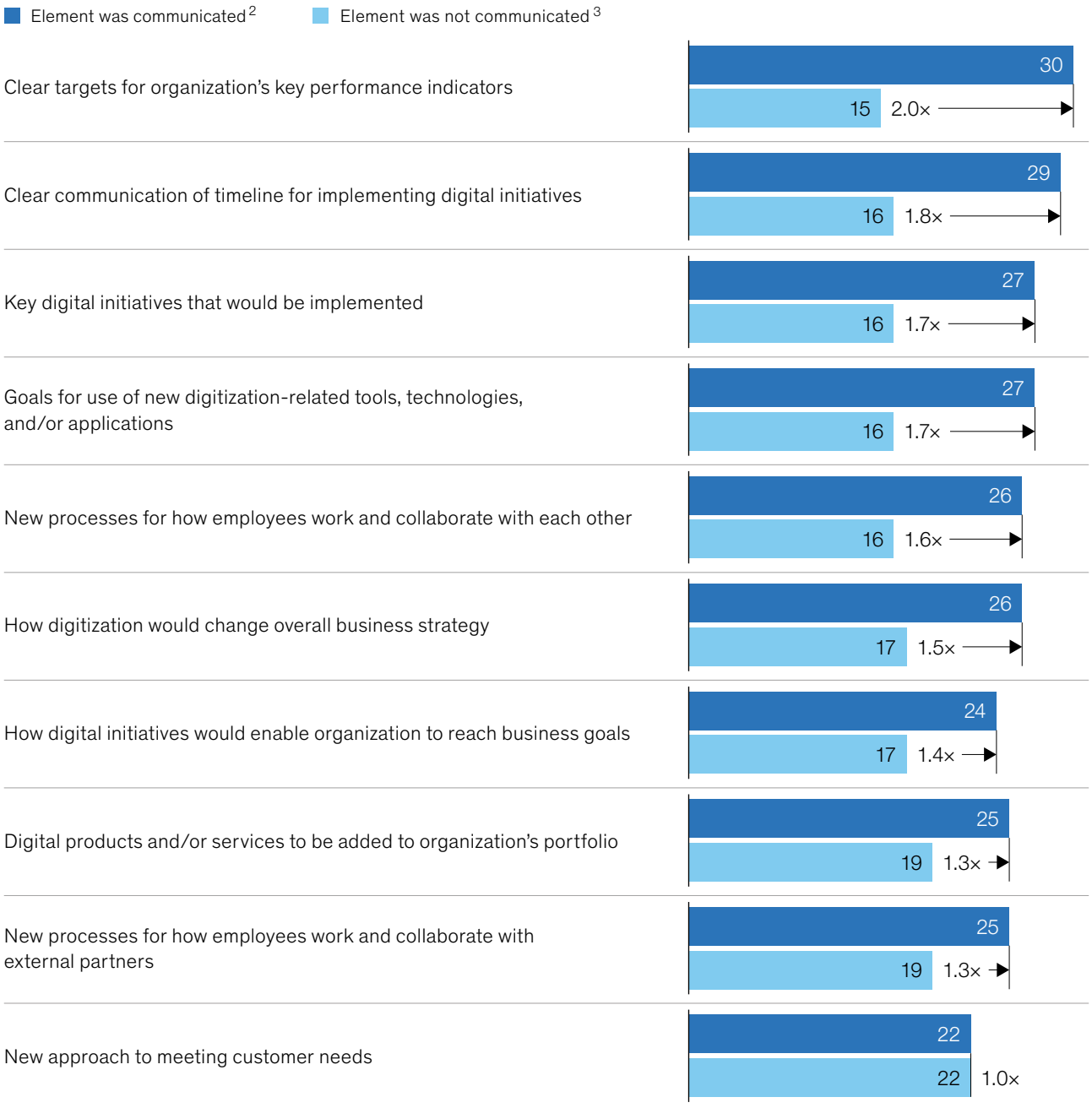


[1] Respondents who report success say their organizations' transformations were very or completely successful at both improving performance and equipping the organizations to sustain improvements over time; n = 263.
[2] Includes respondents who said their organizations have made a given change since the transformation began.
[3] Includes respondents who said their organizations have not made a given change since the transformation began.
[4] Out of 21 key factors of success, determined by Total Unduplicated Reach and Frequency (TURF) and Shapley analyses. These analyses were used to make commensurate comparisons of best practices within a digital transformation, which were tested by using different types and structures of questions.

Exhibit 5

The elements of a change story that most support success are clear targets for key performance indicators and communication of the transformation's timeline.

Success rate of digital transformations[1] by change-story elements communicated, % of respondents



[1] Respondents who report success say their organizations' transformations were very or completely successful at both improving performance and equipping the organizations to sustain improvements over time; n = 263.
[2] Includes respondents who said their management teams communicated a given change-story element during the transformation.
[3] Includes respondents who said their management teams did not communicate a given change-story element during the transformation.

success. The survey results suggest steps companies can take to increase their chances of success during a transformation:

— *Reimagine your workplace.* The results show that success requires both digital-savvy leaders and a workforce with the capabilities to make a digital transformation's changes happen, which other McKinsey research also confirms.[12] The workforce implications of digitization, automation, and other technological trends are significant, and companies will need to invest in and hire for radically different skills and capabilities. Whether or not an organization has already begun a digital transformation, it is important for all companies to think critically about the ways in which digitization could affect their businesses in the near and longer term, and the skills they will need to keep up. One critical step is for organizations to develop clear workforce strategies to help determine the digital skills and capabilities that they currently have—and will need—to meet their future goals.

— *Upgrade the organization's "hard wiring."* As digital requires new ways of working as well as changes to the organization's overall culture, employees must be empowered to work differently and keep up with the faster pace of business. The implementation of digital tools and upgrading of processes, along with the development of a nimbler operating model—that is, the hard wiring of the organization—will support these changes. Of course, leaders have important roles to play, too, by letting go of old practices (command-and-control supervision, for example). Since not all leaders will have the experience to support or enact such changes, dedicated leadership-development programs could help leaders and employees alike to make the necessary shifts in mind-sets and behaviors.

— *Change the ways you communicate.* Good communication has always been a key success factor in traditional change efforts, and it is just as important in a digital transformation. In a digital context, companies must get more creative in the channels they are using to enable the new, quicker ways of working and the speedier mind-set and behavior changes that a digital transformation requires. One change is to move away from traditional channels that support only one-way communication (company-wide emails, for example) and toward more interactive platforms (such as internal social media) that enable open dialogues across the organization. Another key to better communication is developing more concise—and even tailored—messages for people in the organization, rather than lengthier communications.

[12] For more, see James Manyika and Kevin Sneader, "AI, automation, and the future of work: Ten things to solve for," McKinsey Global Institute, June 2018, on McKinsey.com; Jacques Bughin, Peter Dahlström, Eric Hazan, Susan Lund, Amresh Subramaniam, and Anna Wiesinger, "Skill shift: Automation and the future of the workforce," McKinsey Global Institute, May 2018, on McKinsey.com; and "Retraining and reskilling workers in the age of automation," on p. 96 of this compendium.

The contributors to the development and analysis of this survey include **Hortense de la Boutetière**, a partner in McKinsey's Paris office, and **Alberto Montagner** and **Angelika Reich**, an associate partner and partner, respectively, in the Zurich office.

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Part

02

Customer-centric journey design

How to extract maximum value from a zero-based design approach to customer journeys

Companies finding success in transforming their customer journeys are discovering that four practices are critical.

by JP Higgins, Elixabete Larrea, Swapnil Prabha, Alex Singla, and Rohit Sood

In recent years, the business landscape has undergone massive changes thanks to shifting economic conditions, heightened customer expectations, and technological innovation. This reality has put additional pressure on businesses to improve performance and redesign their products, services, and even organizations. Zero-based design has emerged as a potent approach.

If done right, the principles of zero-based design—which essentially encourages people to cast aside assumptions to expand the scope of discovery—will help organizations achieve step changes in performance compared with traditional approaches. Typical results include an increase of 30 to 50 percent in operational productivity and a rise of 10 to 20 points in customer-satisfaction scores, fueled by enhanced responsiveness of up to 80 percent.

Given that impact, many organizations in the financial-services industry have tried to use zero-based design to transform customer journeys. But in practice, those efforts have often fallen short of their full value potential because organizations tend to narrowly define what zero-based design actually is. For this reason, they do not put in place the necessary building blocks so that great ideas lead to great solutions.

In our experience, four issues are the primary culprits: incomplete or unclear definitions of end-to-end journeys (both customer facing and internal),[1] lack of the right skill sets on the journey-redesign team, constrained ideation, and regimented and inflexible ways of working.

To address these issues, we find it helpful to ask the following questions.

1. Are all processes in your organization mapped against end-to-end customer journeys?

Companies often believe they've worked across departments to define end-to-end customer journeys by assembling members of different departments or aligning the organization to resolve a single pain point. This approach, however, doesn't provide the necessary clarity needed to define an end-to-end journey. What's needed is for companies to identify and reframe all processes throughout the organization into a comprehensive set of end-to-end journeys. This means accounting for processes that directly touch the customer as well as the supporting middle- and back-office functions. This is crucial because it is important to have the right definition of journeys to which the zero-based design approach can be applied. Otherwise, companies will risk delivering incomplete and inconsistent experiences to their customers.

A good journey definition includes the following:

— *Places the customer at the center and uses the customer's language.* Taking this perspective will help the journey team work with the customer in mind. For example, an insurance sales customer's journey definition might be, "I want to protect myself from the unexpected."

— *Identifies a clear beginning and end.* Defining the outlines of the customer journey will force the team to think holistically about the customer experience instead of trying to arrive at point-by-point solutions. In insurance, a sales journey may start when a customer begins to evaluate options and end when he or she receives the policy.

— *Crosses departmental boundaries.* By considering the multiple functional groups that touch the customer journey, teams can solve for the customer's integrated experience. In the insurance sales example, the journey will involve a minimum of the sales, pricing, policy-issuance, and even claims departments.

To define a set of end-to-end customer journeys, teams will need to invest significant effort and apply the right resources and capabilities, such as analytics and workforce management. When

[1] For more, see Albert Bollard, Elixabete Larrea, Alex Singla, and Rohit Sood, "The next-generation operating model for the digital world," March 2017, McKinsey.com.

properly done, the outcome will be unprecedented visibility into every aspect of the customer journey. For example, a personal lines property-and-casualty (P&C) carrier defining its end-to-end journeys would quickly realize that a customer who has been in an accident and is now recovering from an injury and getting his or her vehicle repaired would perceive that entire experience as a single journey. Therefore, even if the carrier's claims organization separates the vehicle-damage and injury adjustors into two different groups, they will need to come together to redesign the claims-customer journey.

2. Do you have people with diverse skill sets on your journey-redesign teams?

Many organizations bring together IT employees and business experts to redesign customer journeys. This collaboration helps, but it is not enough.

The success of a zero-based design effort depends on the journey team having a mix of skill sets to help generate ideas, create prototypes, test them, and then iterate on them. Following are two nontraditional but critical roles that need to be part of those teams:

— Experienced *designers* are adept at interpreting multiple stakeholder perspectives and translating them into an optimized possible journey design for the customer.

— *Customer anthropologists* can help the team understand customer insights more deeply. They interpret quantitative and qualitative research data and reconcile nonintuitive inputs to form a coherent narrative around the customer experience.

Financial-services firms and traditional organizations don't necessarily have such nontraditional skills in-house. When they do exist, the skills can vary significantly, and attracting the right external talent is a challenge. Companies that are serious about pursuing zero-based design must invest in updated, innovative recruiting strategies to identify, hire, and develop employees with the right skill sets for these nontraditional roles.

3. Are your ideation sessions sparking true innovation or derivative ideas?

Many proactive organizations are learning the basics of design thinking and ideation sessions. Companies often start with inspiring videos, integrate customer perspectives into ideation sessions, and include subject-matter experts in them as well.

While these steps are an important start, they don't maximize the potential of zero-based design. An "art of the possible" approach can amplify creative thinking by releasing participants from constraints and inspiring them with possibilities.[2] An effective ideation session should include four critical elements (for more, see sidebar, "Applying the 'art of the possible' with ideation sessions"):

— *A clear, bold aspiration in line with the company's overall strategy.* Members of the ideation team must have complete clarity on the company's overall vision, strategy, and goals (both financial and nonfinancial) that they are addressing. To achieve this clarity, senior leaders must be present at ideation sessions to articulate and credibly communicate the vision.

— *Inspiration from outside innovators.* Cross-functional teams that are exposed to examples of creative thinking in action from other sectors are more likely to challenge their own insular thinking and produce creative ideas.

— *Next-generation capabilities.* Zero-based design participants who become familiar with

[2] The "art of the possible" is our approach for implementing zero-based design principles in organizations and teams to spark unconstrained ideation.

Sidebar

Applying the 'art of the possible' with ideation sessions

Imagine that a commercial-lines insurance carrier wants to reimagine the journey by which a newly acquired customer sets up his or her account. Here is what an "art of the possible" ideation session could look like across the four elements:

Aspiration. The CEO and senior leader responsible for this journey kick off the "art of the possible" workshop together with the relevant journey team. They remind the team of the carrier's strategic vision and explicitly link it to measurable goals for the journey in question, such as targets to increase revenue by 10 percent, reduce overall costs by more than 30 percent, and improve already excellent customer-satisfaction scores. The CEO underscores the vision with a challenge to the team to achieve these results within 12 months. The team has clear goals they can shoot for and a way to measure whether they've succeeded.

Inspiration. Next, the team sees and hears about examples of innovative processes and approaches from outside the insurance industry. The group, for example, learns about how e-commerce companies create dynamic shopping experiences that cater to multiple shopper personas and how companies use cognitive agents that can have humanlike interactions, complete with natural-sounding voices.

The participants then debate how these innovations apply to the journey they are redesigning. As a result, they start thinking about how to reinvent the process, drawing on the examples they've reviewed.

Education on next-gen capabilities. The team then learns about specific new technologies, capabilities, and practices, with a goal of demystifying them and understanding how these levers solve specific problems. For example, participants gain an understanding of the solutions that different elements of automation can provide and when to use each capability.

The inspiration element continues as the team learns about, for example, how retail and consumer industries apply geospatial capabilities to optimize their network of stores or how the healthcare industry applies a value-based care approach to measure and compare provider performance. Participants now have a basic knowledge of the building blocks—advanced analytics, performance measurement, new technologies—they need to assemble to reinvent their customer journey.

Ideation. With their creativity primed, participants draw on practices used at some of the most innovative companies in the world. The team works, for example, in 30-second ideation sprints to record ideas quickly, without time to filter or judge their output. This yields a spectrum of creative ideas, which could include chatbot-enabled support for customers to set up accounts or advanced-analytics-enabled loss control and mitigation plans as additional services for customers.

new capabilities such as automation, advanced analytics, and digital are better able to make connections between potential innovative solutions and existing business problems.[3] As a result, "art of the possible" workshops frequently incorporate overviews of advanced capabilities and other relevant educational programming.

— *Ideation in rapid sprints.* All zero-based design sessions require team members to brainstorm. However, "art of the possible" workshops jump-start the process by leading participants through a series of rapid-fire exercises designed to challenge them to take on different points of view. The result is an exciting environment that stimulates creative visions of redesigned journeys.

4. Is your organization as agile as your journey team?

Many organizations that apply zero-based design believe it is sufficient for just their journey-redesign teams to adopt an agile way of working. To get results, however, the entire organization needs to adapt to the pace, flexibility, autonomy, and transparency of the journey teams.

Organizations can achieve the full potential of zero-based design only if they evolve their governance models and infrastructure to enable fast-paced, distributed, and accessible decision making. Successful organizations adopt a test-and-learn mind-set and diligently measure success by results and outcomes. Companies that have been successful at zero-based design share some common traits:

— Leadership updates and steering-committee meetings that focus on discussions and demonstrations in the work area instead of presentations in boardrooms.

— Frequent and rapid investment decisions based on start-up-like pitches supported by rigorous but not cumbersome business cases that can be evaluated and approved to keep pace with the ideation team.

— Adoption of "agile" routines such as regular huddles, brief work sprints focused on output, and regular retrospective evaluations. This mode of working allows organizations to be nimble and respond to market changes quickly.

A fundamental redesign of end-to-end customer journeys is not the place for half measures. Zero-based design can help organizations transform processes, mind-sets, and operations, but only if they fully commit to four essential areas where organizations have traditionally missed the mark.

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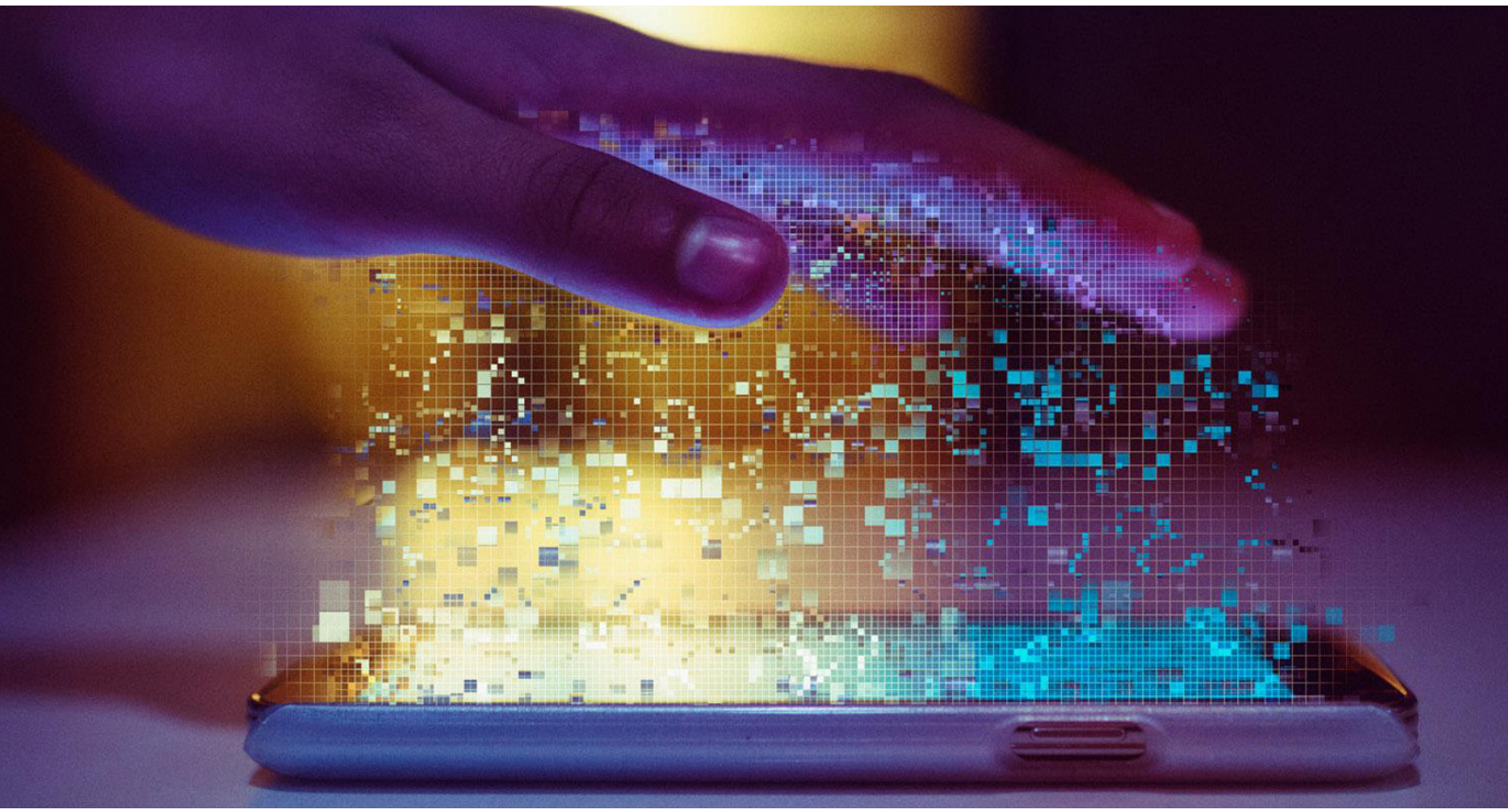
[3] Albert Bollard, Elixabete Larrea, Alex Singla, and Rohit Sood, "The next-generation operating model for the digital world," March 2017, McKinsey.com.

Mastering the digital advantage in transforming customer experience

Digital services and operations are raising the competitive bar in every sector. To capture the opportunity, incumbents should embrace a new operating model that dramatically improves the digital customer experience. Here's how.

by Oliver Ehrlich, Harald Fanderl, and Christian Habrich



Improving customer experience delivers real benefits to companies that successfully execute customer-centric strategies. Across sectors, satisfied customers spend more, exhibit deeper loyalty to companies, and create conditions that allow companies to have lower costs and higher levels of employee engagement.[1] In that dynamic of value creation and durable competitive advantage, delivering digital services and operations has emerged as a prime mover in reshaping customer experience in almost every sector. As digital pure plays such as Amazon, Apple, and Uber continuously reinvent themselves by delivering simple, immediate, and individualized experiences, even traditional business-to-business[2] players in sectors such as chemicals and steel are making bold moves to build dynamic shared digital ecosystems around customer needs.

It is clear that customers, stoked by digital-first attackers and those playing catch-up, will only expect more digital solutions. Our research finds that growing customer expectation of superior service drives efforts to advance and refine digital solutions. In our research, 70 percent of app users preferred added functionality over "look and feel" of the app, and 61 percent of customers said they were more likely to buy from companies delivering custom content. Three-quarters of online customers said they expected help within five minutes, have used comparison services for consumer goods, and trusted online reviews as much as personal recommendations.

It is also clear that those expectations will continue to evolve quickly, pitting incumbent companies' profitability against their ability to deliver services in new ways and master a complex landscape of technologies, marketing approaches, and operational capabilities. Within this dynamic and rapidly changing landscape, important opportunities to build revenue, deepen customer experience, and reduce cost will manifest themselves. A strong will to succeed will be a prerequisite, but by itself will be insufficient to grasp competitive advantage. What is required is a more radical abandoning of traditional ways of working in favor of new approaches. By rethinking traditional operating models that hinder companies from achieving their potential and by combining digital technologies and operating capabilities in an integrated, well-sequenced way, companies can create customer-centric strategies that can sustain new levels of speed, agility, efficiency, and precision.[3]

Toward a next-generation operating model

One typical shortcoming of traditional operating models is a strong focus on optimizing internal capabilities instead of making the customer's needs and wants the organization's central orientation point. The strong individual silos that make up so many of today's organizations are another barrier, at odds with the need for achieving truly cross-functional collaboration. Still other companies remain loyal to big project pipelines that they deliver in a traditional waterfall-like manner, with a long development process and a big announcement at the end, rather than continuously testing and iterating change in a manner more closely tuned to market changes. Finally, in many cases a relentless top-management commitment to embracing digital solutions is missing.

From our digital customer experience and service-operations work with leading practitioners, we have distilled elements that we believe are critical in shifting away from running uncoordinated efforts within organizational silos to launching an integrated operating model organized around customer journeys or the end-to-end experience of a customer buying a product or service. This framework offers a perspective on those elements that help companies to dramatically improve digital customer experience, establish a true omnichannel perspective within their organizations, and drive digitization. In our experience, it is possible for companies to successfully pursue such deep transformations,

[1] See "The CEO guide to customer experience," *McKinsey Quarterly*, August 2016, McKinsey.com.
[2] See Nicolas Maechler, Adina Poenaru, Thilo Rüdt von Collenberg, and Patrick Schulze, "Finding the right digital balance in B2B customer experience," April 2017, McKinsey.com.
[3] Joao Dias, David Hamilton, Christopher Paquette, and Rohit Sood, "How to start building your next-generation operating model," March 2017, McKinsey.com.

starting with a design of the operating model and then transforming the customer journeys that matter most, while simultaneously building an agile and cross-functional approach to customer-centric organization transformation at scale.

The digital component in transforming customer experience

In this article we focus on what we've learned in building this operating model and the four success factors that are key to delivering superior digital experiences, as well as the challenges that companies across industries face in efforts to secure them. The success factors are as follows:

— designing and digitizing customer journeys

— increasing speed and agility in insight generation

— achieving customer adoption of digital customer journeys

— developing agility in delivering journey transformations

It is no surprise that a lot of digital journey transformations struggle to succeed, considering that running a digital customer-experience transformation is a complex, multidimensional task. It requires a combination of traditional transformation elements such as rigorous, top-management commitment and steering, cross-functional teamwork, and more digital elements, including agile delivery of technology, along all journey-transformation phases. That said, the effort can pay off handsomely; in our work we regularly observe up to 15 percent revenue increases and simultaneous cost-to-serve reductions of more than 20 percent.

Customer-centric design of customer journeys

A key to offering an outstanding digital customer experience is creating a radical design (or redesign) of journeys to be improved. What we have found to work extremely well is to apply design-thinking methodologies and to conduct a design boot camp. Such a starting point is also how to best begin the process of developing an agile digital delivery system within a cross-functional team.

In this process, the primary goal is to thoroughly rethink the way the journey works, instead of simply fixing inefficiencies along the way. The customer and his or her needs and preferences are both the starting point and the ongoing proof point for the work, meaning that new designs are immediately tested and iterated based on customer feedback. Within such redesign workshops, it helps to render the customer journey in a clickable prototype in order to obtain a more concrete look and feel of the actual customer experience, which can then be continuously tested with customers. Overall, the approach must, however, allow for seamless integration with existing channels, including non-digital journeys. Furthermore, legacy processes that become redundant as a result of the new journey should still be run in parallel until the new journey is fully operational.

One promising approach is what we call zero-based journey redesign, or designing a customer journey from scratch, without any preconception of the ultimate vision for the journey—rather than simply improving the status quo. One ambitious redesign of the instant account-opening process at a large bank eliminated 15 process steps (including significant paperwork), introduced an instant identification system (via passport and face-recognition software), and established a completely new online and mobile (and in-branch self-service) journey enabling account opening anytime and anywhere. With the inclusion of the in-branch self-service customer journey, the effort boosted self-service sales from zero to more than a third of total sales, with 50 percent higher conversion rates and a reduction in cycle time to

ten minutes, compared with between two and six days previously.

Similarly, a redesign of the customer-relocation journey for a large multinational energy company introduced an approach to automated communication that reduced process steps for customers by half and accelerated processing time by 80 percent, while also making it easy for customers to move their accounts at any time during or after their relocation, via a range of devices. These changes decreased cost to serve by 40 percent and tripled the retention rate of relocating customers. By embedding design thinking in the organization, management was also able to form a new vision of how customers could experience their redesigned services in the future for a broad range of customer journeys.

Increasing speed and agility in generating insights

Digitization and the fast pace of changing market and consumer dynamics require fast, frictionless "real time" insights into a multitude of different areas for decision making, specifically customer-journey management and design.

However, traditional market-research approaches are often not in line with these requirements—they take too long to be generated and don't enable iterative step-by-step building of new experiences that integrate constant customer feedback. Thus, customer-experience leaders need to find ways to be agile in generating insights—for example, by employing much more flexible and dynamic research approaches. Among these are mobile flash surveys and online focus groups, as well as the integration of these insights directly into the customer-experience design and redesign process.

Generating insights in an "agile" way in a digital customer-experience transformation can start with conducting an in-depth user-experience assessment of current customer touchpoints, such as web properties, devices, call centers, and branches. These can then be compared with competitors'. By combining this exercise with the zero-based approach to rethinking the customer journey, it is possible to generate valuable insights as to the strengths and weaknesses of the digital customer-experience design.

During the journey design process, agile insights can then be used to rapidly test new ideas and journey steps with customers, with more scale than traditional focus groups. For example, it is possible to use an online focus group with a carefully selected target audience or live video chats with customers sitting at home testing out a new digital process on screen to provide immediate insights that can help to fine-tune key journey steps. One large European energy player used customer-experience-measurement software to integrate input from text messages and web and email surveys. One large insurer created digital "diaries" to better understand customer pain points.

Achieving customer adoption of digital customer journeys

The awareness of how to build effective digital channels has risen significantly in recent years. However, a typical pitfall we observe is that many projects falter because not enough thinking goes into actively stimulating customer adoption. There are a number of reasons why customers fail to adopt digital channels. In some cases, they are related to sales barriers, such as a preference for in-person contact, the speed with which a product is delivered, or e-care challenges, including a lack of personalized experience. Consequently, customers don't embrace digital self-service channels to the degree desired, limiting efficiency gains and cost savings. Thus, thoroughly orchestrating and stimulating customer adoption of digital journeys is a key success factor.

In our experience, there is no "silver bullet" to stimulate customer adoption of digital journeys. Rather, the answer lies in pulling a combination of different levers and iterating approaches based on customer testing. Broad strategies, each with their own tactics, include informing the customer, making the customer journey relevant to the customer, and guiding him or her to engage:

— ***Informing the customer***

- *Using effective marketing techniques*, such as search-engine optimization (SEO), search-engine advertising (SEA), or offline campaigns, is critical for engaging consumers. Despite focusing on creating digital channels, there still needs to be a well-formed mix between traditional- and digital-media techniques. A great example for this combination is the market launch of Foodora in Germany, where the company successfully applied a mix of SEO/SEA, online awareness campaigns, and offline out-of-home penetration. Other digital pure plays such as Amazon and Zalando have followed similar strategies.

- *Explaining the usage of the new digital channels*, for example, through videos at physical touchpoints, can also be a highly effective mechanism to promote adoption. Companies such as Deutsche Telekom, which promotes new cloud services; Alaska Airlines, with home check-in and baggage-tag printing; or HSBC, with its tutorial videos on redesigned online banking have taken this approach.

- *Triggering initial usage through testing*, user groups, and by pushing reviews has allowed some players to stimulate feedback and word of mouth to gain a critical base.

— ***Making the digital journey relevant***

- *Pooling relevant content and creating a delightful experience*, for example, by bundling functionalities in one app, is key, especially for digital channels that are not frequently used. There is only a limited number of apps that individual customers use, and so these need to contain as much content as possible from the same company. In Turkey, insurer Allianz decided to pool functionalities for health insurance, claims submission, and other services in one app instead of offering multiple apps, which would have a much lower likelihood of usage by consumers.

- *Include high-frequency services to stay in use* (for example, gamification and feedback opportunities). An effective example of this is from the Chinese insurer Ping An, which includes multiple engaging functionalities in its Good Doctor app. In this way, the company triggered higher usage and was able to collect valuable customer-behavior data.

- *Continuously improve and innovate digital journeys.* Draw from user-experience data to increase adoption and success of digital channels over time. Based on effective user-experience assessments and customer tests, some companies have used such simple tactics as developing a new landing page or changing the colors of functional elements on websites to improve subscriptions and click-through rates.

— ***Guiding the customer***

- *Providing incentives* is also a major driver of digital adoption. Offering bonus points or other financial rewards is a common approach. This strategy is exemplified by the *British Sunday Times*'s competitive pure-digital subscription offer over traditional ones.

- *Reducing the effectiveness* or limiting access to competing or legacy channels allows companies to further nudge laggard adopters. This signals commitment and confidence in new digital tools or channels. For example, airline Wizz Air offers digital support on its website for free, while charging a service fee of 15 euros when customers seek help from the call center.

To encourage customer adoption of digital journeys, it is critical to not simply rely on the quality of the channel but to find a suitable individual solution

using multiple levers to drive adoption. Furthermore, it is essential to achieve internal alignment in the organization across channel and business-unit leadership. Conflicts that arise among leaders on strategy, targets, incentives, and mind-sets can be highly disruptive.

Developing agile delivery of journey transformations

Delivering customer-journey projects often poses a stiff challenge to companies, particularly when it requires solving technological and IT-related issues.

Traditional waterfall delivery models build up research and testing over a long period of time and typically introduce a new effort with fanfare and a big announcement. In contrast, digital leaders increasingly rely on delivering customer-journey transformations following agile methodologies in which high-performing, cross-functional teams work toward a common, customer-centric vision, relying on real-time decision making, rapid iteration, and end products that can be presented and refined continually. There are some key advantages to this:

— Cross-functional teams—including representation from the business, information technology, and other support functions, such as back-end operations—co-locate and collaboratively work together toward a single vision for a new customer experience.

— Disaggregating project complexity by defining a minimum viable product can deliver a product or service to the customer in only a few months, rather than in a year or more for traditional approaches. Continuous improvement is also possible.

— A joint push for development in weekly or biweekly sprints sets up the team for quick successes on a weekly or biweekly basis.

— Encouraging strong collaboration and daily interactions enables teams to identify and remove roadblocks early and pragmatically iterate designs and solutions.

— Delivery time and risk of failure are minimized simultaneously.

As digital-first disruptors reshape the business landscape, customer demands for more digital services and operational expertise are posing a challenge to incumbent players across all sectors. The response calls for a new operating model that puts the customer's needs and wants at the center of a digital-transformation strategy, enabled by redesigned customer journeys and agile delivery of insights and services.

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Managing a customer-experience transformation in banking

As banks rush to transform their customer experience, it's easy to trip up. Here's how to execute a step change that moves ahead of competitors.

by Nicolas Maechler, Jonathan Michael, Robert Schiff, and Thomas Rüdiger Smith

Regulation. Fickle customer loyalties. Nontraditional competitors. As if a decade of razor-thin margins and reputation issues weren't enough, the mix of challenges facing global banks makes it easy to see why so many now voice a commitment to improved customer experience as a legitimate differentiator in an increasingly competitive environment. Of the 50 largest global banks, three out of four now pledge themselves to some form of customer-experience transformation.[1]

The benefits of such a strategy have been increasingly clear for some time across sectors and geographies. As practitioners such as Amazon and Apple have demonstrated, real value resides not only in the products and services a company provides but also in the way that it delivers them. A seamless customer experience can be worth at least as much as a superior product or efficient process for building customer loyalty, reducing costs, making employees happier, and boosting revenues significantly. One bank that undertook a customer-experience transformation concluded that the lifetime profitability of a satisfied customer willing to actively recommend the bank to his or her friends was five to eight times greater than one who had a negative perception.

Many leading banks are pouring tremendous resources into transforming the customer experience, often with mixed results. This is understandable. A customer's banking relationship includes key journeys that range from onboarding and transacting to maintenance and problem resolution. Effective transformations must not only recognize the complexity of these relationships but also make a priority of the parts of the experience that matter most—in order to manage the cross-functional, end-to-end nature of customer needs rather than deferring to existing organizational structures.

Depending on a bank's customer-experience goals, transformations can vary in regard to the time and resources required. In our experience, a handful of elements are necessary to execute any program that will deliver durable impact. These include, among other things, a consistent focus on value, ensuring the customer's central role in any transformation, and the ability to scale a program. This article explores the ways that some banks have implemented these and other critical steps in constructing successful customer-experience transformations.

Failure modes

Customers are central to a wave of new opportunities and challenges facing banking executives, with regulators increasingly expecting banks to deliver on more than just credit-risk management and associated capital requirements. For example, regulators around the world increasingly examine customer complaints for examples of problematic sales practices and inadequate customer service. For the biggest banks, how they treat their customers is becoming more of a political issue, as any CEO who has been called before a congressional or parliamentary inquiry can attest.

Customers' loyalty is also at risk. Banks face an expanding array of new competitors. The entry of companies such as Alipay, Amazon Cash, Facebook Messenger P2P, WeChat, and other services skilled at customer ease and experience may, in the longer term, disintermediate traditional banks from customer relationships and reduce banks' distribution margins. Another concern is that players outside the traditional financial-services industry are starting to set the benchmarks for customer experience in banking. Internet retailers and other e-commerce players typically sit atop customer-satisfaction rankings. Banks often lumber in toward the middle of the pack.

As banks pour more effort into improving experience, we find three missteps to be the most likely culprits when efforts fall short of the mark. First, many banks ignore the need to achieve early, quick wins

[1] Analysis of the 50 largest global banks' annual reports and investor presentations for the latest financial year; based on the S&P Global Market Intelligence list of banks by total assets.

to demonstrate value and build momentum for change. Teams eager to achieve dramatic impact set out to create moments of customer delight and fix pain points across all journeys or processes at the same time and are often overwhelmed by the complexity and costs of redesign.

For example, one bank moved to fix its full mortgage journey in a single focused effort. Despite a large investment of time and money, however, its gold-plated solution proved too complex to implement all at once. Early impact never materialized. As payback deadlines loomed, the team couldn't deliver convincingly on redesigning complex systems, processes, or risk policies. Senior management balked at committing additional time and energy. The transformation never got off the ground and was ultimately abandoned.

Ironically, another way that customer-experience transformation efforts go awry is by failing to focus front and center on the customer during the change effort. Despite the growing awareness of the value in superior customer experience, efforts to improve it are rarely held to the same rigor as an effort behind, say, a traditional productivity transformation. The customer's voice is often left silent as change agents latch onto digitization to leapfrog competitors, implement self-service improvements, and revamp staffing models.

One payments player sought to improve its process of resolving customer disputes. It was considering a complete reworking of its technology to reduce processing time. However, after collecting customer feedback and conducting additional customer interviews, the company learned that the major pain point was not processing time but a lack of status updates for customers. By better understanding what was disturbing customers, the company was able to solve the problem with much less effort and with a greater likelihood of improving the experience.

Finally, banks often fail to set up transformation programs with scaling in mind. In complex organizations it is easy for change efforts to get stuck in the depths of business silos, even when the objective is to create a cross-functional platform for tracking customer preferences and improving outcomes. Efforts that don't give customer experience the same top-team and board attention as large-scale productivity-improvement efforts, and that don't devote the same resources to oversight and measurement, risk lapsing into cursory efforts marked by meaningless bulletin-board slogans, such as "Customer experience is everyone's job."

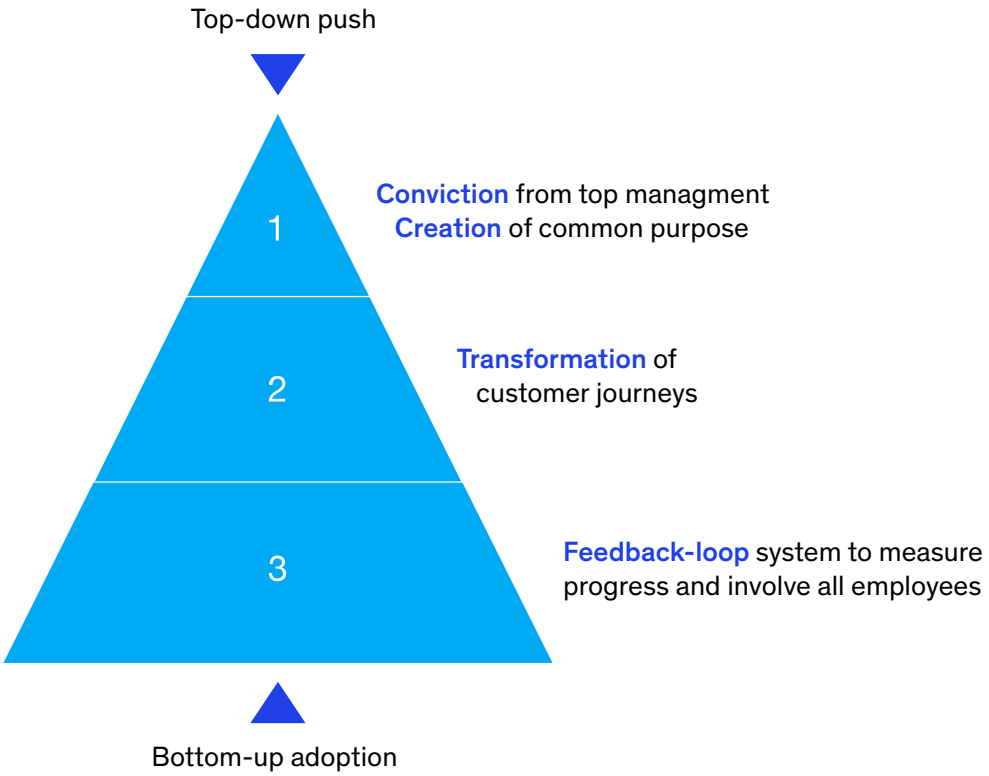
Toward a durable transformation program

In our experience, banks are increasingly finding success with "at scale" transformation efforts. These efforts define the bank as a series of customer journeys that can be reimagined and applied across functions and the organization as a whole. As value is demonstrated, larger and larger parts of the organization are included. In the early stages, such transformations take advantage of cross-functional teams that work within existing roles and in parallel with reporting structures. Over time, by emphasizing this type of agile collaboration, organizational structures can be revamped to deliver the new experiences sustainably over multiple years. The result is a transformation that delivers early impact and momentum and an opportunity to evolve as needs change, without the disruptive shock of tearing up an operating model in the fragile, early stages.

Every customer-experience transformation following such a model relies on certain prerequisites (Exhibit 1). These begin with a top-down, unwavering C-suite commitment to the program and to modeling the customer-experience behaviors that the organization espouses. They also include commitment to a bottom-up feedback

Exhibit 1

Successful customer-experience programs combine top-down purpose with a bottom-up feedback loop to make journey transformations stick.



loop to measure progress and involve employees in implementing and refining improvements. At the center of such efforts lies a dedication to a customer's end-to-end experience with the bank—that is, the whole journey rather than individual, transactional touchpoints in the relationship. In turning that commitment into a successful business strategy for banks, we find five elements critical to implementing a superior customer-journey and -experience transformation at scale.

Hardwire customer experience to value

The financial benefits of improving customer experience are clear. One bank found that customers willing to promote the bank were four times more likely than neutral customers to add additional products. These customers also typically saw the bank as their main financial institution—a key driver of overall lifetime revenue. Many customer-experience programs are launched from analyses such as this. However, few of these programs home in on where the value comes from. In addition, many do not hold themselves accountable for delivering greater profitability. Without a quantified link to value and a sound business case, transformation efforts can't show early gains, build momentum among functional executives, or earn a seat at the executive team's table.

To that end, we find it useful for banks to apply the same rigorous value attribution to customer experience as they do to productivity programs. One US payments company, for example, used fine-grained customer feedback coupled with advanced analytics to identify customer pain points that were driving problem calls to its call center. Managers selected the five customer journeys that drove about 20 percent of calls and redesigned them with the aim of eliminating all those calls. During implementation, the team realized that it had a broader opportunity for improving the vast majority of its customer-service interactions over a period of several years.

Stay agile to ensure scalability

While the overall transformation needs to be broken up into manageable work efforts, setting up for scale should be the goal from the first day. Too often, retail banks build oversized bespoke teams and processes to address individual customer journeys without adequate ways of collaborating across functions and measuring progress.

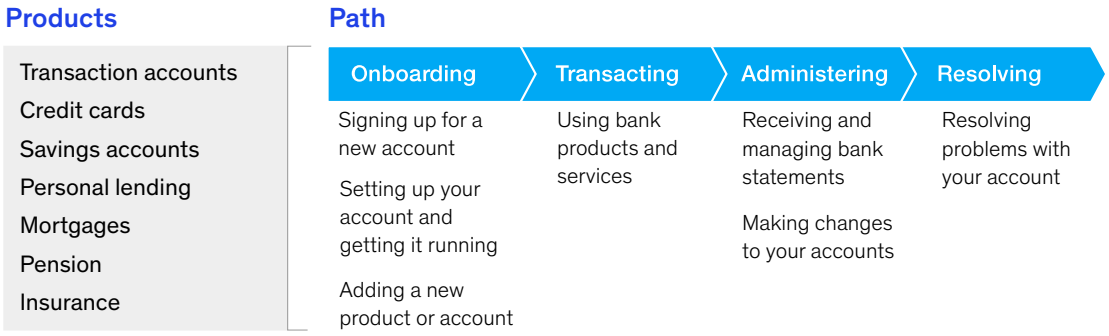
One global bank sought to take customer satisfaction to a higher level to break away from the competition. Managers set out to systematically reengineer key steps along customer journeys but found they were inhibited by the lack of a common language to define those journeys. Executives on the marketing side thought about life events, while product owners viewed the customer experience through the lens of purchasing products. Without a common language, the bank struggled to approach customer-experience transformation in a uniform way across functions, handcuffing efforts to collect the right facts to jointly identify and resolve pain points.

A breakthrough came when the team was able to collaboratively define a simple and pragmatic taxonomy arranged by products and across steps in the key banking customer journeys (Exhibit 2). The common language achieved could then be used to broaden the customer-experience transformation across multiple parts of the organization.

The next step was to systematically redesign and reengineer the customer journeys at scale. In order to provide senior management with a consistent way of discussing the status of journey redesign, bank managers set out to define a common “maturity” model that could be applied across all journeys.

Exhibit 2

A simple taxonomy of journeys combines a product and a path.



The maturity model addressed four key gates to pass through on the way to customer-experience improvement (Exhibit 3). The work at level one was to establish a fact base behind prioritized customer journeys: for example, learning what truly drives customer experience and satisfaction in securing a home loan.

At the next level, the team defined an overall target for improving the journey and established an "agile studio" to stimulate solution ideas and execute improvements. Such sprints took place over periods of two to four weeks. At the third level, the team mapped pain points to the underlying elements for each critical step in the journey and their importance to the overall customer experience. In this case, the real issue for customers was how the bank delivered the conversation about loan pricing. Against this deeper understanding of the sources of customer dissatisfaction, the team was then able to put in place an iterative process of developing and testing rapid prototypes of minimum viable products and refining knowledge with each new application.

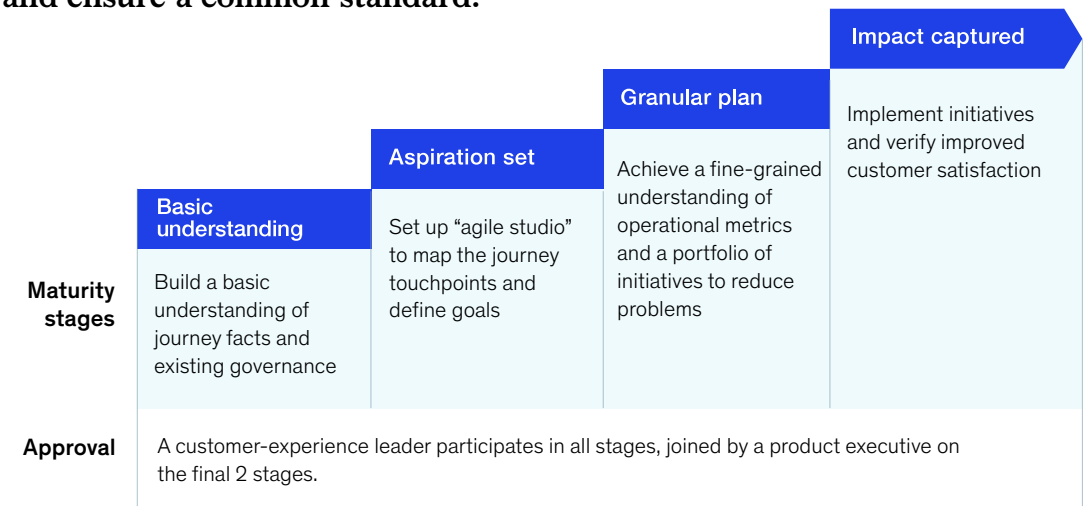
The end result: a set of actions that encouraged earlier, better conversations with the customer on price. Throughout the process, the team also continuously tracked impact via customer and employee feedback. Over a period of nine months, the bank registered a 15-point improvement in customer satisfaction for its home-loan journey, from a score of negative five to ten.[2]

This bank's story is not unique. Banks struggle to pursue customer-experience transformation amid the complexities of running their day-to-day business. But by combining a common taxonomy with a structured maturity model, it is possible to quickly identify customer pain points and to create minimum viable products. Agile, iterative testing then allows a team to test new approaches, learn from failure, and refine and start over again at a high metabolic rate. This approach can produce value early and provide the successes to build momentum and secure ongoing support from the organization.

[2] On a scale ranging from negative 100 to 100.

Exhibit 3

A journey maturity model can govern the transformation of each journey and ensure a common standard.



Don't forget the customer

Even banks that have thoughtfully created a flexible, iterative improvement process at times inadvertently overlook the most critical stakeholder: the customer. In the rush to digitally enable customer journeys and transform the customer experience, it's easy to be swept away by a bias for technological solutions. But key customers can easily become skeptical about not having a human representative to call when things go wrong. The right balance requires study, but when interactions are new or particularly complex, the personal touch is still an important differentiator of customer service. Without an explicit link to and inclusion of the customer, no transformation will ever be fully right.

Similarly, gathering and segmenting data are classic starting points in understanding customers. But data by themselves are insufficient. The most successful customer-experience efforts apply a human filter to collected information to address key questions about the motivations and wishes of customers. Some of the successful transformations we've observed have included customers in their design via a variety of techniques, such as structured interviews, customer panels, zero-based-design workshops, and having executives spend time in call centers and branches to experience firsthand what customers encounter and to shape customer-centric responses.

Continuously push for more value

Improving customer journeys is not a linear process. Often the first round of initiatives will not deliver the desired satisfaction levels. Moving from good improvement to great will require regularly going back to the drawing board and maintaining patience and a mind-set of always pushing for more in the interest of customers.

One European bank established a rhythm of regularly recurring customer-journey improvements. At the beginning of its customer-experience transformation, it identified and redesigned each of its most important journeys. Since then, it has reconvened its cross-functional customer-experience teams at regular intervals of 12 to 36 months, depending on the importance of the journey under review. In these "hot periods," lasting several weeks, the teams react to all customer feedback that requires structural adjustments larger than can be handled alongside day-to-day operations. Concentrating this work effort in a cross-functional team is an effective way for the bank to regularly optimize journeys.

Such a continuous-improvement regimen can help foster a superior customer-experience mind-set. One way to enable continuous improvement is at the front line, with employees closing the loop with customers on direct feedback, then using those insights to change the way the process is designed. A continuous-feedback loop also informs improving service design. Product companies understand better than do banks and other service organizations that using customer insights is a way to develop a superior product. But banks have rarely invested the same way in service design. Creating a pipeline of feedback and actions, rather than simply reporting metrics, is one way to ensure that the customer's voice is always present in any transformation effort.

Establish a cross-functional team with C-suite backing

Transforming customer experience in a bank requires bringing stakeholders from distribution, product, risk, legal, pricing, and other departments to the table. These groups often have conflicting agendas or timelines. Overcoming such barriers requires active sponsorship from the top.

Leaders in customer experience pursue a number of approaches to deal with this kind of complexity. One way is to set up a dedicated customer-experience organization within the bank. Dedicated teams encourage a continuous focus on customer experience across product, service, and geographical silos. In contrast, trying to fit customer-experience team members seamlessly

into the existing organization can wind up emphasizing narrow customer touchpoints, which reduces effectiveness. In all cases, the CEO must make customer experience a priority, and in some cases, the appointment of a chief customer officer can serve to underline that commitment.

The benefits of superior customer experience—bottom-line results and stronger customer and frontline-worker loyalty—are not lost on banks. By keeping a focus on the handful of elements central to successfully transforming customer journeys, banks can tap into those benefits for durable competitive advantage.

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Part

03

Next-generation levers and technologies

Payments disputes in banking: A pathway to deeper customer relationships

Transforming the disputes-resolution process can provide banks with an opportunity to solidify bonds with their customers while driving down costs.

by David Deninzon, Vijay D'Silva, and Rohit Sood

Card-related payments disputes between customer and merchant occur in fewer than one percent of transactions, but these moments can have an outsized impact on bank-customer relationships. The cornerstone of these relationships is trust—trust that customers' deposits are safe and that they can dispute a charge or transaction and get a quick, factual answer.

For customers, disputes can be a source of frustration and inconvenience. For banks, disputes are expensive to resolve. If banks treat disputes simply as issues to be minimized, they can miss the silver lining—that is, the opportunity to strengthen their relationships with customers.

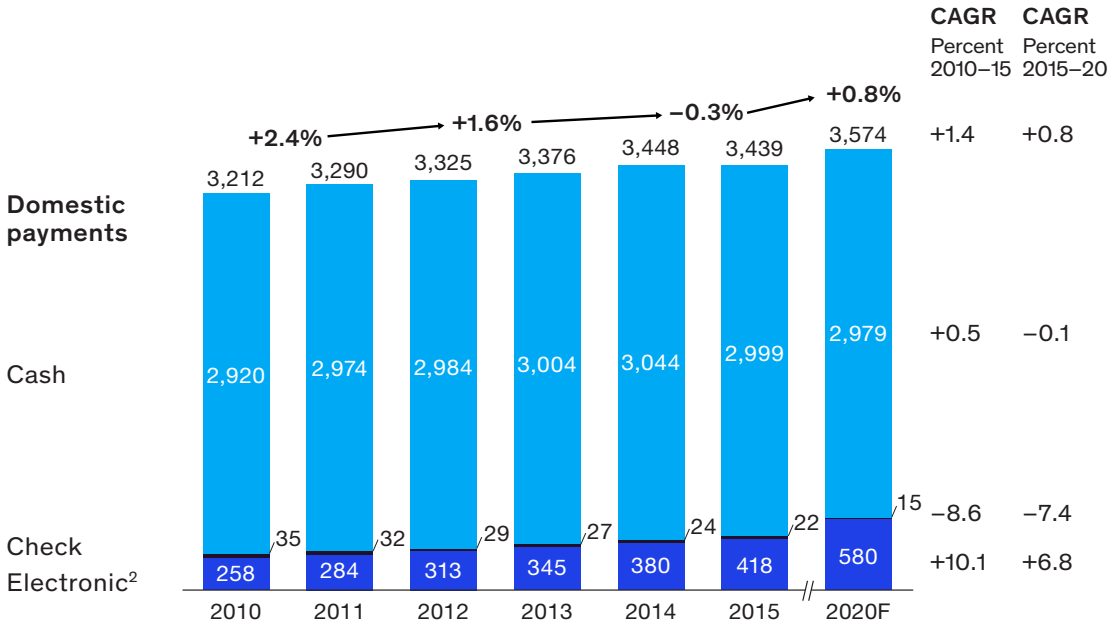
This point is particularly important today. Globally, customers continue to move away from cash and checks toward electronic payments (Exhibit 1). Overall, this trend is a positive development for banks and card issuers, but as card transactions grow, so does the number of disputable transactions (and the incidence of fraud), putting pressure on disputes processes that often are already overextended, and leading to increases in operating costs of hundreds of millions of dollars.

As they benefit from growth in credit- and debit-card use, in other words, banks and card providers must ensure that the customer experience is not degraded. A number of banks are therefore rethinking the way they manage disputes, with an

Exhibit 1

Electronic payments continue to gain share, increasing the pool of payments that can be disputed.

Global payment volumes,[1] number of transactions, $ billion



[1] Cash deposits and withdrawals are not included.
[2] Includes direct debits, credit transfers, and card transactions.

Source: McKinsey Global Payments Map 2015

eye toward maintaining and even strengthening their trust-based customer relationships—all while processing disputes more cost-efficiently, at lower regulatory risk.

Complex operating models and other obstacles

Today, most banks face a number of costly obstacles as they seek to address a rising number of card disputes:

— *Complex operating models.* Most banks' traditional, budget-controlled functional structures lack a clear, end-to-end chain of responsibility for the disputes experience. The operating model's complexity obscures distinct ownership of the client experience, and in some cases, there is a definitive separation among the functions required to take in and resolve disputes (the call center, disputes research, and back office, for example). This disjointed model leads to more customer pain points and delays in time-to-credit and overall disputes resolution. To exacerbate matters, most disputes organizations are scattered geographically—some US-based banks have as many as 15 disputes-resolution locations—which intensifies operational complexity.

— *Overprocessing of disputes.* Banks and issuers usually process all disputes above $25—regardless of dollar amount, customer, or the merchant's disputes history—and apply the same process across the board. This lack of triage allows disputes volume to rise and puts pressure on disputes teams to process disputes quickly to lower costs and avoid regulatory infractions.

— *Long, complex research process.* In most banks, the disputes process involves multiple IT systems and tends to be driven by the technology the bank has rather than the technology it needs. In some cases, banks must turn to third parties to conduct additional research on fraud. For example, banks usually have a case-management system to make decisions about disputes, but analysts often have to leverage other systems (ATM camera recordings or ACH platforms, for example) to access information needed for the decision.

— *Ineffective quality assurance.* At some banks, the process of reviewing disputes decisions is overly focused on checking regulatory boxes rather than on the overall accuracy of the decision. Banks and issuers thus miss the opportunity to catch and fix incorrect decisions. This problem is especially prevalent at larger institutions, where intense regulatory scrutiny often inadvertently makes compliance a higher priority than quality control. Instead, leading banks are now embedding regulatory checks into more effective disputes processes.

— *Inadequate performance management.* Process complexity of the kind that characterizes disputes resolution at most banks results in highly variable individual performance. As mentioned, banks are often overly focused on preventing regulatory violations at the expense of performance. McKinsey has seen differences in productivity of more than two and a half times between the top and bottom quartiles of disputes-research analysts who process disputes. Limited use of metrics, a lack of individual- and team-performance targets, and a dearth of fact-based coaching to improve individual performance and identify problems all exacerbate the challenge.

— *Overreliance on the case-management system.* Years ago, many institutions implemented case-management systems for disputes resolution, with the expectation that the technology would drive down costs. However, most realized only

marginal improvements in efficiency and speed of resolution. In McKinsey's experience, case-management systems deliver full value only when they can integrate effectively with the various systems used to investigate disputes—fraud-prevention, ATM, and transaction-history systems, for example—and can follow a streamlined process to resolve them. Typically, the handle time for resolving a case does not go beyond an hour, but it can take up to five days to provide an answer to the customer.

— *Increasing regulatory focus.* Customer-protection regulations, such as Regulations E and Z in the United States, tighten the timelines for banks to resolve disputes and raise the pressure on teams to process disputes and provide credit faster. However, while providing credit faster alleviates one pain point, many card providers see it as a simply a Band-Aid, leaving the underlying issue unresolved.

Simpler, smarter processing

New insights, tools, and capabilities are emerging that enable banks to address many of the obstacles they currently face in the disputes-resolution arena. An integrated next-generation operating model based on these new capabilities improves the customer experience (providing 100 percent of customers with real-time, provisional credit decisions), reduces costs (with efficiency gains of 30 percent or more) and financial losses (by up to 5 to 7 percent), and lowers regulatory risk (reducing customer-impacting errors by 80 percent). To achieve these results, banks and card issuers can focus on five imperatives (Exhibit 2):

1. Digitize the disputes-resolution process

Digitizing the disputes process dramatically reduces the time and effort required for a customer to file a dispute and for the bank to take in the dispute. Best-in-class institutions are simplifying their intake process—taking a customer-centric view—to the point where customers can file disputes in a couple of minutes on their mobile devices (compared to the ten minutes it takes to do so speaking on the phone). Banks are also streamlining the research process by providing a set of questions that customers must answer up front. Call-center agents and customers no longer have to plow through a questionnaire to understand or explain the dispute.

Traditionally, banks have sought to improve the disputes process through technology investments and process tweaks—leading to only marginal gains. Only banks that have conducted a "zero-based" design of the entire disputes process have achieved dramatic change. Designing a new disputes process from scratch is the only way to truly simplify disputes research policies and requirements. Some banks have increased productivity quickly by categorizing disputes according to their complexity (such as number of transactions or number of different systems required to decision).

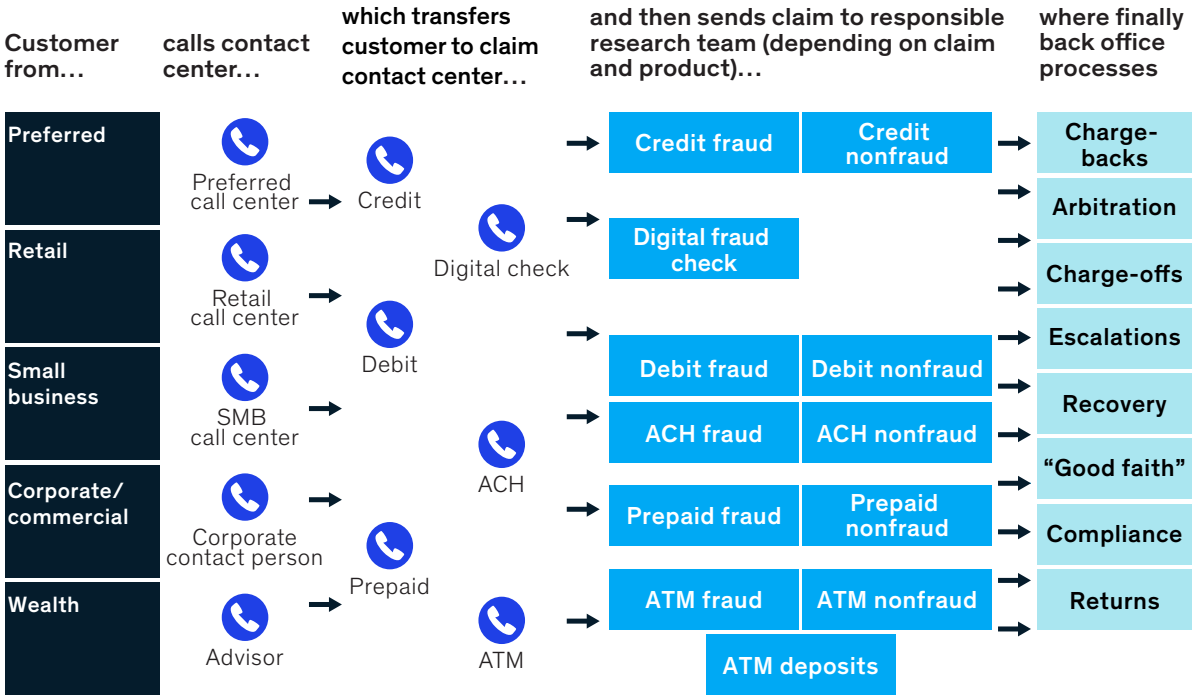
2. Apply advanced analytics

Some banks and issuers are leveraging advanced analytics and machine learning (in which computers "learn" patterns from examples and apply the insights to new data) to predict disputes and fraud (for example, letting customers know that a suspicious transaction has occurred and giving them the option to decline it). While fraud detection has leveraged neural networks for the past two decades, the next generation of models is substantially more powerful, leveraging more data within shorter time spans. These processes work by using dozens to hundreds of variables to determine whether provisional or final immediate credit is the optimal strategy for resolving a particular dispute. Banks are also using analytics to estimate the amount of effort required to research a dispute, based on the customer's history and the merchant profile. The value of such an approach is significant; consider that one regional US bank was conducting a complete research process for all disputes before providing provisional credit, despite the fact that it approved final credit in 98 percent of cases. Advanced analytics also dramatically improves the customer experience by expediting time-to-funds, and it frees up research capacity to focus on more complex and higher-impact disputes.

Exhibit 2

At most banks, silos result in limited end-to-end ownership of the disputes experience.

Simplified example



3. Employ intelligent process automation
Intelligent process automation (IPA), or robotics, is used to automate aspects of the end-to-end disputes-processing value chain. IPA reduces disputes-resolution cycle times, boosts operational efficiency, and improves overall customer experience. The most common use cases include:

— *Fraud prevention.* Advanced analytics flags potentially fraudulent transactions and addresses them before they become disputes. For example, McKinsey has worked with QuantumBlack to develop a model that uses machine learning and a random-forest model to flag potential fraud cases based on 13 months of transaction history.

— *Intake review.* Machine learning identifies the type of dispute (for example, fraudulent versus nonfraudulent or PIN-based versus non-PIN-based).

— *Disputes management.* Advanced analytics is used to separate complex disputes from simple ones and assign them to the appropriate analyst. For example, a US bank used an algorithm to identify complex disputes and matched the disputes to analysts based on the analysts' skill set and the other disputes they were working on that day. The result was less "context changing" and a 10 percent increase in productivity.

— *Disputes processing.* Banks use robotics to collect information automatically and prepare cases for human processing.

— *Post-disputes processing.* Robotics is used to process credits and to send notifications and status alerts to customers.

— *Post-disputes quality assurance on fraud.* Machine learning is used to identify paid disputes cases that need to be audited.

— *Disputes support.* Cognitive agents and robochat functionality can answer customer queries during the disputes-research process.

4. Strengthen management systems

While new technologies offer banks the opportunity to reenvision and redesign disputes processes, there is no substitute for best-in-class management systems. Banks and card issuers that excel at disputes management usually take an end-to-end approach to managing the disputes process. They assign a product owner to the entire disputes process for each product or claim, and that owner is responsible for—and compensated for—delivering better customer experience, quality, and efficiency across intake, research, payout, and communication. Clarity in expected customer outcomes and strong key performance indicators (KPIs)—such as those that measure the process

Sidebar

A disputes transformation

A top 20 US bank recently simplified its disputes process from end to end. Before this effort, the bank's operational costs were rapidly growing, while customers were forced to go through lengthy processes to resolve their disputes—attracting the growing scrutiny of regulators. As part of a bankwide transformation of the customer experience, the bank decided to deliver a next-generation disputes experience to its customers.

The bank focused on three areas: dramatically enhancing the customer experience, simplifying the process to improve speed and quality, and reducing costs. The transformation started with a map of internal and external pain points based on customer insights, frontline interviews, and cross-functional focus groups. The bank then redesigned the end-to-end process to reduce steps and to limit the information needed, installed an advanced analytics model to determine the likelihood of a disputes payout so that more customers could be given immediate credit, and installed a new operating model in the disputes-research areas. A management system that drives continuous improvement supports the new operating model.

These initiatives were piloted with a group of 150 employees for two months before being rolled out enterprise-wide.

The transformation resulted in a 25 percent increase in productivity after two months. About 500,000 customers benefited from immediate credit provisioning, error rates dropped by 80 percent, and the number of customer complaints resulting from disputes dropped by 20 percent. Invigorated by this success, the management team has leveraged this same approach to transform other key customer processes across the bank.

from end to end or those that assess performance from the customer's perspective—help staff to focus on the right goals.

Making the most of disputes

Transforming the disputes-resolution process provides banks with an opportunity to solidify bonds with their customers while driving down costs (see sidebar, "A disputes transformation"). The benefits can be grouped into three broad categories:

— *Strengthening trust.* A quick resolution—and provisional funds when appropriate—can turn a negative customer experience into a loyalty-building moment. Loyal customers tend to feel that their bank "has their back," but it often takes a dispute for them to reach that level of comfort.

— *Cutting operating costs.* McKinsey estimates that the top 15 US banks spend approximately $3 billion each year, combined, on disputes processing. (About 50 million to 100 million disputes occur annually in the United States, with a cost per dispute ranging from $10 to $50.) Implementing the next-generation operating model reduces these operating expenses by 25 to 40 percent.

— *Improving quality.* Given the complexities in the disputes-research process and the pressure to resolve disputes quickly, quality can suffer. McKinsey has seen banks where 10 percent of disputes outcomes are incorrect (both for and against customers). Simplifying and automating the process leads to better decisions.

The disputes process is often overlooked as a chance to build trust with customers. This is a missed opportunity, as the tools and capabilities that will enhance the customer experience can also improve bank outcomes and reduce costs. As banks seek to improve the disputes process, they should look beyond traditional incremental changes and reimagine the process from start to finish. This will not be a simple endeavor, but the rewards can be significant.

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The automation imperative

As many organizations move to build their automation capabilities, recent survey results suggest that certain best practices will differentiate successful efforts from others.

Organizations in every region and industry are automating at least some business processes, yet only a slight majority have succeeded at meeting their targets, according to a new McKinsey Global Survey on the topic.[1] As advances in artificial intelligence, software robotics, machine learning, and innovative technology platforms enable businesses to redefine processes, workplace automation is expected to provide a significant opportunity for improvements in performance and efficiency.[2] Indeed, three-quarters of all respondents say their companies have already begun to automate business processes or plan to do so within the next year. The results also suggest which practices best support a successful automation effort: making automation a strategic priority, deploying technologies systematically, decentralizing governance, ensuring the IT function's involvement, internalizing automation's costs and benefits, and prioritizing workforce management.

Automation, a global phenomenon

Across regions and industries, the survey results suggest that automating businesses is a global phenomenon (Exhibit 1). A majority of all respondents (57 percent) say their organizations are at least piloting the automation of processes in one or more business units or functions. Another 38 percent say their organizations have not begun to automate business processes, but nearly half of them say their organizations plan to do so within the next year.[3] Across regions, respondents in developing markets are just as likely as their peers to report automation activity.

Not surprisingly, the high-tech and telecom industries are leading the way on automation. Three-quarters of respondents in those sectors say they are at least piloting automation in one or more business units or functions. Nonetheless, the results suggest that all industries have been or expect to be deploying automation technologies. At least half of respondents in all other industries say their companies have already begun to pilot or adopt automation.

The results also suggest that larger organizations are leading smaller ones in pursuing automation.[4] Among respondents at large companies, 40 percent say theirs are using automation across the organization or have fully automated processes in at least one function or business unit. At smaller organizations, just 25 percent say the same.

The factors in automation success

Although automation has become commonplace, the results indicate that success is by no means assured. We looked closely at the responses from larger organizations, where automation is more prevalent. Across industries, more than half of large-company respondents say their organizations have seen success to date (that is, their automation efforts have been successful or very successful at meeting targets). The results also point to six practices that the most successful companies tend to employ.

Make automation a strategic priority

According to respondents, organizations with successful automation efforts are more likely than others to designate automation as a strategic priority. When asked about their companies' primary reasons for adopting automation technologies, these respondents are more likely

[1] The online survey was in the field from January 16 to January 26, 2018, and garnered responses from 1,303 participants representing a full range of regions, industries, company sizes, functional specialties, and tenures. Of these respondents, 764 work at organizations that have piloted the automation of, or that have fully automated, business processes in at least one function or business unit. To adjust for differences in response rates, the data are weighted by the contribution of each respondent's nation to global GDP.

[2] For more, see "Harnessing automation for a future that works," McKinsey Global Institute, January 2017, and "What's now and next in analytics, AI, and automation," McKinsey Global Institute, May 2017, both available on McKinsey.com.

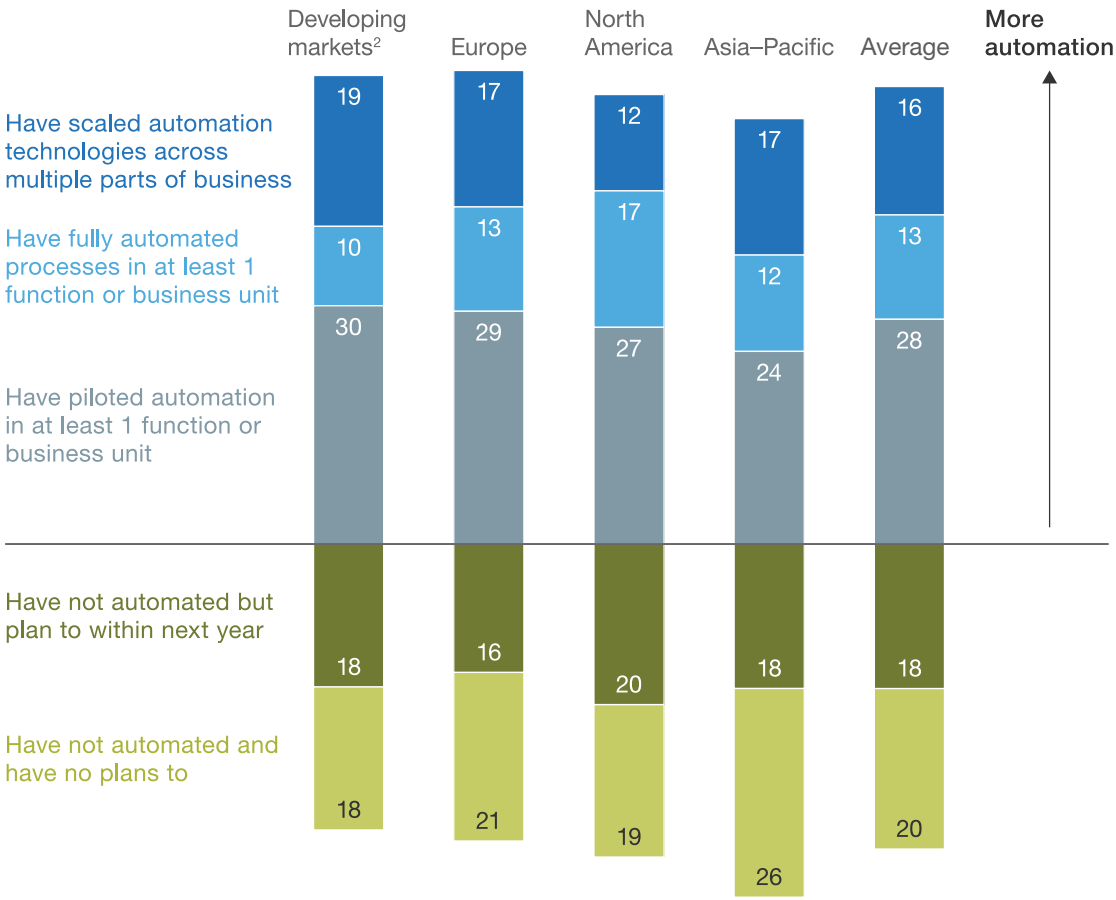
[3] All other respondents (4 percent) say they don't know what actions their organizations have taken to automate business processes. They were not asked the remaining questions in the survey.

[4] "Large companies" are defined as those with annual revenues of $1 billion or more, according to respondents. Those with annual revenues of less than $1 billion are classified as "small companies."

Exhibit 1

Automation is a global phenomenon.

Steps organizations have taken to automate business processes, by office location, % of respondents[1]



[1]Respondents who answered "don't know" are not shown. Total n = 1,303; in developing markets, n = 373; in Europe, n = 479; in North America, n = 281; and in Asia–Pacific, n = 170.
[2]Includes respondents in China, India, Latin America, Middle East, and North Africa.

than others to say automation was defined as a priority during the strategic-planning processes or is required to keep pace with competitors (Exhibit 2).

Deploy automation technologies systematically

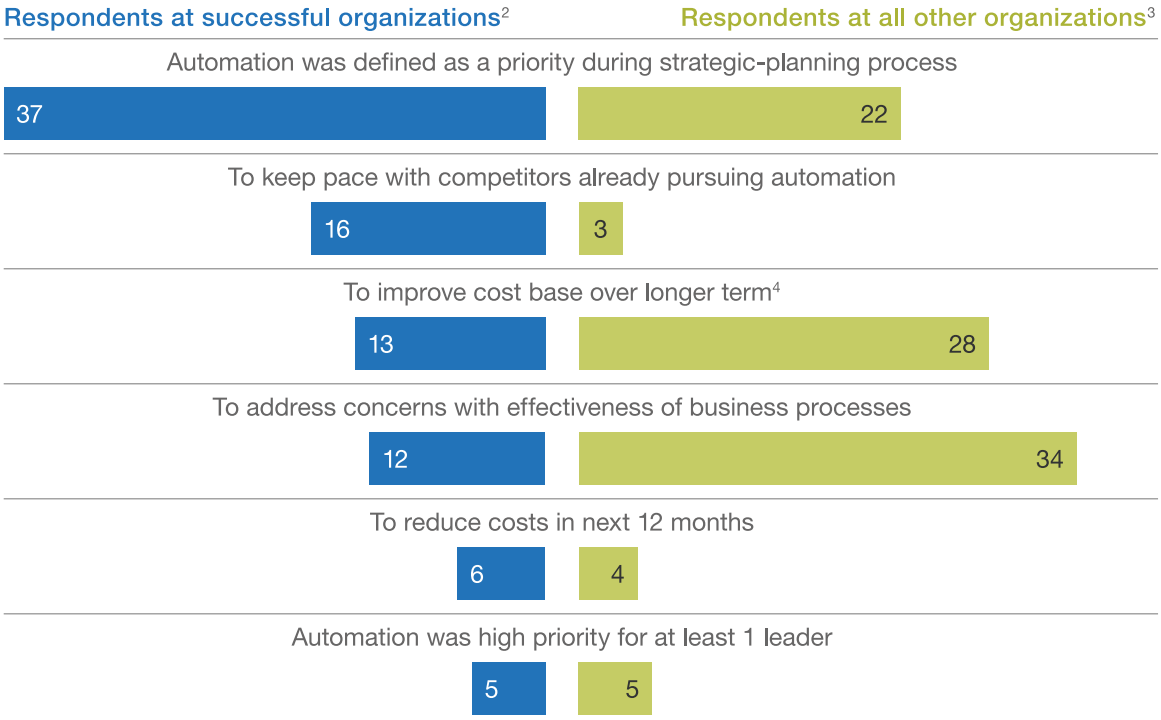
While automation success is possible through either traditional top-down (waterfall) deployment or more-flexible agile methods, a systematic approach is key. Only 5 percent of respondents at successful companies say their deployment methods have been ad hoc, compared with 19 percent of peers not reporting success (Exhibit 3).

What's more, successful organizations are implementing different automation technologies from the ones other organizations are adopting. Respondents with successful automation efforts are more than twice as likely as others to say their

Exhibit 2

Organizations with successful automation efforts are more likely than others to designate automation a strategic priority.

Primary reason for pursuit of automation, % of respondents at large organizations[1]



[1]Respondents working at organizations with annual revenue of $1 billion or more, n = 162. Respondents who answered "other" or "don't know" are not shown.
[2]Respondents who say their companies have been successful or very successful at meeting targets for automation efforts.
[3]Respondents who say their companies have been unsuccessful, very unsuccessful, or neither successful nor unsuccessful at meeting targets for automation efforts.
[4]That is, next 2–3 years.

organizations are deploying machine learning (Exhibit 4). They are also more likely to cite the use of other cognitive-based automation capabilities, such as cognitive agents and natural-language processing.[5] At respondents' organizations overall, the most commonly adopted automation technology is robotic process automation, which respondents say is deployed in equal shares of successful and other organizations.

Decentralize governance

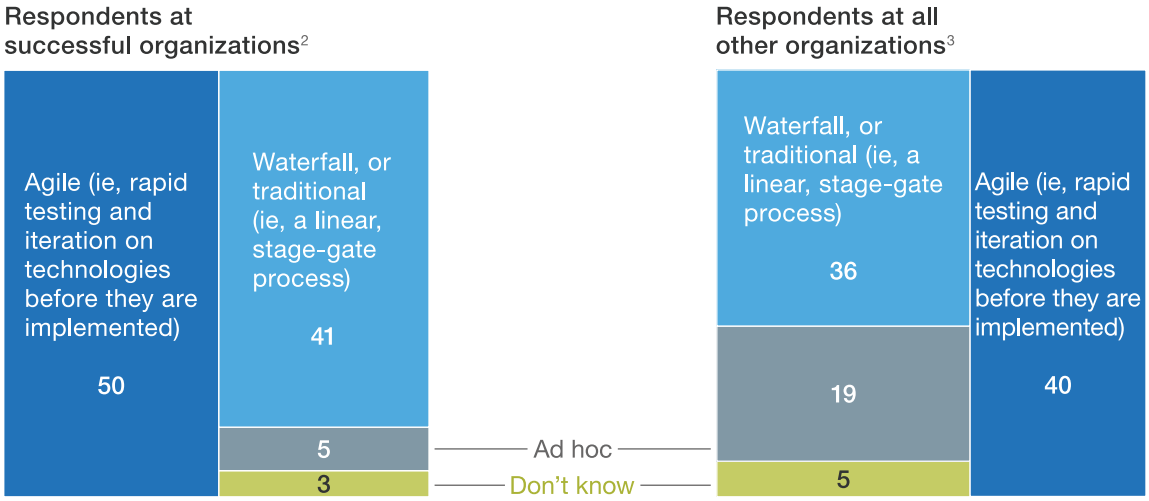
Another differentiator of automation success, the results suggest, is the way programs are organized. The results favor decentralization. Respondents at successful organizations are more likely than their peers to say their functions or business units are accountable for delivering automation efforts, with or without support from a central team. Conversely, respondents at less successful organizations are

[5]For more on the changing demand for cognitive work, see "Skill shift: Automation and the future of the workforce," McKinsey Global Institute, May 2018, on McKinsey.com.

Exhibit 3

Success with automation is most often achieved with a systematic approach to deploying technologies.

Organizations' process for deploying automation technologies,
% of respondents at large organizations[1]



[1]Respondents working at organizations with annual revenue of $1 billion or more, n = 162. Figures may not sum to 100%, because of rounding.
[2]Respondents who say their organizations have been successful or very successful at meeting targets for automation efforts.
[3]Respondents who say their companies have been unsuccessful, very unsuccessful, or neither successful nor unsuccessful at meeting targets for automation efforts.

more than twice as likely as those at successful ones to say a central team is solely responsible for automation delivery across the organization.

Ensure the IT function's involvement

The success of automation programs also relies on the early engagement of the IT function, according to respondents from organizations with successful efforts. First, these organizations' IT teams are more likely to have automated their own processes.[6] Furthermore, IT's involvement in the automation effort also is a differentiator of success. More than 75 percent of respondents from successful organizations say IT was involved in initial discussions of automation projects, compared with 58 percent of all other respondents (Exhibit 5). By contrast, just 13 percent of respondents who consider their automation efforts successful say IT was not brought onboard until pilots were already underway.

Internalize both costs and benefits

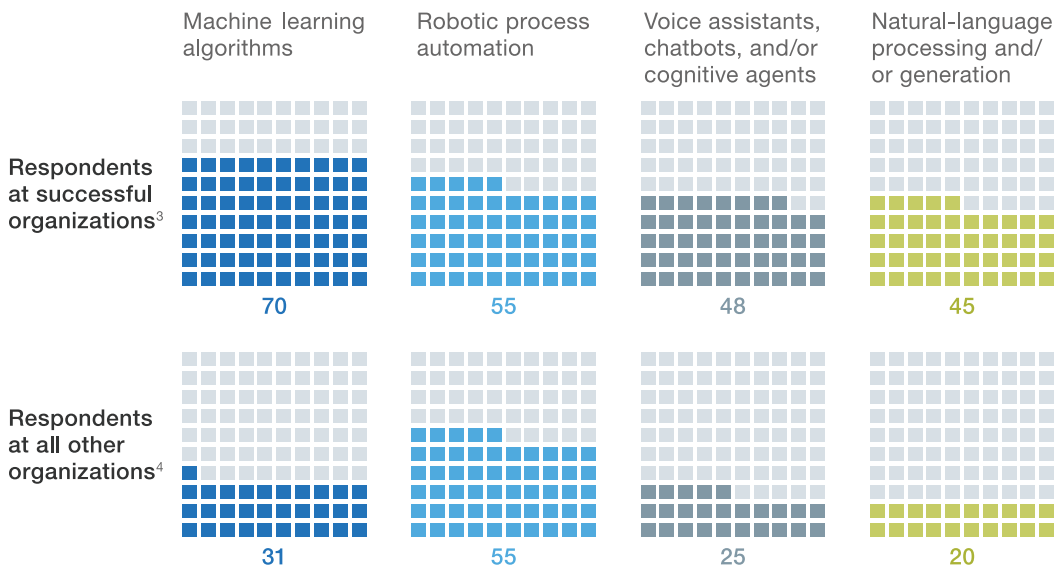
Successful and less successful automation efforts also diverge in regard to management's understanding of the total cost of ownership (TCO).[7] Half of respondents with successful automation

[6]Among large companies, 75 percent of respondents who report successful automation efforts say their IT functions have automated at least one business process, compared with 56 percent of all others.
[7]For more information on optimizing total cost of ownership, see Kalle Bengtsson, Tyler Duvall, Samuel Magid, and Robert Palter, "Releasing the pressure on road agencies," February 2011, McKinsey.com.

Exhibit 4

Success-group respondents are twice as likely to report deployment of machine learning, cognitive agents, and natural-language processing.

Automation technologies currently deployed in production,[1]
% of respondents at large organizations[2]



[1]That is, deployed beyond the piloting phase.
[2]Respondents working at organizations with annual revenue of $1 billion or more, n = 162. Respondents who answered "other" or "don't know" are not shown.
[3]Respondents who say their organizations have been successful or very successful at meeting targets for automation efforts.
[4]Respondents who say their companies have been unsuccessful, very unsuccessful, or neither successful nor unsuccessful at meeting targets for automation efforts.

efforts say their leaders understand very well the TCO for automation projects. Only 7 percent of peers at other organizations say the same. That said, respondents report similar benefits from their automation efforts, regardless of their success to date at meeting targets. The most common benefit reported is reduced costs, identified by about one-third of all respondents.

Prioritize workforce management

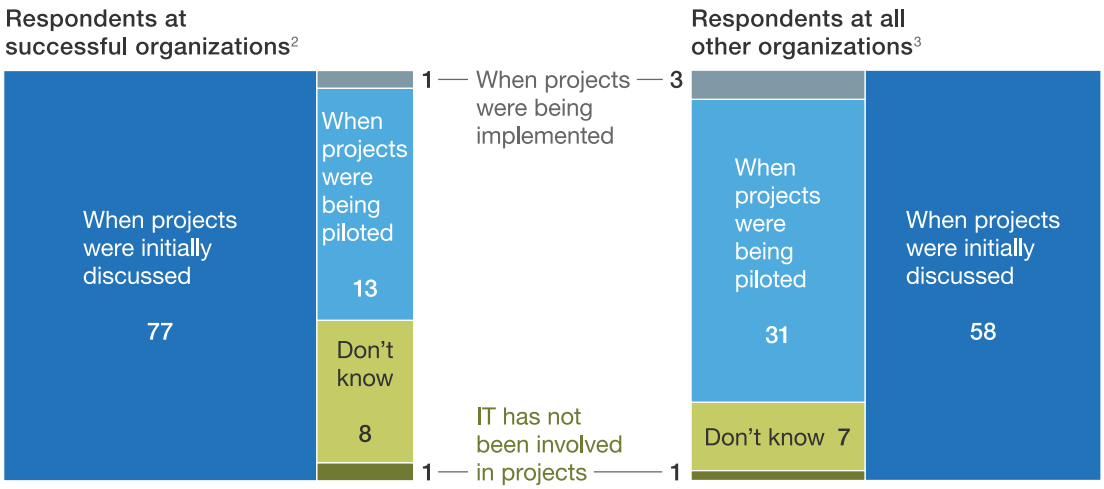
Among all large organizations reported to be pursuing automation, a majority of respondents predict that their companies will face automation-related skill gaps in the future. Only 8 percent believe there will be no gaps to address. And while most respondents say addressing potential automation-related skill gaps is a top ten priority for their organizations, respondents at successful organizations are more than three times likelier than others to consider the effort a top five priority (Exhibit 6).

What's more, organizations with successful automation efforts are more likely than others to report concerns about talent acquisition. They are five times likelier (40 percent, compared with 8 percent) to say acquiring employees with the right skills will be their organizations' most significant automation-related challenge in the next three years.

Exhibit 5

Successful automation efforts tend to involve IT early.

Project stage when central IT groups were first involved in automation planning,
% of respondents at large organizations[1]



[1]Respondents working at organizations with annual revenue of $1 billion or more, n = 162.
[2]Respondents who say their organizations have been successful or very successful at meeting targets for automation efforts.
[3]Respondents who say their companies have been unsuccessful, very unsuccessful, or neither successful nor unsuccessful at meeting targets for automation efforts.

What success looks like at small companies

Smaller companies are less likely than larger companies to automate processes, but their success rate is higher. The findings from these organizations show that several differentiators for success hold true regardless of company size.

As with large companies, IT's involvement in small companies' automation efforts is greater at successful companies. More than 80 percent of respondents at successful small companies say their IT functions were involved in the initial discussion phase of planning for automation projects, compared with two-thirds of respondents at other small companies. And 64 percent of respondents from successful small companies report the automation of at least one business process in IT, compared with 41 percent of their small-company peers.

Understanding costs also is a marker of success at smaller firms. At successful small companies, nearly half of respondents say their leaders understand the total cost of ownership of automation efforts very well or completely, while only 28 percent of respondents from other companies say the same. The findings also suggest that automation-related talent management is top of mind for leaders at successful small companies. And like their large-company peers, respondents from the most successful small companies are likelier than others to say that addressing potential automation-related skill gaps is at least a top ten priority for their organizations.

Exhibit 6

Successful organizations are more likely to make potential automation-related skill gaps a priority.

Importance of addressing potential automation-related skill gaps compared with other priorities, % of respondents at large organizations[1]

[1]Respondents working at organizations with annual revenue of $1 billion or more, n = 162. Respondents who answered "don't know" are not shown.
[2]Respondents who say their companies have been successful or very successful at meeting targets for automation efforts.
[3]Respondents who say their companies have been unsuccessful, very unsuccessful, or neither successful nor unsuccessful at meeting targets for automation efforts.

Looking ahead

The findings from this survey can be applied to organizations at all stages of the automation journey. Depending on an organization's current state, its leaders can take several steps to reap the rewards of automation.

— *Prioritize automation.* Organizations that are just launching automation programs would benefit from making automation a strategic priority from the outset. Ways to put this in action include defining clear strategic objectives for automation, having an executive sponsor for the program, beginning automation work with a comprehensive understanding of both the costs and benefits, and making automation an enterprise-wide, rather than functional, mandate.

— *Focus on roles and people.* Organizations that are struggling to implement automation successfully would do well to elevate the role of IT—for example, involving the function often and as early as possible in all future efforts. These organizations also should take a discerning look at workforce management. This includes development of an approach to capture value from automation and an assessment of the skills and new roles for the workforce that accompany future-state automated processes.

— *Expand ownership and adoption.* Finally, organizations that are successfully deploying automation technologies should also look to expand the governance of and buy-in on automation. They can benefit from encouraging a truly enterprise-wide program and pursuing more advanced cognitive automation technologies. Structuring automation programs to be technology neutral will allow organizations to keep pace with the rapid advances being made, rather than rethinking their approach every time they adopt a new technology.

The contributors to the development and analysis of this survey include **Alexander Edlich**, a senior partner in McKinsey's New York office; **Fanny Ip**, an associate partner in the Southern California office; and **Rohit Panikkar** and **Rob Whiteman**, an associate partner and partner, respectively, in the Chicago office.

They wish to thank Gary Herzberg for his contribution to this work.

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Using analytics to increase satisfaction, efficiency, and revenue in customer service

Payments providers that adopt advanced analytics to develop integrated approaches to customer service are seeing significant improvements.

by Krishna Bhattacharya, Greg Phalin, and Abhilash Sridharan

As payments providers around the globe cope with increasing pressure on revenues and margins, customer service is increasingly becoming an important asset for driving top- and bottom-line performance and improving the customer experience. While most banks, card companies, and other payments providers have implemented various degrees of customer-service transformation by using advanced analytics, the discipline has yet to be fully leveraged in this regard. To realize the full potential of today's analytical capabilities, financial institutions will need to possess, acquire, or develop the relevant capabilities and use them to customize and enhance a wide range of customer interactions.

Payments providers that adopt advanced analytics to develop broad integrated approaches are seeing significant improvement: customer satisfaction scores rose 5 to 10 percent and operating costs declined 15 to 20 percent when they used analytics to eliminate cross-channel leakage and migrate more customer interactions into self-serve channels. Analytics also enabled these firms to improve customer retention and revenues by 10 percent or more, by enhancing the customer journey and improving cross-selling.

The future of customer service

Customer service is shifting dramatically, from phone and branch-centric models to an omni-channel interaction dynamic in which customers move seamlessly among service channels, including mobile, phone, chat, and online. A McKinsey survey in 2015 showed digital channels accounted for 30 percent of customer interactions. We expect this share will approach 50 percent by 2020, and of this, 26 percent will be exclusively digital, with no branch interaction.

Payments customers expect high-quality service across channels, similar to what they enjoy at other financial institutions and leading service providers such as Amazon and Zappos. To deliver this level of service, payments firms need to optimize customer and prospect telecommunications and deliver seamless omnichannel interactions.

Building an omnichannel customer-service model

Traditionally, financial institutions have tried to optimize customer service within channel silos, including call centers, online, and mobile. The key to delivering a high-quality omnichannel experience is adopting a broad customer-journey approach that integrates customer interactions across digital and traditional channels. Several institutions have already embarked on implementing such a model. A global life insurer, for example, recently developed a five-year plan to migrate nearly half of its customer journeys into self-serve channels. However, too often such changes are viewed as one-time efforts rather than as a large-scale transformation. Designing a comprehensive, ongoing program is key to sustaining omnichannel service improvements.

Investing in the talent to transform

A key part of transforming the customer experience is migrating basic transactions to self-service channels and complex transactions to agent-assisted channels. While most organizations invest in ongoing agent training and capability building, transforming the customer experience demands a more substantial investment in talent. It requires investing in technology that enables customer-service professionals to have more effective interactions with customers. For example:

— Real-time coaching software, such as Cogito, provides live feedback about customers to agents during customer calls so that agents can tailor the discussion to customer needs.

— Applications such as Verint use speech analytics that foster more personalized interactions with customers.

To provide more personalized customer service, financial institutions must rethink how they interact with customers and prospects. Analytics can personalize customer experience by, for example, identifying the next-best action or product offering.

Investments in technology are, of course, critical to transforming the customer experience. Two investment types in particular are key: developing the agility to rapidly build, pilot, and launch a broad transformation; and robotics or artificial intelligence (AI) to reduce manual workloads, improve cycle times, and minimize back-office errors. McKinsey research shows that 65 percent of back-office tasks at contact centers, and 30 to 50 percent of frontline calls, can now be automated.

Six hallmarks of analytics success

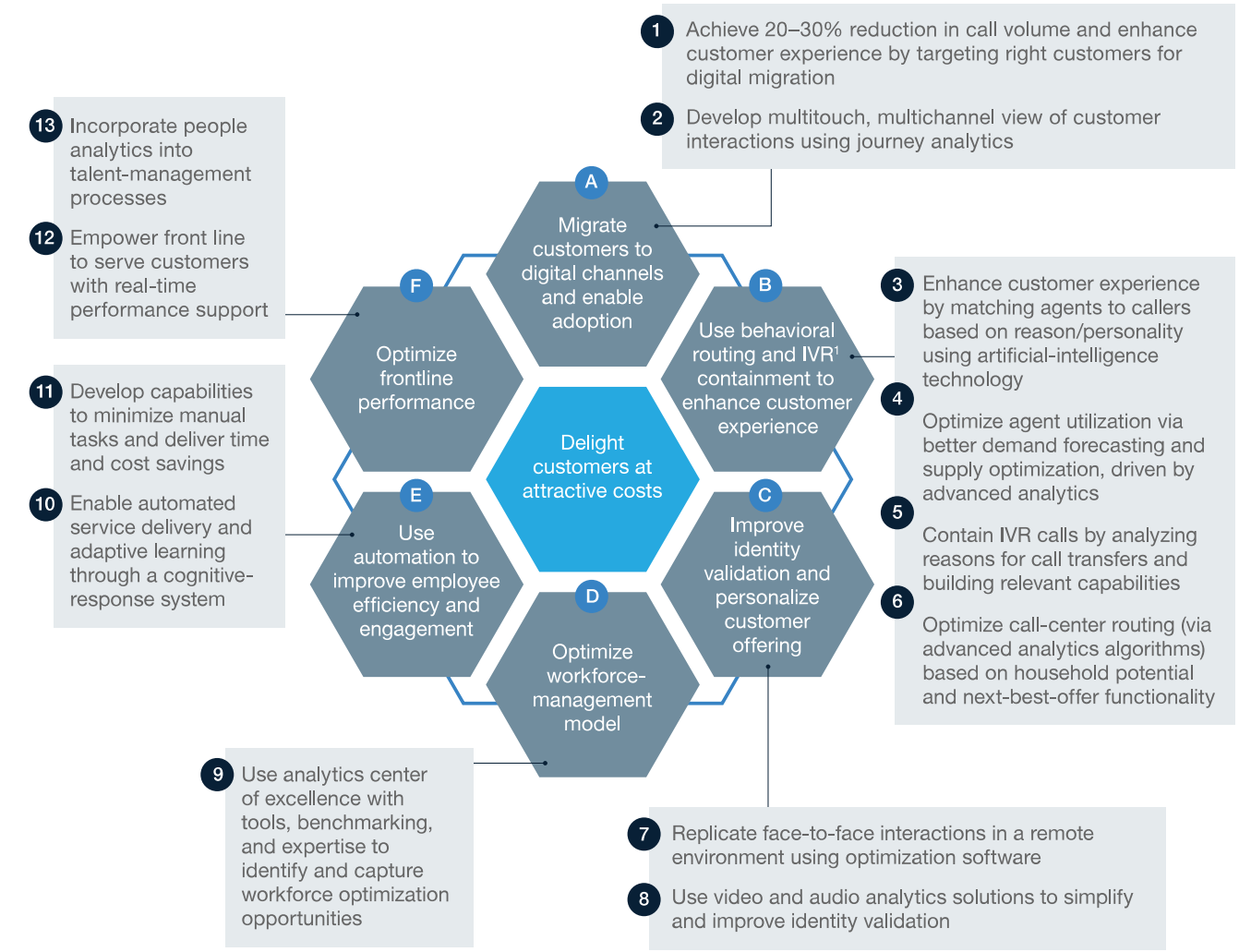
Financial institutions that are successfully using advanced analytics to enhance the customer experience share six common hallmarks (Exhibit 1).

1. Migrating customers to digital channels

Given customers' preference for omnichannel service, there are two important questions financial institutions must address. First, how do they create seamless transactions for digital natives, who

Exhibit 1

Analytics use cases in customer care center around six core imperatives.



[1]Interactive voice response.

prefer digital-only service? Second, in serving less-digitally-inclined customers, how can financial institutions use tools such as journey analytics to prevent the use of multiple channels for the same query? The main challenge for customer-service organizations is to identify the most appropriate transactions for migration and to ensure they are completed satisfactorily in digital channels whenever possible. Payments leaders in digital migration are achieving 20 to 30 percent reductions in call volume and successfully enhancing the customer experience. Some industry leaders are also developing a 360-degree, multitouch, multichannel view of customer interactions using journey analytics, but this requires robust integrated data sets that can capture customer interactions across channels.

2. Improving behavioral routing and IVR containment

Financial institutions have been using interactive voice response (IVR) technology for several decades, but few have optimized these capabilities. Doing so requires more than investing in additional IVR capabilities. Financial institutions can apply advanced analytics or AI-based technologies to improve behavioral routing and IVR containment:

— Using analytics to identify reasons for call transfers can help increase the number of interactions contained within the IVR environment. Deeper analysis of calls can classify customers into clusters based on value, behavior, and tenure, speeding up IVR service and streamlining unnecessary trees.

— Matching agents to callers based on personality (using technologies such as Afiniti and Mattersight) can meaningfully improve customer experience and call efficiency.

— Directing calls from high-potential customers to agents trained to present tailored products (using algorithms based on the customer's needs) can boost productivity.

3. Strengthening identity validation and personalizing product offerings

The layering of analytics on video and audio channels can improve identity validation and personalize the product offering. Examples include:

— Replicating face-to-face interactions in a remote environment using optimization software enables more personalized and secure interaction.

— Identity validation can be simplified and improved with features such as facial recognition (online identification) and voice recognition (in app account access).

4. Optimizing the workforce-management model

Most financial institutions have established internal analytics centers staffed with experts working to capture workforce-optimization opportunities. Yet, most workforce-management practices are rooted in backward-looking general demand-supply matching, assuming some average service level for a day. However, customer research reveals that assumptions of averages fall short. There are three important challenges for each financial institution:

— How can they effectively manage the tails that drive customer satisfaction or dissatisfaction?

— How can they use machine learning to manage resiliency and drive the next level of predictive modeling on demand (for example, impact of hurricanes)?

— How can analytics centers use real-time simulation tools to create efficiencies in workforce management?

5. Automating to improve employee efficiency and engagement

Thus far, automation has not been systematically applied in the customer-service environment. In customer care, AI can be used to automate services by supporting customers with virtual agents and

contact-center agents through real-time interaction tools (such as automated knowledge-management systems) and back-end automation (such as robotic process automation). Virtual agents can solve customer requests by using natural-language-processing technology and get smarter over time through machine learning. For example, programs such as IPSoft's Amelia can play the role of any customer-service agent by rapidly absorbing call logs, recognizing emotional context, and interacting with customers, thereby lowering costs and lifting both revenue and customer experience. With large tech players moving into the digital-assistant arena, we expect things to evolve quickly in this area.

6. Optimizing frontline performance through analytics in recruiting

Recruiting processes for customer-service organizations are seldom informed by what makes agents successful. Leading firms take an approach called people-analytics methodology, which reverse-engineers the process, starting with the best customer-service agents and identifying common traits that make them successful. They then apply these insights at the top of the recruiting funnel in selecting candidates. By applying people analytics in this way, financial institutions can improve talent management in customer experience as well as in the wider organization.

Case example I: Improving digital-channel experience and digital adoption

Recently, a North American bank used journey analytics to accelerate digital adoption across its customer base. Using analytics and design thinking to address digital-adoption levers across customer journeys (rapid digitization, containment, signature moments, customer targeting), the bank achieved a gain of more than 20 percentage points in digital engagement. The initiative included the following elements:

— *Journey-level scan:* Using interaction data and analytics from all channels (digital, call, branch, email/text, ATM), the bank prioritized about 15 core customer journeys and more than 40 subjourneys for digitization.

— *Quantified journey redesign:* The bank then redesigned each core journey using analytics-based quantified experience design (QED),[1] leading to an increase in digital engagement of 10 to 15 percentage points and similar improvements in customer-experience measures. Analytics drills targeted key drivers of customer experience and other cross-cutting themes.

— *Real-time customer nudging:* The bank introduced a customer-targeting process based on customer behaviors and journeys to accelerate digital adoption, which generated a 5- to 10-percentage-point increase in product adoption.

— *Journey tracking:* The bank transitioned from an overall customer-experience-based performance-measurement system to one based on operating drivers for each journey and channel, to track improvements and reorient the program.

— *Capability building:* Using journey analytics and QED, the bank designed and launched a capability-building program for more than 800 contact-center agents.

Case example II: Enhanced contact management

A credit-card company was struggling to migrate customers to its self-serve channels despite having invested in natural-language-speech IVR. Consequently, it devised a three-pronged approach to accelerate migration, which focused on resolving

[1] QED is a data and design methodology that helps executives prioritize and implement customer-journey designs and helps designers focus on features that will maximize value for customers. For more insight, see "Design, meet data: Unlocking design ROI," November 2016, McKinsey.com.

(and containing) a higher percentage of calls within its IVR, and delivered a differentiated experience along the customer journey:

1. To better understand its customers' behavior, the company analyzed five million customer calls. With these findings, it classified customers into eight archetypes based on their value, behavior, and length of time as customers.

2. Management also used brainstormin techniques to develop and refine several initiatives based on feasibility, potential economic impact, and customer-experience improvement. This generated 48 prioritized initiatives that spanned IVR (for example, capture additional information and make it less easy for customers to "rep out"), routing (for example, adapt service standards to match expectations of different customers), and post-IVR (for example, focus on education and self-service awareness for disengaged customers).

3. The company also surveyed 1,500 employees, conducted focus groups that engaged managers, and surveyed more than 1,000 customers to explore tactics for increasing IVR containment and digital engagement.

Through these efforts, the credit-card provider identified 200 to 500 basis points in potential improvement in the containment rate (Exhibit 2). The IVR enhancements and post-IVR agent initiatives also led to a 5 to 10 percent reduction in costs or incremental annualized savings.

Case example III: Demand forecasting

The call-center head of a large UK-based bank turned to analytics to optimize agent utilization by automating demand forecasting as part of a larger analytics-driven transformation at the institution. The approach incorporated the following elements:

— creation of a robust integrated data set that is foundational for the analytics exercise by combining five different data sources: data for more than ten million customers, call data, agent data, bank data related to IT outages, and other external data such as weather

— development of two sets of random-forest machine learning models to continuously learn thresholds and forecast both number of calls and average handling time on a monthly basis (four to 16 months ahead and updated monthly) and a 30-minute level basis (eight to ten weeks ahead and updated daily)

— Bayesian techniques to capture the most recent dynamics for extrapolation, nonlinear regression models for forecasting, and more than a hundred features to capture different levels of seasonality

The bank achieved a 20 to 40 percent error reduction in forecasting for a subset of the population and is rolling it out across all full-time employees.

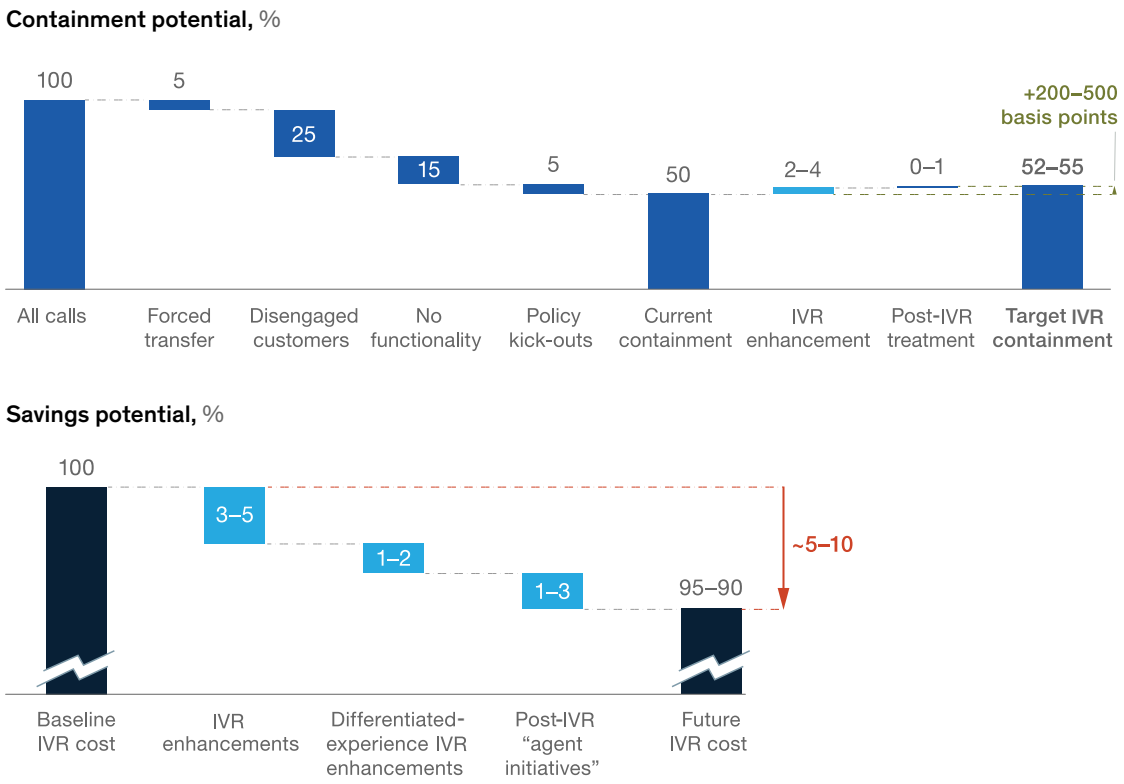
Starting the journey on analytics to customer service

When introducing advanced analytics, a critical first step is clearly understanding the organization's current position in terms of one of three horizons (Exhibit 3).

Those on Horizon 1 generally have low levels of awareness regarding recent developments in advanced analytics for customer service. These organizations need to begin their transformation by building a business case, educating their leadership, and obtaining organizational buy-in. Once these initiatives are underway, quick, tangible wins should be pursued to reinforce the organization's commitment to a full transformation. Additionally,

Exhibit 2

Interactive-voice-response (IVR) containment and differentiated customer experience led to 200 to 500 basis points containment increases and annual cost savings of 5 to 10 percent.



Note: 100 million calls into the client IVR per year.

another challenge faced by these organizations is lack of in-house knowledge on relevant frameworks and solutions to diagnose and prioritize initiatives.

Enterprises on Horizon 2 have a better understanding of recent advances in the field and have started to experiment with or adopt them. However, they have done so largely on an ad hoc, unstructured basis. Unfortunately, informal approaches are likely to leave significant value on the table. The key challenge for Horizon 2 organizations is to identify the most efficient path for delivering the desired results. This might be accomplished, for instance, by shaping their perspectives through a sharing of external best practices and then setting challenging timelines.

Horizon 3 firms are well ahead of the curve, applying next-generation analytics solutions to transform the customer-service model. At this stage, the key

Exhibit 3

Most financial institutions are situated on one of three horizons in terms of their customer-service analytics journey.

	Horizon 1	Horizon 2	Horizon 3
	Financial institutions mostly in the preliminary stages of digital and analytics evolution	Financial institutions that have an analytics plan but an unstructured approach, leaving value on the table	Firms that are already in the midst of next-gen digital and analytics transformation but need support to accelerate value delivery
Typical challenges	Need to build awareness among senior leaders about analytics use cases and develop buy-in to start transformation Lack framework and relevant solutions to diagnose and prioritize initiatives Need early tangible wins to reinforce senior leadership's confidence in transformation	Lack structured road map, benchmarked with external best practices, to drive milestones Lack well-articulated plan for how to create and capture value Lack capabilities, tools, and talent to execute	Business-as-usual activities crowd out dedicated resourcing to implement the project Lack knowledge about best practices in analytics solutions across industries to help set benchmarks and accelerate value delivery

challenge is finding ways to advance to even higher levels and to continue to invest in next-generation solutions.

The use of new analytical tools and capabilities is transforming customer service in financial services. The following questions can help firms shape their strategy discussions:

- Where do we stand currently in terms of the three advanced analytics/customer-service horizons?
- What challenges are preventing us from advancing to the next horizon?
- What immediate steps can we take to address these challenges?

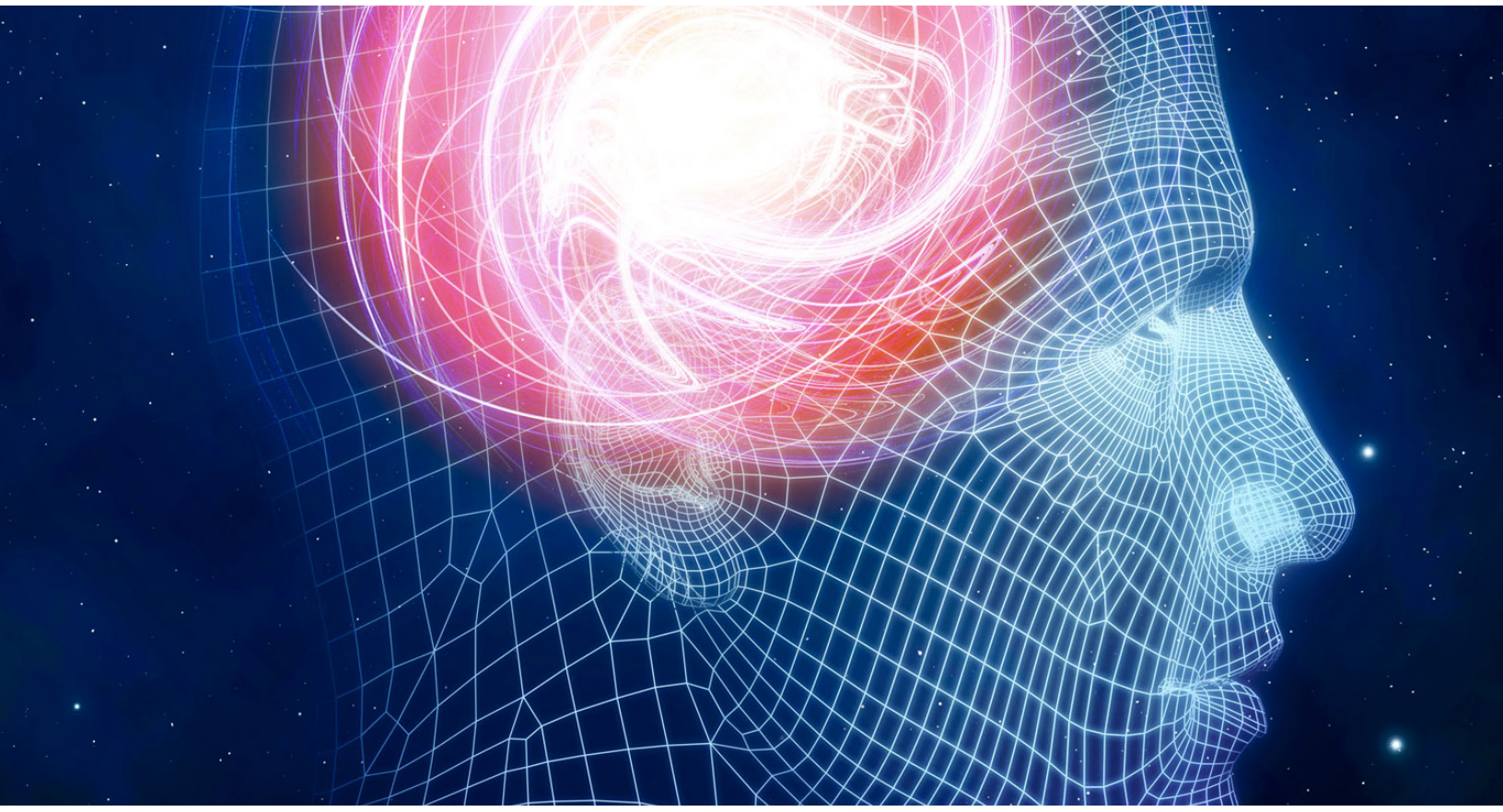
Krishna Bhattacharya is a partner in McKinsey's New York office, where **Greg Phalin** is a senior partner and **Abhilash Sridharan** is a consultant.

Designed by Global Editorial Services

Insurance 2030: The impact of AI on the future of insurance

The industry is on the verge of a seismic, tech-driven shift. A focus on four areas can position carriers to embrace this change.

by Ramnath Balasubramanian, Ari Libarikian, and Doug McElhaney



Welcome to the future of insurance, as seen through the eyes of Scott, a customer in the year 2030. His digital personal assistant orders him an autonomous vehicle for a meeting across town. Upon hopping into the arriving car, Scott decides he wants to drive today and moves the car into "active" mode. Scott's personal assistant maps out a potential route and shares it with his mobility insurer, which immediately responds with an alternate route that has a much lower likelihood of accidents and auto damage as well as the calculated adjustment to his monthly premium. Scott's assistant notifies him that his mobility insurance premium will increase by 4 to 8 percent based on the route he selects and the volume and distribution of other cars on the road. It also alerts him that his life insurance policy, which is now priced on a "pay-as-you-live" basis, will increase by 2 percent for this quarter. The additional amounts are automatically debited from his bank account.

When Scott pulls into his destination's parking lot, his car bumps into one of several parking signs. As soon as the car stops moving, its internal diagnostics determine the extent of the damage. His personal assistant instructs him to take three pictures of the front right bumper area and two of the surroundings. By the time Scott gets back into the driver's seat, the screen on the dash informs him of the damage and confirms the claim has been approved and a mobile response drone has been dispatched to the lot for inspection. If the vehicle is drivable, it may be directed to the nearest in-network garage for repair after a replacement vehicle arrives.

While this scenario may seem beyond the horizon, such integrated-user stories will emerge across all lines of insurance with increasing frequency over the next decade. In fact, all the technologies required in the above scenario already exist, and many are available to consumers. With the new wave of deep learning techniques, such as convolutional neural networks,[1] artificial intelligence (AI) has the potential to live up to its promise of mimicking the perception, reasoning, learning, and problem solving of the human mind (Exhibit 1). In this evolution, insurance will shift from its current state of "detect and repair" to "predict and prevent," transforming every aspect of the industry in the process. The pace of change will also accelerate as brokers, consumers, financial intermediaries, insurers, and suppliers become more adept at using advanced technologies to enhance decision making and productivity, lower costs, and optimize the customer experience.

As AI becomes more deeply integrated into the industry, carriers must position themselves to respond to the changing business landscape. Insurance executives must understand the factors that will contribute to this change and how AI will reshape claims, distribution, and underwriting and pricing. With this understanding, they can start to build the skills and talent, embrace the emerging technologies, and create the culture and perspective needed to be successful players in the insurance industry of the future.

Four AI-related trends shaping insurance

AI's underlying technologies are already being deployed in our businesses, homes, and vehicles, as well as on our persons. Four core technology trends, tightly coupled with (and sometimes enabled by) AI, will reshape the insurance industry over the next decade.

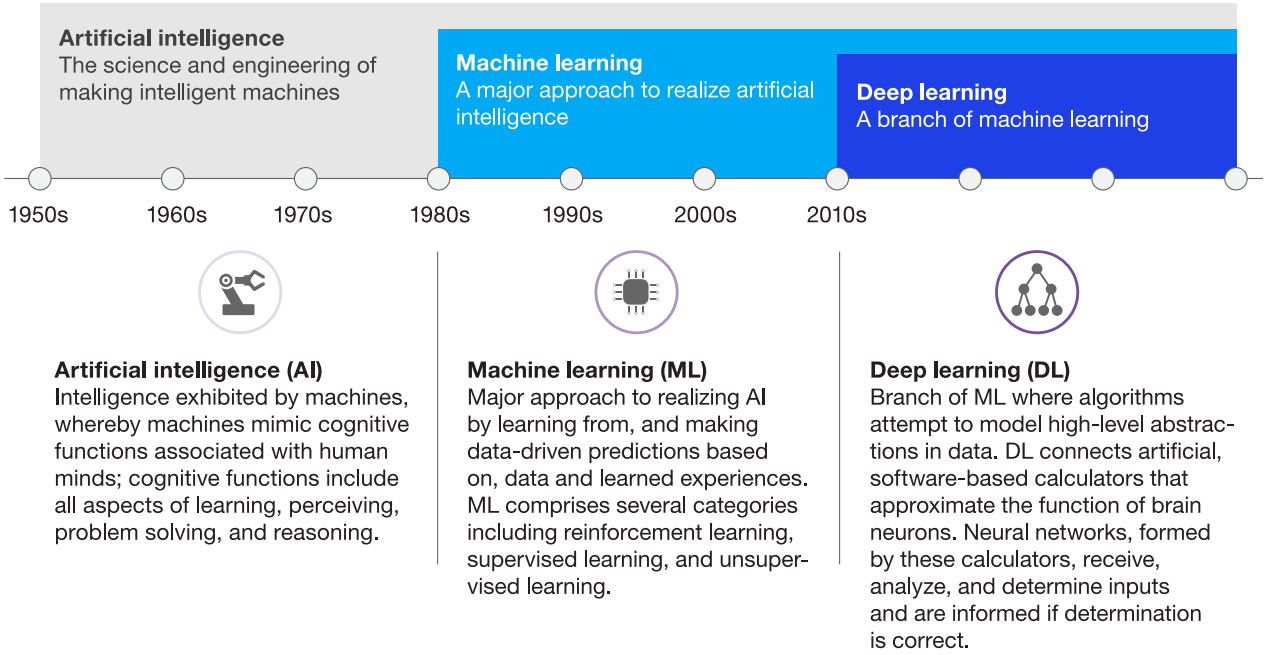
Explosion of data from connected devices

In industrial settings, equipment with sensors has been omnipresent for some time, but the coming years will see a huge increase in the number of connected consumer devices. The penetration of existing devices (such as cars, fitness trackers, home assistants, smartphones, and smart watches) will continue to increase rapidly, joined by new, growing categories such as clothing, eyewear, home appliances, medical devices, and shoes. The resulting avalanche of new data created by these devices will allow carriers to understand their clients more deeply, resulting in new product categories, more personalized pricing, and increasingly real-

[1] Convolutional neural networks contain millions of simulated "neurons" structured in layers.

Exhibit 1

Artificial intelligence can deliver on industry expectations through machine learning and deep learning.



Source: Nvidia; *Science in the news*, "The history of artificial intelligence," blog entry by Rockwell Anyoha, August 28, 2017, sitn.hms.harvard.edu

time service delivery. For example, a wearable that is connected to an actuarial database could calculate a consumer's personal risk score based on daily activities as well as the probability and severity of potential events.

Increased prevalence of physical robotics

The field of robotics has seen many exciting achievements recently, and this innovation will continue to change how humans interact with the world around them. Additive manufacturing, also known as 3-D printing, will radically reshape manufacturing and the commercial insurance products of the future. By 2025, 3-D-printed buildings will be common, and carriers will need to assess how this development changes risk assessments. In addition, programmable, autonomous drones; self-driving cars; autonomous farming equipment; and enhanced surgical robots will all be commercially viable in the next decade. By 2030, the proportion of autonomous vehicles on the road could exceed 25 percent, having grown from 10 percent just four years earlier.[2] Carriers will need to understand how the increasing presence of robotics in everyday life and across industries will shift risk pools, change customer expectations, and enable new products and channels.

[2] *Deep shift: Technology tipping points and societal impact*, World Economic Forum, September 2015, weforum.org.

Open source and data ecosystems
As data becomes ubiquitous, open source protocols will emerge to ensure data can be shared and used across industries. Various public and private entities will come together to create ecosystems in order to share data for multiple use cases under a common regulatory and cybersecurity framework. For example, wearable data could be ported directly to insurance carriers, and connected-home and auto data could be made available through Amazon, Apple, Google, and a variety of consumer-device manufacturers.

Advances in cognitive technologies
Convolutional neural networks and other deep learning technologies currently used primarily for image, voice, and unstructured text processing will evolve to be applied in a wide variety of applications. These cognitive technologies, which are loosely based on the human brain's ability to learn through decomposition and inference, will become the standard approach for processing the incredibly large and complex data streams that will be generated by "active" insurance products tied to an individual's behavior and activities. With the increased commercialization of these types of technologies, carriers will have access to models that are constantly learning and adapting to the world around them—enabling new product categories and engagement techniques while responding to shifts in underlying risks or behaviors in real time.

The state of insurance in 2030

AI and its related technologies will have a seismic impact on all aspects of the insurance industry, from distribution to underwriting and pricing to claims. Advanced technologies and data are already affecting distribution and underwriting, with policies being priced, purchased, and bound in near real time. An in-depth examination of what insurance may look like in 2030 highlights dramatic changes across the insurance value chain.

Distribution
The experience of purchasing insurance is faster, with less active involvement on the part of the insurer and the customer. Enough information is known about individual behavior, with AI algorithms creating risk profiles, so that cycle times for completing the purchase of an auto, commercial, or life policy will be reduced to minutes or even seconds. Auto and home carriers have enabled instant quotes for some time but will continue to refine their ability to issue policies immediately to a wider range of customers as telematics and in-home Internet of Things (IoT) devices proliferate and pricing algorithms mature. Many life carriers are experimenting with simplified issue products, but most are restricted to only the healthiest applicants and are priced higher than a comparable fully underwritten product. As AI permeates life underwriting and carriers are able to identify risk in a much more granular and sophisticated way, we will see a new wave of mass-market instant-issue products.

Smart contracts enabled by blockchain instantaneously authorize payments from a customer's financial account. Meanwhile, contract processing and payment verification are eliminated or streamlined, reducing customer-acquisition costs for insurers. The purchase of commercial insurance is similarly expedited as the combination of drones, IoT, and other available data provides sufficient information for AI-based cognitive models to proactively generate a bindable quote.

Highly dynamic, usage-based insurance (UBI) products proliferate and are tailored to the behavior of individual consumers. Insurance transitions from a "purchase and annual renewal" model to a continuous cycle, as product offerings

constantly adapt to an individual's behavior patterns. Furthermore, products are disaggregated substantially into microcoverage elements (for example, phone-battery insurance, flight-delay insurance, different coverage for a washer and dryer within the home) that consumers can customize to their particular needs, with the ability to instantaneously compare prices from various carriers for their individualized baskets of insurance products. New products emerge to cover the shifting nature of living arrangements and travel. UBI becomes the norm as physical assets are shared across multiple parties, with a pay-by-mile or pay-by-ride model for car sharing and pay-by-stay insurance for home-sharing services, such as Airbnb.[3]

The role of insurance agents has changed dramatically by 2030. The number of agents is reduced substantially as active agents retire and remaining agents rely heavily on technology to increase productivity. The role of agents transitions to process facilitators and product educators. The agent of the future can sell nearly all types of coverage and adds value by helping clients manage their portfolios of coverage across experiences, health, life, mobility, personal property, and residential. Agents use smart personal assistants to optimize their tasks as well as AI-enabled bots to find potential deals for clients. These tools help agents support a substantially larger client base while making customer interactions (a mix of in-person, virtual, and digital) shorter and more meaningful, given that each interaction will be tailored to the exact current and future needs of each individual client.

Underwriting and pricing

In 2030, manual underwriting ceases to exist for most personal and small-business products across life and property and casualty insurance. The process of underwriting is reduced to a few seconds as the majority of underwriting is automated and supported by a combination of machine and deep learning models built within the technology stack. These models are powered by internal data as well as a broad set of external data accessed through application programming interfaces (APIs) and outside data and analytics providers. Information collected from devices provided by mainline carriers, reinsurers, product manufacturers, and product distributors is aggregated in a variety of data repositories and data streams. These information sources enable insurers to make ex ante decisions regarding underwriting and pricing, enabling proactive outreach with a bindable quote for a product bundle tailored to the buyer's risk profile and coverage needs.

Regulators review AI-enabled, machine learning–based models, a task that requires a transparent method for determining traceability of a score (similar to the rating factor derivations used today with regression-based coefficients). To verify that data usage is appropriate for marketing and underwriting, regulators assess a combination of model inputs. They also develop test policies for providers when determining rates in online plans to ensure the algorithm results are within approved bounds. Public-policy considerations limit access to certain sensitive and predictive data (such as health and genetic information) that would decrease underwriting and pricing flexibility and increase antiselection risk in some segments.

Price remains central in consumer decision making, but carriers innovate to diminish competition purely on price. Sophisticated proprietary platforms connect customers and insurers and offer customers differentiated experiences, features, and value. In some segments, price competition intensifies, and razor-thin margins are the norm, while in other segments, unique insurance offerings enable margin expansion and differentiation. In

[3] Some insurtech companies are already beginning to design these types of products; Slice, for example, provides variable commercial insurance specifically tailored for home sharing.

jurisdictions where change is embraced, the pace of pricing innovation is rapid. Pricing is available in real time based on usage and a dynamic, data-rich assessment of risk, empowering consumers to make decisions about how their actions influence coverage, insurability, and pricing.

Claims

Claims processing in 2030 remains a primary function of carriers, but head count associated with claims is reduced by 70 to 90 percent compared with 2018 levels.[4] Advanced algorithms handle initial claims routing, increasing efficiency and accuracy. Claims for personal lines and small-business insurance are largely automated, enabling carriers to achieve straight-through-processing rates of more than 90 percent and dramatically reducing claims processing times from days to hours or minutes.

IoT sensors and an array of data-capture technologies, such as drones, largely replace traditional manual methods of first notice of loss. Claims triage and repair services are often triggered automatically upon loss. In the case of an auto accident, for example, a policyholder takes streaming video of the damage, which is translated into loss descriptions and estimate amounts. Self-driving vehicles that sustain minor damage direct themselves to repair shops for service, while a self-driving replacement car is dispatched in the interim. In the home, IoT devices will be increasingly used to proactively monitor water levels, temperature, and other key risk factors and will proactively alert both tenants and insurers of issues before they arise.

Automated customer-service apps handle most policyholder interactions through voice and text, directly following self-learning scripts that interface with the claims, fraud, medical-service, policy, and repair systems. The turnaround time for resolution of many claims is measured in minutes rather than days or weeks. Human claims management focuses on a few areas: complex and unusual claims, contested claims where human interaction and negotiation are empowered by analytics and data-driven insights, claims linked to systemic issues and risks created by new technology (for example, hackers infiltrate critical IoT systems), and random manual reviews of claims to ensure sufficient oversight of algorithmic decision making.

Claims organizations increase their focus on risk monitoring, prevention, and mitigation. IoT and new data sources are used to monitor risk and trigger interventions when factors exceed AI-defined thresholds. Customer interaction with insurance claims organizations focuses on avoiding potential loss. Individuals receive real-time alerts that may be linked with automatic interventions for inspection, maintenance, and repair. For large-scale catastrophe claims, insurers monitor homes and vehicles in real time using integrated IoT, telematics, and mobile phone data, assuming mobile phone service and power haven't been disrupted in the area. When power goes out, insurers can prefile claims by using data aggregators, which consolidate data from satellites, networked drones, weather services, and policyholder data in real time. This system is pretested by the largest carriers across multiple catastrophe types, so highly accurate loss estimations are reliably filed in a real emergency. Detailed reports are automatically provided to reinsurers for faster reinsurance capital flow.

How insurers can prepare for accelerating changes

The rapid evolution of the industry will be fueled by the extensive adoption and integration of automation, deep learning, and external data ecosystems. While no one can predict exactly what insurance might look like in 2030, carriers can take several steps now to prepare for change.

1. Get smart on AI-related technologies and trends

Although the tectonic shifts in the industry will be tech-focused, addressing them is not the domain of the IT team. Instead, board members and customer-experience teams should invest the time

[4] This shift to a more automated claims function has already begun. Fukoku Mutual Life Insurance, for example, has been using IBM's Watson Explorer since January 2017 to do the work of 34 claims adjusters—30 percent of its claims staff.

and resources to build a deep understanding of these AI-related technologies. Part of this effort will require exploring hypothesis-driven scenarios in order to understand and highlight where and when disruption might occur—and what it means for certain business lines. For example, insurers are unlikely to gain much insight from limited-scale IoT pilot projects in discrete parts of the business. Instead, they must proceed with purpose and an understanding of how their organization might participate in the IoT ecosystem at scale. Pilots and proof-of-concept (POC) projects should be designed to test not just how a technology works but also how successful the carrier might be operating in a particular role within a data- or IoT-based ecosystem.

2. Develop and begin implementation of a coherent strategic plan

Building on the insights from AI explorations, carriers must decide how to use technology to support their business strategy. The senior leadership team's long-term strategic plan will require a multiyear transformation that touches operations, talent, and technology. Some carriers are already beginning to take innovative approaches such as starting their own venture-capital arms, acquiring promising insurtech companies, and forging partnerships with leading academic institutions. Insurers should develop a perspective on areas they want to invest in to meet or beat the market and what strategic approach—for example, forming a new entity or building in-house strategic capabilities—is best suited to their organization.

This plan should address all four dimensions involved in any large-scale, analytics-based initiative—everything from data to people to culture (Exhibit 2). The plan should outline a road map of AI-based pilots and POCs and detail which parts of the organization will require investments in skill building or focused change management. Most important, a detailed schedule of milestones and checkpoints is essential to allow the organization to determine, on a regular basis, how the plan should be modified to address any shifts in the evolution of AI technologies and significant changes or disruptions within the industry.

In addition to being able to understand and implement AI technologies, carriers also need to develop strategic responses to coming macrolevel changes. As many lines shift toward a "predict and prevent" methodology, carriers will need to rethink their customer engagement and branding, product design, and core earnings. Auto accidents will be reduced through autonomous-vehicle usage, in-home flooding will be prevented by IoT devices, buildings will be reprinted after a natural disaster, and lives will be saved and extended by improved healthcare. Likewise, autonomous vehicles will break down, natural disasters will continue to devastate coastal regions, individuals will require effective medical care, as well as support when a loved one passes. As these changes take root, profit pools will shift, new types and lines of products will emerge, and how consumers interact with their insurers will change substantially. Winning carriers of the future will create and enact strategic plans that successfully position their brand, products, customer interactions, and technology to take advantage of the new economic structure on the horizon.

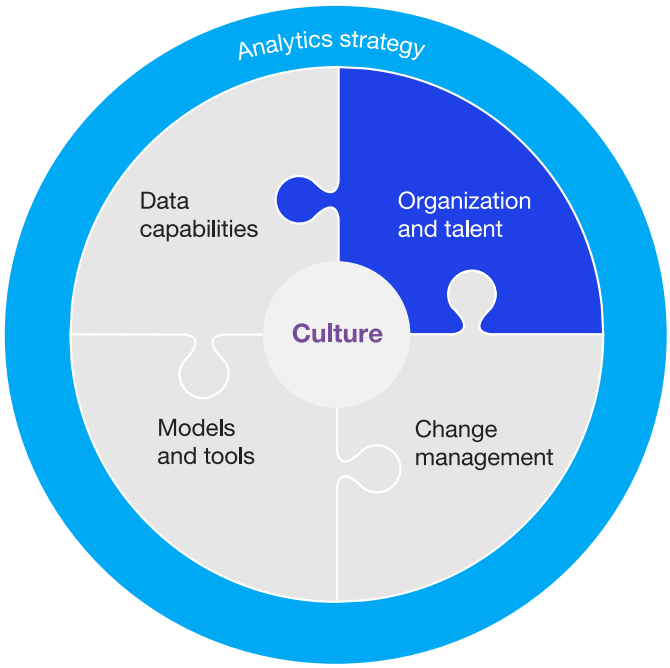
All of these efforts can produce a coherent analytics and technology strategy that addresses all aspects of the business, with a keen eye on both value creation and differentiation.

3. Create and execute a comprehensive data strategy

Data is fast becoming one of the most—if not the most—valuable asset for any organization. The insurance industry is no different: how carriers identify, quantify, place, and manage risk is all predicated on the volume and quality of data they acquire during a policy's life cycle. Most AI technologies will perform best when they have a high volume of data from a variety of sources. As such, carriers must develop a well-structured and

Exhibit 2

There are four core elements in defining a successful artificial intelligence strategy.



actionable strategy with regards to both internal and external data. Internal data will need to be organized in ways that enable and support the agile development of new analytics insights and capabilities. With external data, carriers must focus on securing access to data that enriches and complements their internal data sets. The real challenge will be gaining access in a cost-efficient way. As the external data ecosystem continues to expand, it will likely remain highly fragmented, making it quite difficult to identify high-quality data at a reasonable cost. Overall, data strategy will need to include a variety of ways to obtain and secure access to external data, as well as ways to combine this data with internal sources. Carriers should be prepared to have a multifaceted procurement strategy that could include the direct acquisition of data assets and providers, licensing of data sources, use of data APIs, and partnerships with data brokers.

4. Create the right talent and technology infrastructure

In augmented chess, average players enabled by AI tend to do better than expert chess players enabled by the same AI. The underlying reason for this counterintuitive outcome depends on whether the individual interacting with AI embraces, trusts, and understands the supporting technology. To ensure that every part of the organization views advanced analytics as a must-have capability, carriers must make measured but sustained investments in people. The insurance organization of the future will require

talent with the right mind-sets and skills. The next generation of successful frontline insurance workers will be in increasingly high demand and must possess a unique mix of being technologically adept, creative, and willing to work at something that will not be a static process but rather a mix of semiautomated and machine-supported tasks that continually evolve. Generating value from the AI use cases of the future will require carriers to integrate skills, technology, and insights from around the organization to deliver unique, holistic customer experiences. Doing so will require a conscious culture shift for most carriers, which will rely on buy-in and leadership from the executive suite. Developing an aggressive strategy to attract, cultivate, and retain a variety of workers with critical skill sets will be essential to keep pace. These roles will include data engineers, data scientists, technologists, cloud-computing specialists, and experience designers. To retain knowledge while also ensuring the business has the new skills and capabilities necessary to compete, many organizations will design and implement reskilling programs. As a last component of developing the new workforce, organizations will identify external resources and partners to augment in-house capabilities that will help carriers secure the needed support for business evolution and execution. The IT architecture of the future will also be radically different from today's. Carriers should start making targeted investments to enable the migration to a more future-forward technology stack that can support a two-speed IT architecture.

Rapid advances in technologies in the next decade will lead to disruptive changes in the insurance industry. The winners in AI-based insurance will be carriers that use new technologies to create innovative products, harness cognitive-learning insights from new data sources, streamline processes and lower costs, and exceed customer expectations for individualization and dynamic adaptation. Most important, carriers that adopt a mind-set focused on creating opportunities from disruptive technologies—instead of viewing them as a threat to their current business—will thrive in the insurance industry in 2030.

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04

Foundational capabilities

Leading agile transformation: The new capabilities leaders need to build 21st-century organizations

To build and lead an agile organization, it's crucial that senior leaders develop new mind-sets and capabilities to transform themselves, their teams, and the organization.

by Aaron De Smet, Michael Lurie, and Andrew St George

For many organizations, surviving and thriving in today's environment depends on making a fundamental transformation to become more agile.[1] Those making the transition successfully are achieving substantive performance and health improvements: enhanced growth, profitability, customer satisfaction, and employee engagement.

More than any other factor, the key to a successful agile transformation is for leaders, particularly senior leaders, to develop substantially new mind-sets and capabilities. This article summarizes our guide to readying leaders for agile transformations, *Leading agile transformation: The new capablities leaders need to build 21st-century organizations.*[2]

The agile story

Before we dive deep, it's useful to take a broader view of agile, and particularly what sets agile organizations apart from traditional ones.

Characteristics of traditional and agile organizations

Simply put, the dominant traditional organization model evolved primarily for stability in a well-known environment. It is based on the idea of an organization as a machine with a static, siloed, structural hierarchy that operates through linear planning and control to execute one or very few business models.

Agile organizations, which are viewed as living systems, have evolved to thrive in an unpredictable, rapidly changing environment. These organizations are both stable and dynamic. They focus on customers, fluidly adapt to environmental changes, and are open, inclusive, and nonhierarchical; they evolve continually and embrace uncertainty and ambiguity. Such organizations, we believe, are far better equipped than traditional ones for the future.

While there are many different forms of enterprise agility, they share some common trademarks. We have identified and enumerated these in a related article, "The five trademarks of agile organizations."[3]

Leadership in agile organizations

This new kind of agile organization requires a fundamentally different kind of leadership.

Recent research confirms that leadership and its role in shaping culture are the biggest barriers to—and enablers of—successful agile transformations.

Organizations must therefore begin by both extending and transcending the competencies that made their leaders successful in the past. Leading a successful agile transformation requires three new sets of capabilities. First, you must learn to transform yourself by evolving new personal mind-sets and behaviors. Second, you must learn how to transform your teams to work in new ways. Third, it's essential you learn how to transform your organization by building agility into the design and culture of the whole enterprise.

Transforming yourself

To fully transform yourself, several shifts will be necessary, and leaders will need to make these changes in a disciplined way.

Shifting from reactive to creative mind-sets

Changing our mind-set—or adjusting it to the new context—is no easy task, but developing this "inner agility"[4] is essential in releasing our potential to lead an agile transformation. It is clear from the work of Robert Kegan and many others that leaders of agile organizations must, above all, make a profound personal shift in their mind-sets from reactive to creative.

Reactive, or socialized, mind-sets are an outside-in way of experiencing the world based on reacting to our circumstances and other people's expectations of us. We typically default to this mode when

[1] The term "agile" as applied to a way of working originated in 2001 with a new approach to software development. As organizations increasingly sought to become more agile in the sense of faster and more flexible, they recognized that principles of agile software development could be applied much more broadly to organizations as a whole.
[2] Available on McKinsey.com.
[3] Wouter Aghina, Aaron De Smet, Gerald Lackey, Michael Lurie, and Monica Murarka, "The five trademarks of agile organizations," January 2018, McKinsey.com.
[4] Sam Bourton, Johanne Lavoie, and Tiffany Vogel, "Leading with inner agility," *McKinsey Quarterly*, March 2018, McKinsey.com.

challenged—in other words, very frequently during a typical business day—which limits our perspective, focuses us on what can go awry, and causes feelings of fear, anxiety, frustration, and stress.

Creative, or self-authoring, mind-sets are an inside-out way of experiencing the world based on creating our reality and way forward through tapping into and expressing our authentic selves, our core passion and purpose. Being "in the creative" expands our perspective and focuses us on the positive, and we experience joy, fun, love, and flow.

Research shows that most adults spend the large majority of their days "in the reactive," and as a result, traditional organizations are designed to run on the reactive.[5] To build and lead agile organizations, leaders must make a personal shift to run primarily in the creative. Think about your typical day. Do you (and your team) spend most of your time reacting to problems and your boss's requests, seeking to control others, and working to deliver perfect outcomes?

Or do you spend most of your time pursuing your purpose and passion, trusting and empowering others, and exploring new and sometimes messy possibilities?

There are three fundamental reactive-to-creative mind-set shifts we have found critical to foster the culture of innovation, collaboration, and value creation at the heart of agile organizations: from certainty to discovery, from authority to partnership, and from scarcity to abundance.

— *From certainty to discovery: fostering innovation.* A reactive mind-set of certainty is about playing not to lose, being in control, and replicating the past. Today, leaders need to shift to a creative mind-set of discovery, which is about playing to win, seeking diversity of thought, fostering creative collision, embracing risk, and experimenting.

— *From authority to partnership: fostering collaboration.* Traditional organization design tends toward siloed hierarchies based on a reactive mind-set of authority. The relationship between leaders and teams is one of superior to subordinate. Designed for collaboration, agile organizations employ networks of autonomous teams. This requires an underlying creative mind-set of partnership, of managing by agreement based on freedom, trust, and accountability.

— *From scarcity to abundance: fostering value creation.* In stable markets, companies maximize their shares at the expense of others. This win–lose approach reflects a reactive mind-set of scarcity, based on an assumption of limited opportunities and resources. Today's markets, however, evolve continually and rapidly. To deliver results, leaders must view markets with a creative mind-set of abundance, which recognizes the unlimited resources and potential available to their organizations and enables customer-centricity, entrepreneurship, inclusion, and cocreation.

A disciplined approach

While these mind-set shifts might be new and require a significant "letting go" of old beliefs and paradigms, collectively, they form a very disciplined approach to leadership. And because of inherent autonomy and freedom, leadership in agile organizations comes from a self-disciplined approach—leading not by fear of punishment or sanction but in service to purpose and passion.

Transforming your teams

Next, it's important to learn how to help teams work in new and more effective ways.

Helping teams work in agile ways

How might leaders help teams work in new and more agile ways? And what does this new way of working require of leaders? There are three essential leadership requirements that follow from all agile ways of working.

[5] See Carol S. Dweck, *Mindset: The New Psychology of Success,* New York: Ballantine Books, 2016.

First, leaders must learn to build teams that are small, diverse, empowered, and connected. Second, leaders must allow and encourage agile teams to work in rapid cycles to enable them to deliver greater value more efficiently and more quickly. Third, leaders must keep agile teams focused on the external or internal customer and on creating value for customers, by understanding and addressing their unmet, and potentially even unrecognized, needs.

Embrace design thinking and business-model innovation

We have found that in addition to being able to lead in this new agile way of working, it is important for leaders to understand the key elements of two other relatively new disciplines: design thinking and business-model innovation.

Originating in industrial and other forms of design, design thinking is a powerful approach to developing innovative customer solutions, business models, and other types of systems. This begins with understanding the entire customer experience at each stage of the customer journey.

In organizations that are agile, each team is viewed as a value-creating unit, or as a "business." These teams pursue business-model innovation at every opportunity, seeking new ways to meet the needs of their internal or external customers and deliver more value to employees, investors, partners, and other stakeholders.

Transforming your organization

Here, leaders must learn how to cocreate an agile organizational purpose, design, and culture.

Purpose: Find the north star

The first distinctive organization-level skill leaders need to develop is the ability to distill a clear, shared, and compelling purpose—a north star—for their organization. Rather than using the traditional executive-team approach, leaders in agile organizations must learn to sense and draw out the organization's purpose through conversation with people across the enterprise.

Design: Apply the principles and practices of agile organization design

The second organization-level skill leaders need to develop is the ability to design a strategy and operating model based on agile principles and practices. Most senior leaders of traditional companies have a well-honed skill set in this area that reflects traditional organization design as a relatively concentrated, static system: one or a very limited number of major businesses, each with a long-established business model, typically coexisting somewhat uneasily with a set of corporate functions.

To design and build an agile organization, leaders need a different set of skills based on a different understanding of organizations. They must learn to design their organization as a distributed, continually evolving system. Such an organization comprises a network of smaller empowered units, with fewer layers, greater transparency, and leaner governance than a traditional model. More specifically, leaders must learn how to disaggregate existing large businesses into a more granular portfolio; transform corporate functions into a lean, enabling backbone, and attract a wide range of partners into a powerful ecosystem.

Culture: Shape an agile organizational culture

The third organization-level skill leaders need to develop is the ability to shape a new culture across the organization, based on the creative mind-sets of discovery, partnership, and abundance and their associated behaviors.

Given the openness and freedom people experience in an agile organization, culture arguably plays an even more important role here than in traditional organizations. To shape this culture, leaders must learn how to undertake a multifaceted culture-transformation effort that

centers on their own capabilities and behaviors. This includes the following steps:

— *role modeling* new mind-sets and behaviors authentically

— *fostering understanding and conviction* in a highly interactive way, through sharing stories and being inspired by the energy and ideas of frontline teams

— *building new mind-sets and capabilities across the organization*, including among those who do not formally manage people, and weaving learning into the fabric of daily activity to become a true learning organization

— *implementing reinforcement mechanisms* in the agile organization design

An agile approach to developing leaders

Many organizations start their agile pilots in discrete pockets. Initially, at least, they can build agile leadership capabilities there. But to scale agility successfully throughout an organization, top leaders must embrace its precepts and be willing to enhance their own capabilities significantly. Eventually, a full agile transformation will need to encompass building the mind-sets and capabilities of the entire senior leadership across the enterprise. To do this in an agile way, five actions are essential:

1. *Build a cadre of enterprise agility coaches*, a new kind of deeply experienced expert able to help leaders navigate the journey, supported by a leadership-transformation team.

2. *Get the top team engaged in developing its own capabilities* early on, as all senior leaders will take their cue from the executive team.

3. *Create an immersive leadership experience* (anything from a concentrated effort over three or four days to a learning journey over several months) to introduce the new mind-sets and capabilities and roll them out to all senior leaders.

4. *Invite leaders to apply their learning in practice*, both in agile-transformation initiatives already underway and through launching new organizational experiments.

5. *Roll out the leadership capability building at an agile tempo*, with quarterly pauses to review the leadership experiences, experiments, and culture shifts over the previous 90 days and finalize plans and priorities for the next 90 days.

Agile transformation is a high priority for an increasing number of organizations. More than any other factor, the key enabler to a successful agile transformation is to help leaders, particularly senior leaders, develop new mind-sets and capabilities. Doing so in an agile way will enable the organization to move faster, drive innovation, and both adapt to and shape its changing environment.

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Retraining and reskilling workers in the age of automation

Executives increasingly see investing in retraining and "upskilling" existing workers as an urgent business priority on which companies, not governments, must lead.

by Pablo Illanes, Susan Lund, Mona Mourshed, Scott Rutherford, and Magnus Tyreman

The world of work faces an epochal transition. By 2030, according to a recent McKinsey Global Institute report, *Jobs lost, jobs gained: Workforce transitions in a time of automation*,[1] as many as 375 million workers—or roughly 14 percent of the global workforce—may need to switch occupational categories as digitization, automation, and advances in artificial intelligence (AI) disrupt the world of work. The kinds of skills companies require will shift, with profound implications for the career paths individuals will need to pursue.

How big is that challenge? In terms of magnitude, it's akin to coping with the large-scale shift from agricultural work to manufacturing that occurred in the early 20th century in North America and Europe and more recently in China. But in terms of who must find new jobs, we are moving into uncharted territory. Those earlier workforce transformations took place over many decades, allowing older workers to retire and new entrants to the workforce to transition to the growing industries. But the speed of change today is potentially faster. The task confronting every economy, particularly advanced economies, will likely be to retrain and redeploy tens of millions of midcareer, middle-aged workers. As the MGI report notes, "There are few precedents in which societies have successfully retrained such large numbers of people."

So far, growing awareness of the scale of the task ahead has yet to translate into action. Indeed, public spending on labor-force training and support has fallen steadily for years in most member countries of the Organisation for Economic Co-operation and Development (OECD). Nor do corporate training budgets appear to be on any kind of upswing. But that may be about to change.

Among companies on the front lines, according to a recent McKinsey survey, executives increasingly see investing in retraining and "upskilling" existing workers as an urgent business priority—and they also believe that this is an issue where corporations, not governments, must take the lead. Our survey, which was in the field in late 2017, polled more than 1,500 respondents from businesses, the public sector, and not for profits across regions, industries, and sectors. The analysis that follows focuses on answers from roughly 300 executives at companies with more than $100 million in annual revenues.

Among this group, 66 percent see "addressing potential skills gaps related to automation/digitization" within their workforces as at least a "top ten priority." Nearly 30 percent put it in the top five (Exhibit 1). The driver behind this sense of urgency is the accelerating pace of enterprise-wide transformation. Looking back over the past five years, only about a third of executives in our survey said technological change had caused them to retrain or replace more than a quarter of their employees. But when they look out over the next five years, that narrative changes.

Sixty-two percent of executives believe they will need to retrain or replace more than a quarter of their workforce between now and 2023 due to advancing automation and digitization. The threat looms larger in the United States and Europe (64 percent and 70 percent, respectively) than in the rest of the world (only 55 percent)—and it is felt especially acutely among the biggest companies. Seventy percent of executives at companies with more than $500 million in annual revenues see technological disruption over the next five years affecting more than a quarter of their workers.

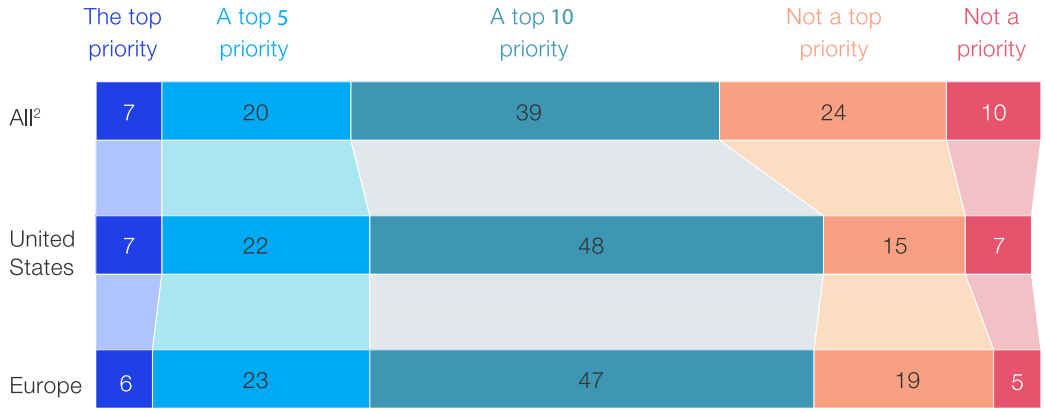
Appropriately, this keen sense of the challenge ahead comes with a strong feeling of ownership. While they clearly do not expect to solve this alone—forging creative partnerships with a wide range of relevant players, for example, will be critical—by a nearly 5:1 margin, the executives in our latest survey believe that corporations, not governments, educators, or individual workers, should take the lead in trying to close the looming skills gap. That's the view of 64 percent of the private-sector executives in the United States, and 59 percent of those in Europe, who see this as a top ten priority (Exhibit 2).

[1] See James Manyika, Susan Lund, Michael Chui, Jacques Bughin, Jonathan Woetzel, Parul Batra, Ryan Ko, and Saurabh Sanghvi, "Jobs lost, jobs gained: What the future of work will mean for jobs, skills, and wages," McKinsey Global Institute, November 2017, on McKinsey.com.

Exhibit 1

How important is addressing potential skills gaps related to automation and/or digitization within your organization's workforce?

Private-sector organizations with >$100 million annual revenue[1]
% of respondents by perceived priority



[1]Total n=283 respondents (US n=76, Europe n=115).
[2]All includes rest of world.
Note: All analysis filters out "Don't know" responses from data set. Figures may not sum to 100 percent, because of rounding.

Source: McKinsey panel survey, November 2017 (n=1,549); McKinsey analysis

As for solutions, 82 percent of executives at companies with more than $100 million in annual revenues believe retraining and reskilling must be at least half of the answer to addressing their skills gap. Within that consensus, though, were clear regional differences. Fully 94 percent of those surveyed in Europe insisted the answer would either be an equal mix of hiring and retraining or mainly retraining versus a strong but less resounding 62 percent in this camp in the United States. By contrast, 35 percent of Americans thought the challenge would have to be met mainly or exclusively by hiring new talent, compared to just 7 percent in this camp in Europe (Exhibit 3).

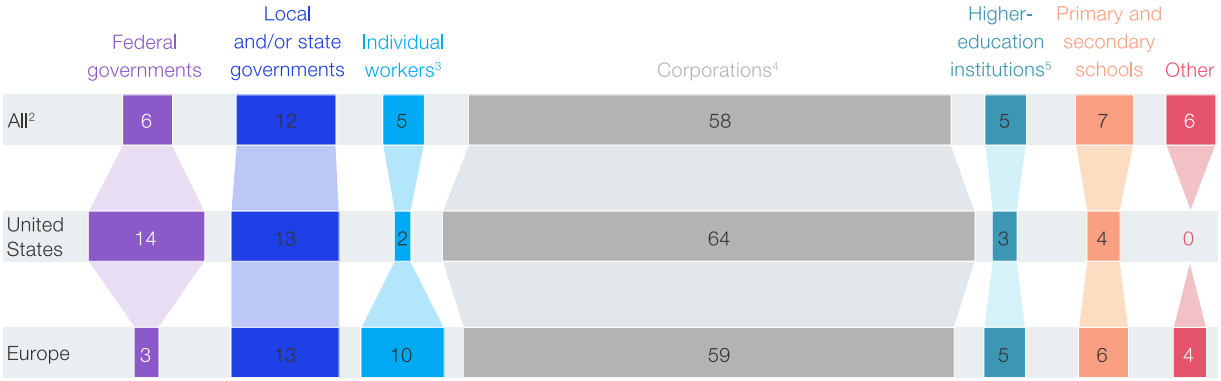
Now the bad news: only 16 percent of private-sector business leaders in this group feel "very prepared" to address potential skills gaps, with roughly twice as many feeling either "somewhat unprepared" or "very unprepared." The majority felt "somewhat prepared"—hardly a clarion call of confidence.

What are the main barriers? About one-third of executives feel an urgent need to rethink and upgrade their current HR infrastructure. Many companies are also struggling to figure out how job roles will change and what kind of talent they will require over the next five to ten years. Some executives who saw this as a top priority—42 percent in the United States, 24 percent in Europe, and 31 percent in the rest of the world—admit they currently lack a "good understanding of how automation and/or digitization will affect our future skills needs."

Exhibit 2

Which of the following groups or institutions should take the lead in addressing any potential skills gaps related to automation and/or digitization over the next five years?

Private-sector organizations with >$100 million annual revenue[1] who view the skills gap as a top 10 priority
% of respondents



[1]Total n=197 respondents.
[2]All includes rest of world.
[3]As in individuals building their own individual skill sets.
[4]Corporations addressing skills gaps and needs within their own workforces.
[5]Such as universities or community colleges.
Note: All analysis filters out "Don't know" responses from data set. Figures may not sum to 100 percent, because of rounding.

Source: McKinsey panel survey, November 2017 (n=1,549); McKinsey analysis

Such a high degree of anxiety is understandable. In our experience, too much traditional training and retraining goes off the rails because it delivers no clear pathway to new work, relies too heavily on theory versus practice, and fails to show a return on investment (ROI).

Generation, a global youth-employment not for profit founded in 2015 by McKinsey, deliberately set out to address those shortcomings. Operating in five countries across more than 20 professions, Generation operates programs that focus on targeting training to where strong demand for jobs exists and gathers the data needed to prove the ROI to learners and employers. As a result, Generation's more than 16,000 graduates have over 82 percent job placement, 72 percent job retention at one year, and two to six times higher income than they did prior to the program.

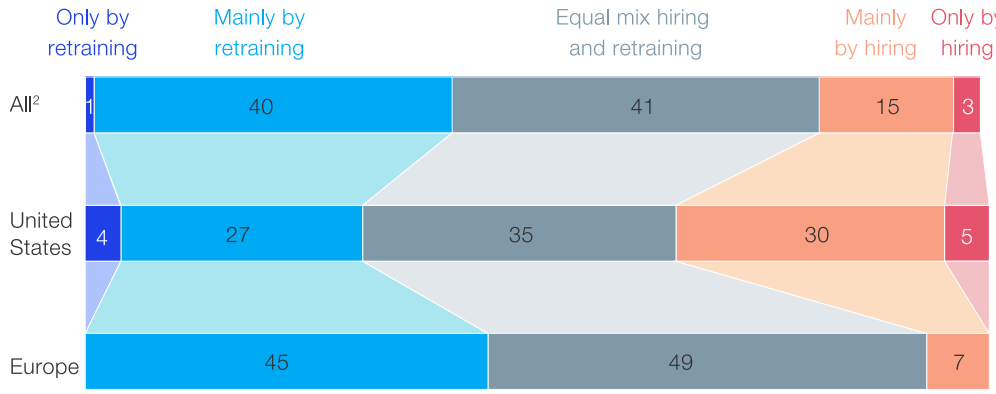
Generation will soon pilot a new initiative, Re-Generation, to apply this same formula—which includes robust partnerships with employers, governments, and not for profits—to helping mid-career employees learn new skills for new jobs.

For many companies, cracking the code on reskilling is partly about retaining their "license to operate" by empowering employees to be more productive. Thirty-eight percent of executives in our survey, across all regions, cited the desire to "align with our organization's mission and values" as a key reason for taking action. In a similar vein, at last winter's World Economic Forum in Davos, 80 percent of CEOs who were investing heavily in AI also publicly pledged to retain and retrain existing employees.

Exhibit 3

How can your organization best resolve its potential skills gaps related to automation and/or digitization over the next five years?

Private-sector organizations with >$100 million annual revenue[1] who view the skills gap as a top 10 priority, % of respondents



[1]Total n=197, or "Do not expect skills gaps" responses.
[2]All includes rest of world.
Note: All analysis filters out "Don't know" responses from data set. Figures may not sum to 100 percent, because of rounding.

Source: McKinsey panel survey, November 2017 (n=1,549); McKinsey analysis

But the biggest driver is this: as digitization, automation, and AI reshape whole industries and every enterprise, the only way to realize the potential productivity dividends from that investment will be to have the people and processes in place to capture it. Managing this transition well, in short, is not just a social good; it's a competitive imperative. That's why a resounding majority of respondents—64 percent across Europe, the United States, and the rest of the world—said the main reason they were willing to invest in retraining was "to increase employee productivity."

We hear that thought echoed in a growing number of C-suite conversations we are having these days. At the moment, most top executives have far more questions than answers about what it will take to meet the reskilling challenge at the kind of scale the next decade will likely demand.

They ask: How can I map the future against my current talent pool and processes? What part of future employment demand can I meet by retraining existing workers, and what is the ROI of doing so versus simply hiring new ones? How best can I tap into what are, for me, nontraditional talent pools? What partners, either in the private, public, or nongovernmental-organization sectors, might help me succeed—and what are our respective roles?

Good questions all. Over the coming months we intend to share more of our own thinking and analytical work—and some of the best ideas we are finding elsewhere—about the solutions that are emerging. Success will require first developing a granular map of how technology will change the skill requirements within your company. Once this is understood, the next step will be deciding whether to tap into new models of online and offline learning

and training or partner with traditional educational providers. (Over time, a more fundamental rethinking of 100-year-old educational models will also be needed.) Policy makers will need to consider new forms of unemployment income and worker-transition support as well as foster more intensive and innovative collaboration between the public and private sectors. Individuals will need to step up too, as will governments. Depending on the speed and scale of the coming workforce transition, as MGI noted in its recent report, many countries may conclude they will need to undertake "initiatives on the scale of the Marshall Plan."

But for now, we simply take comfort from the clear message of our latest survey: among large companies, senior executives see an urgent need to rethink and retool their role in helping workers develop the right skills for a rapidly changing economy—and their will to meet this challenge is strong. That's not a bad place to start.

Pablo Illanes is a partner in McKinsey's Stamford office; **Susan Lund** is a partner of the McKinsey Global Institute in McKinsey's Washington, DC, office, where **Mona Mourshed** and **Scott Rutherford** are senior partners; and **Magnus Tyreman** is a senior partner in the Stockholm office.

Designed by Global Editorial Services

The continuous improvement leader: Engaging people for a digital age

Lean management creates enormous value, but improvement that's truly continuous is often elusive. Innovation in fields such as digital and IT make it more urgent, achievable, and human.

by Zachary Surak

Over the past two decades, the world has embraced lean-management thinking. What was once a set of ideas for building better cars now drives better work in general—and better results—in everything from the world's largest companies to a new generation of start-ups and in every sector from healthcare to IT to financial services to nonprofits. Lean transforms the entire organization, creating new forms of leadership, new ways of working together, and, above all, shared mind-sets and behavior that strengthen an organization's capabilities and performance.

Yet today's chronic state of upheaval, with disruption compounding disruption, means that even some of the most successful organizations find it harder to build on lean management's gains and instill the right beliefs and behavior more deeply. Momentum flags just as the challenges seem greatest. Digitization, automation, analytics, design thinking—all are competing for the attention of leaders in the constant search for new ways to improve customer experiences and transform how businesses generate value.

These new capabilities all matter. But to find the right combination, business leaders need every worker to be more engaged and productive than ever. And because few combinations will remain right for long, organizations will keep needing more engagement and more productivity. That makes the role of the leader even more critical in sustaining an environment where engagement can thrive.

A few organizations are therefore realizing what the phrase "continuous-improvement culture" really implies: the very practices that support continuous improvement must themselves improve continuously. What these leaders are called on to lead is a continuous-improvement system that's centered on people: the lean-management system (exhibit).

The need to engage people

Fundamentally, organizations are fighting commoditization: faster innovation means that any competitive advantage solely from technical excellence is now more fleeting than ever.

Take product quality. Over the past few decades, the average number of defects in new automobiles has plummeted, despite dramatic increases in the product's complexity—to the point where the quality among many brands barely differs. Likewise, in the United States, customer-satisfaction gaps between the largest retail chains, food manufacturers, banks, and household-appliance makers are now quite small.

Instead, what increasingly matters is a whole range of human capabilities related to how companies communicate and work with customers. Recorded via smartphone, a single poor service encounter can now cause real reputational damage, amplified in social media to a potential audience in the hundreds of millions.

In this environment, lasting competitive advantage comes from the ability to learn faster, respond faster, and develop deeper ties to customers. Technologies will naturally play a crucial role. The McKinsey Global Institute estimates that at least 30 percent of the activities in about 60 percent of all occupations could be automated, potentially freeing up people for more valuable contributions.

But too often, organizations think that technology alone will get them out of a competitive hole. In focusing so intently on the latest algorithm or big data application or straight-through-processing platform, corporate leaders easily lose sight of what the new techniques are supposed to do: help to serve clients more effectively, directly or indirectly. The new tools take on a life of their own, consuming time and talent for an impact that dissipates quickly.

By contrast, the most promising opportunities are revealing themselves to the organizations that best manage the human beings who shape, use, and revise the new capabilities every day. What enables these exceptional organizations to break through barriers that block so many others?

Exhibit

The lean-management system is articulated through four integrated disciplines.

New value from lean management

What distinguishes these leaders is that they are not only redoubling their efforts with lean to create new operating models that deploy human skill with unmatched agility and responsiveness but also focusing on delivering value. As a result, such companies can respond to new problems in real time. Rather than wait for decisions to march up and down a bureaucratic citadel, teams of workers can rely on their own skills (and managerial support) to test and implement new solutions on their own.

Lean thinking informs every aspect of these organizations' work, from transforming customer journeys—the steps cumulatively involved in providing a service or product spanning multiple touchpoints and channels—to accelerating

value creation as part of an enterprise strategy of adapting to the digital world. They're combining digital technologies and process-improvement capabilities in an integrated, sequenced way that drastically improves customer journeys and internal processes. The Dutch banking group ING, for example, uses lean principles to create new product experiences for customers, as well as an unusually flexible organizational model that constantly evolves.

Companies are further building upon a foundation of lean management by applying digital technologies to synchronize their strategies, activities, performance, and health. They're generating better data to drive the management system, with clear strategies and goals (and tight feedback loops) that cascade throughout the organization.

And they're building a more flexible, modular architecture for improvement. Commonwealth Bank of Australia, for example, has changed the way it structures change, so that people can adapt to it more quickly and deeply.

These same organizations are successfully realizing an even greater advance: they are making continuous improvement an enterprise-wide reality, including in business areas that traditionally haven't been seen as fertile ground for lean concepts because their operations do not resemble factories. Corporate business functions, such as HR, risk, and finance, are not only just as ripe for lean's rewards as any other group but can also multiply the benefits of lean by encoding it into the organization's governance and people processes. Moreover, these functions' constraints, such as a heavy reliance on experts, mean that their successes will open yet more areas for lean management to target—such as highly complex expert-led functions and businesses.

In Chicago, for example, the international law firm Seyfarth Shaw fosters a deeper understanding of its clients by using lean to help traditionally siloed experts align with others.

Leaders building new leaders

But the most striking difference in these enterprises is the way that their leaders work—how they have changed the daily management of the business, from the routines they practice to the expectations they set with their people.

These leaders become not just role models but anchors keeping their organizations from being dragged back to old habits. As work with lean management starts to mature, they systematically transfer the scientific mind-set to other leaders across the enterprise. Their codifying and role modeling of crucial practices (such as "standard work") help their companies develop people, sustain improvement, and help the entire organization to keep pace.

But this means achieving a shared understanding of the purpose of lean work—with rigorous planning that outlines how the company will get there—to develop the behavior, leadership, and systems that help all employees learn from the work they do.

Ultimately, it means positioning continuous improvement not as a thing to achieve, but as a way of thinking and working that becomes self-reinforcing.

Zachary Surak is a partner in McKinsey's New Jersey office.

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Five enterprise-architecture practices that add value to digital transformations

Enterprise-architecture teams can play an integral role in transforming companies through technology. New survey findings and firsthand experience highlight the practices that matter most.

by Sven Blumberg, Oliver Bossert, and Jan Sokalski

What does it take for traditional companies to create value with digital technology? McKinsey research suggests that successful digital reinventors—digital natives and digitally transformed incumbents—employ a range of approaches, such as investing boldly and adopting cutting-edge technologies at scale. Efforts like these can run into various difficulties, though. In our experience, a push to launch more digital applications can make a company's technology landscape increasingly complex and difficult to manage, to the point that it impedes transformation programs.

Things don't have to be this way. A new survey by McKinsey and Henley Business School highlights the need for enterprise architects to facilitate digital transformations by managing technological complexity and setting a course for the development of their companies' IT landscape. These responsibilities fall within the typical enterprise-architecture (EA) team's remit, which is to manage the way that all of the company's IT systems work together to enable business processes. But not all EA teams carry out their responsibilities in the same manner. Survey respondents who described their companies as "digital leaders" indicated that their EA teams adhere to several best practices (see sidebar, "About the survey"). These teams engage senior executives and boards and spend extra time on long-term planning. They track their accomplishments in terms of how many business capabilities are deployed, while implementing more services. And they attract talent primarily by offering people appealing assignments, ample training opportunities, and well-structured career paths. Here we take a closer look at these best practices and their benefits.

1. Engage top executives in key decisions

A number of EA teams we know have helped accelerate their companies' digital transformations by participating in discussions of business strategy, which deal increasingly with technology. When we asked survey respondents about their involvement with various stakeholder groups, 60 percent of those at digital leaders named C-suite executives and strategy departments as the stakeholders they interact with most. By comparison, just 24 percent of respondents from other companies said they interact most with C-suite executives and strategy departments.

Sidebar

About the survey

McKinsey has conducted a survey on enterprise architecture in collaboration with Henley Business School since 2015. Respondents come from a number of countries and a variety of industries. The findings presented in this article are drawn from more than 150 responses collected in 2017. (Respondents are not required to submit answers to every survey question, so the number of respondents can vary from one question to another.) The findings are based on a two-sided t-test with an error value of $p \leq 0.05$. Respondents are asked to identify their companies as "digital leaders," and these choices form the basis for our comparative analysis of digital leaders and other companies.

Survey respondents who say their companies are not digital leaders indicated that it's common for their executive teams and boards to discuss enterprise architecture only when significant issues arise, such as spending decisions, while CIOs alone usually oversee the enterprise architecture.

While few if any EA groups would claim not to be focused on the business, effective teams truly invest their time in understanding business needs and convince senior leaders to invest time in enterprise architecture. Our experience suggests that digital transformations are more likely to succeed when board members understand the importance of technology for their business model and commit their time to making decisions that seem technical but ultimately influence the success or failure of the company's business aims.

2. Emphasize strategic planning

The survey results also indicate that EA teams at digital leaders maintain a clearer orientation toward the future than do teams at other companies. One hundred percent of respondents from digital leaders said their architecture teams develop and update models of what the business's IT architecture should look like in the future; just 58 percent of respondents from other companies said they adhere to this best practice.

Another key difference emerged when we asked respondents how much time their companies devote to strategic planning. Respondents who said their companies' EA teams devote a higher-than-average proportion of their capacity to strategic planning were also more likely to say they create added value for their organizations. (On average, respondents said strategic planning takes up about one-fifth of the EA team's working capacity.) Teams that spend more capacity than average on strategic planning were more likely to report delivering sustainable business solutions, making greater contributions to the benefits of projects, and gaining wider recognition within the enterprise (Exhibit 1).

Given the versatility of enterprise architects, leaders may be tempted to assign them to help resolve urgent problems of various kinds. However, this can cause the architecture team to spend most of its time solving problems and little or no time on advance planning. As a result, the drive to quickly fulfill demand for particular applications takes precedence over the thoughtful design process that is required to maintain a cost-effective, flexible, and resilient IT environment.

3. Focus on business outcomes

At a high level, digital transformation involves reshaping business models with advanced technology solutions. This puts a premium on collaboration between business functions and IT. In our experience, a lack of coordination between business and IT hinders large transformations. We have seen that such disconnects sometimes originate in the posture of IT functions: instead of concentrating on the enablement of business priorities, they focus excessively on the delivery of technology solutions as an end in itself.

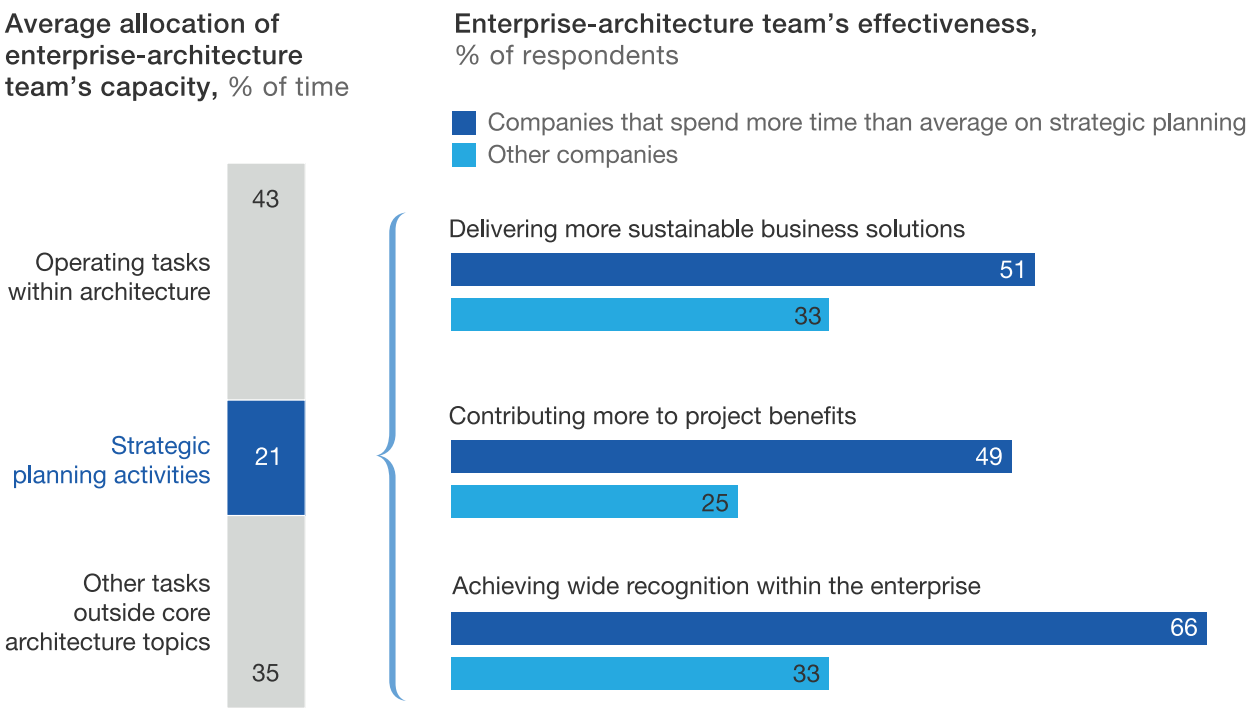
According to our survey, EA teams at digital leaders appear to avoid this trap. Respondents from digital leaders were more likely to say that EA teams contribute "high" or "very high" benefits to business and IT (Exhibit 2).

4. Use capabilities to connect business and IT

We've seen that an EA team can better align the IT function's priorities with the business's priorities by tracking its accomplishments with respect to the business capabilities that it delivers, rather than the sheer number of technology applications that it implements. Capabilities are self-contained business activities, usually belonging to an end-to-end business process, that result in discrete outcomes: for example, predicting a customer's next purchase so that a website or a call-center representative can make suggestions.

Exhibit 1

The enterprise-architecture department brings more value to companies when it spends extra time on strategic planning.



Note: Figures may not sum to 100%, because of rounding.

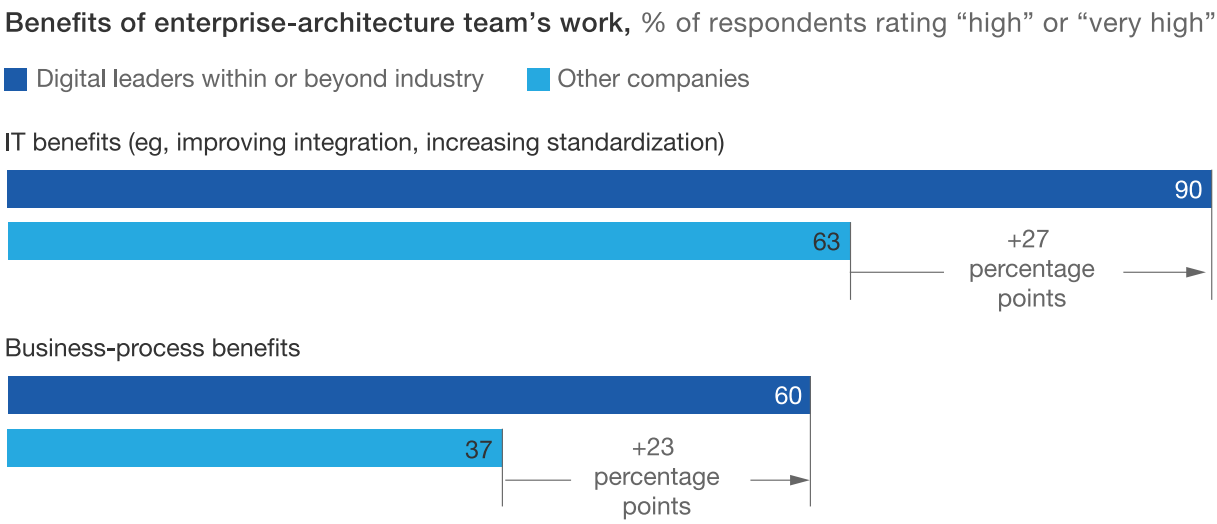
Source: Enterprise Architecture Survey, a joint survey from McKinsey and Henley Business School

This use of capabilities stood out in the survey. Respondents from digital leaders were more likely to say that their EA teams use capabilities as their primary grouping for the delivery of milestones toward their target architecture (Exhibit 3). Further grouping of capabilities into business domains (which generally correspond to business functionalities such as finance or customer management) can have the additional benefit of allowing an EA team to shape the IT landscape according to the business strategy.

The survey results show that digital leaders are also distinguished by how they structure their IT landscape. Digital leaders have implemented three times as many services as other companies. When it comes to integrating applications, a smaller proportion of their integrations consist of point-to-point connections between two applications (56 percent versus 76 percent at other companies), which lessens their "technical debt." Respondents from digital leaders were twice as likely as respondents from other companies to say that their companies are piloting architectures based on microservices, which are independent components that developers assemble into software applications.

Exhibit 2

At digital leaders, enterprise-architecture teams make valuable contributions.



Source: Enterprise Architecture Survey, a joint survey from McKinsey and Henley Business School

5. Develop and retain high-caliber talent

Because EA departments play an important role in digital transformations, we've seen that IT leaders do well to staff them with motivated, highly skilled professionals. Yet our experience also suggests that enterprise architecture's long-held reputation as a mundane field with limited room for advancement can create challenges when it comes to attracting top talent.

The good news is that prospective hires appear to be drawn toward exciting work that offers opportunities to learn and grow. Our survey results indicate that enterprise architects generally seek interesting challenges, recognition from their peers, learning opportunities, and structured career paths. Respondents from digital leaders were more likely to cite peer recognition, education, and well-defined career paths as features that appeal to their employees (Exhibit 4). They were also more likely to say that they offer enterprise architects the chance to pursue career paths in departments other than enterprise architecture.

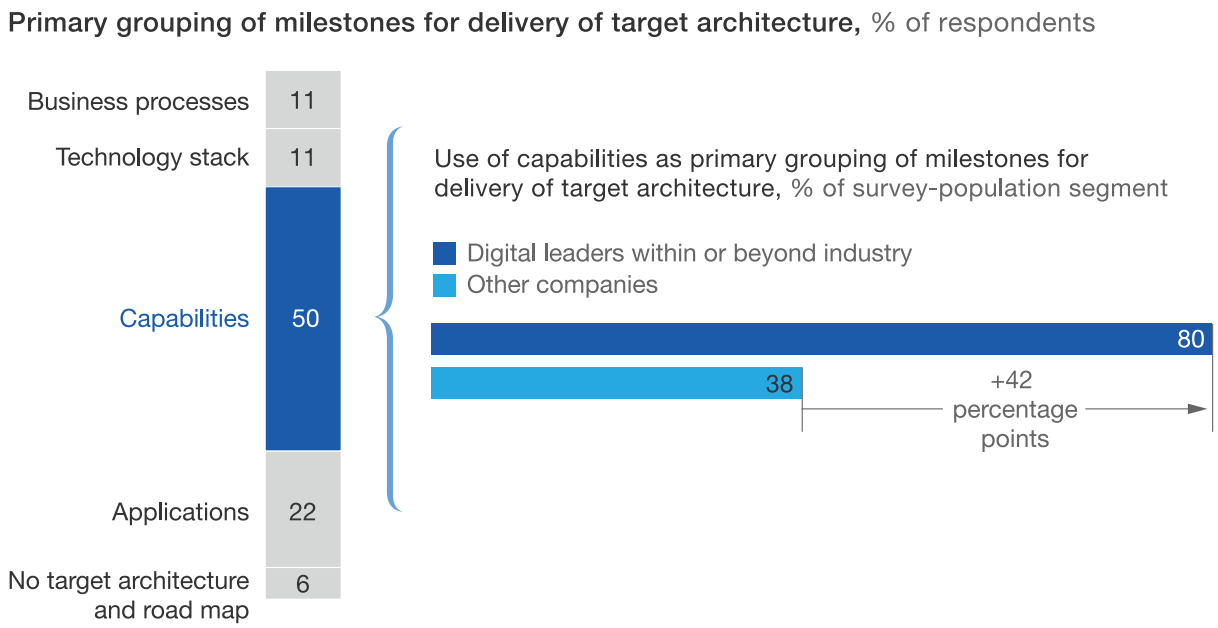
Capturing the opportunity for enterprise architecture

For EA teams, supporting successful digital transformations involves more than implementing well-chosen technology solutions. It requires an operating model that aligns governance, processes, and talent models with the business's needs and promotes effective collaboration between business and IT. The survey findings, along with our experience in enterprise architecture, suggest that four moves can help EA teams advance their companies' digital transformations:

— *Translate architecture issues into terms that senior executives will understand.* Enterprise architects can promote closer alignment between business and IT by helping to translate

Exhibit 3

At digital leaders, enterprise-architecture teams are more likely to track their milestones through delivering capabilities.



Note: Figures may not sum to 100%, because of rounding.

Source: Enterprise Architecture Survey, a joint survey from McKinsey and Henley Business School

architecture issues for business leaders and managers who aren't technology savvy. Engaging senior management in discussions about enterprise architecture requires them to dedicate time and actively work on technology topics. It also requires the EA team to explain technology matters in terms that business leaders can relate to.

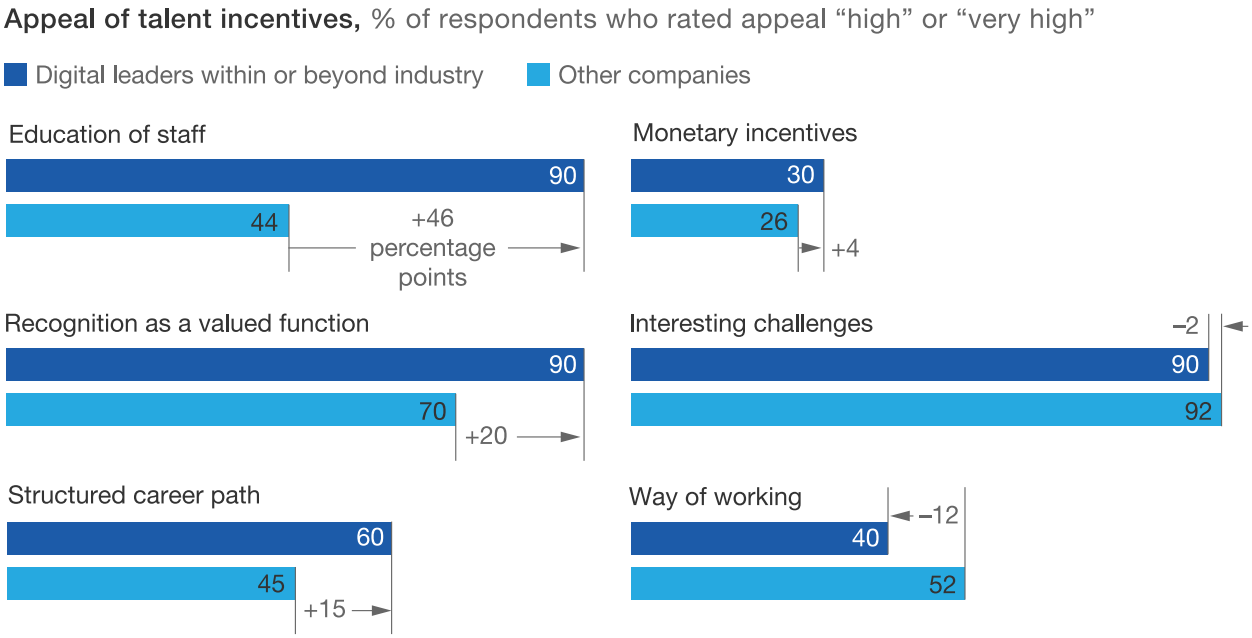
— *Draw capability maps to link IT priorities with business needs.* Capability maps appear to be effective communication aids for enterprise architects: respondents from digital leaders were more likely to report using capability maps (80 percent) than respondents from other companies (38 percent). Focusing on business processes can lead companies to end up with multiple systems that perform similar functions, such as customer-relationship management. Concentrating too much on technology can cause EA teams to organize their work around building applications rather than enabling the business.

— *Start with a clear target architecture and strategy.* Digital leaders spend more time on planning the future and building a strategy to achieve it. EA departments also need to balance their long-term planning activities with meeting the business's day-to-day demands.

— *Provide training that helps enterprise architects to succeed.* The enterprise architect of tomorrow needs similar skills to those of his colleagues on the business side: communication, coaching,

Exhibit 4

Enterprise-architecture professionals appear motivated by interesting challenges and recognition, but digital leaders offer more opportunity.



Source: Enterprise Architecture Survey, a joint survey from McKinsey and Henley Business School

and problem solving. Without these skills, architects won't be able to bridge business and IT perspectives. Companies can revise their training programs and development paths so they place greater emphasis on business and management acumen.

With these tactics, EA teams can build stronger working relationships with senior executives and managers—and thereby position themselves as strategic partners in their companies' digital transformations.

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The authors wish to thank Sharm Manwani of Henley Business School for his contributions to this article.

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Part

05

Next-generation operating model in action

An insurance company transforms itself by putting technology first

The deep transformation of healthcare company Anthem presented unique challenges. Here's how the company set up its strategy to meet them.

Anthem wanted to transform itself *from a healthcare business that uses technology into a technology company that runs a healthcare business. That required a comprehensive digital adoption strategy, enterprise-wide buy-in, the ability to attract and retain new talent, and a tolerance for failure. Anil Bhatt, vice president and head of digital solutions and experience for Anthem, discusses his company's digital journey with McKinsey's Barr Seitz.*

Reinventing Anthem through a digital transformation

The digital transformation at Anthem really started in early 2017. While we had small, incremental mobile-application or portal initiatives going on, we did not have a deep transformation of digital going on across our financial, HR, and other functional areas. In March 2017, we combined all our efforts together to drive the deep transformation that we needed from within to really improve the experience for our constituents.

At that time, my team was around 2,000 people from a total of around 3,000 people engaged in the digital transformation. So it was a pretty huge effort across the board. The team was a mix of technology, business, customer-service, and functional leaders who were engaged on a day-to-day basis.

As a result of this transformation, we essentially moved from being a healthcare business that was using technology to being a technology company that is running a healthcare business.

Leadership around what matters

As you are embarking on your digital journey, one thing that is very important is having the tolerance for failure and the tolerance for adjustments as you move forward. Nothing will be perfect from day one.

The main thing for you to understand as a leader is to make sure you see a measurable difference in the way the team is executing, that you see the commitment the team has toward the planned deliverable, and that the team is moving in the right direction on those initiatives they want to deliver.

Providing the right focus, the right leadership, and showing them exactly what is expected will result in a great product for you at the end of the day. Having that patience and conducting regular check-ins to make sure the team is really moving in the right direction is terribly important.

What you do not want is to lose contact with the team and experience a surprise in six months. That's the worst-case situation. You also can't worry about small missed milestones here and there. If you are too hung up on missing a milestone on any given day, you'll lose focus on the big picture, and it ends up demoralizing the team. So as a leader, you have to make those assessments and encourage the team that it is heading on the right path.

Important management challenges

A digital transformation needs a lot of things to come together at the same time. In this case, we really wanted to make sure that we had buy-in from the business leaders and had the processes, change management, and everything else in place. We started off by bringing together the key leaders from across the organization, making sure that they were all following the digital agenda of Anthem and understood what their role in this execution would be.

Lastly, we also made sure that change management across the board was very well understood. You can build great digital tools, but if you don't create a great adoption strategy to go with them, they won't be adopted. So we had our internal and external adoption strategy in place to maximize the usage of these digital tools.

Key learnings

One of the things we learned in our journey was to make sure we were focused on creating a best-in-class experience for our constituents.

That meant revamping the way our journeys were defined within our company and examining what each journey needed from a product-ownership and execution perspective. It also meant moving toward more-nimble development and a fail-fast approach.

Another one of the surprises for me was to see how much enthusiasm there was in each functional area within Anthem to really do better for their members. When we identified what digitization of their processes and experience could do for them, they really jumped on it. They were really the proponents of delivering those benefits to our members, our brokers, and our providers.

What also surprised me was that, while we had the talent, we lacked the existing structure to execute in an agile way. So we focused on building a more agile organization, identifying key product owners who were going to help us define the road map we wanted to execute. We also developed an execution backbone to support quick delivery and speed to market by using these digital tools.

Identifying quick wins to create future funding models

We had to look at our talent and investments across the board and take a plan back to our leadership that spelled out what we needed to be a digital-first organization. We wanted to show measurable differences on the investment our leaders were going to make.

A lot of the initiatives we executed provided us results within the year, which basically created the future funding model for new initiatives we wanted to undertake. Identifying your quick wins, identifying where you can make a very big difference with a minimum investment, and then using that as an impetus for your future leap on the digitalization journey is very, very important.

I'll give you an example. We pushed for digital ID cards as an option through our self-service channels. This allowed members to get an ID card on their mobile or print one from our portals. That reduced the expense of sending ID cards to these members, which was a direct savings that we could articulate.

Filling the talent gaps

Talent is a major issue when embarking on a digitalization journey. One of things we did was create a road map of the talent we needed to be successful. We then worked with our HR teams to identify roles for these individuals and revamped our compensation and reward structures to make sure we could entice this new talent to join us.

When you have computer-science graduates just coming out of college, their aspiration is to go work for the Googles, the Microsofts, or the Apples of the world. To get them to understand what a healthcare-insurance company like ours is doing with technology is a very tough task. But we had leaders who traveled to the campuses and told them exactly what we were doing, how we were working with the new digital technologies. The ability to bring these new graduates to Anthem to work with us was a first step in the right direction.

And the networks these students create within their universities is crucial. New graduates always want to see where the last batch of graduates ended up, so we've been able to create a pipeline of talent who really want to come and work with us.

Retaining new talent

Retaining talent is one of the core things we need to work on as leaders. It's great to hire a new talent, but you need to keep them engaged, and not only from a technology perspective but from a product-owner perspective. It's very important to show them the value that they're generating for our constituents. Whether a person is working on a member journey or on a provider journey, it's really about valuing the output that they're creating.

It's also essential to make sure that they're aware of their career path as they complete a

key engagement. Putting them together with a mentor whom they can really lean on in terms of knowing what they need to do next and making sure that their individual development plan reflects the growth they want to experience are also very important.

Overcoming the challenge of fatigue

Every journey that you take, whether it's a digital journey, a technology revamp, or a business-process improvement, goes through a cycle. It goes through a phase where there's a lot of enthusiasm, where people are really engaged and willing to go out of their way to ensure success.

Then there is a fatigue that develops slowly and steadily. If you cannot show them what difference they are making in the lives of members and constituents, it's going to be very difficult for you to keep them motivated as you move forward. The reward structure that you put in place is another way you can make sure that they're engaged, so they know the effort they are putting in results in some kind of benefit for them.

Making sure that you are getting constant feedback is also critical. We had a control-tower structure set up, where each individual delivery leader as well as initiative owners could provide constant feedback. As leaders, we needed to make sure that we stayed on top of that. The worst thing you can do for your team is to get feedback and do nothing. We reached out individually over the transformation process to react to that feedback in a positive way.

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The Western Union Way of digital transformation

Western Union uses a central team to build new capabilities across the business.

The transformation of a legacy company *whose roots lie in the era of the telegraph involves more than just lean deployments and agile methodologies. It requires a change in process and culture, the adoption of a common lingo, executive buy-in, and a center of excellence to ensure enterprise-wide success. Dan Nordlander, senior vice president of Western Union Way Operations at Western Union, discusses his company's unique transformation journey with McKinsey's Barr Seitz.*

Jump-starting growth via transformation

The primary reason we decided to go through with this transformation is that we saw an opportunity to positively impact revenue through our daily operations and behaviors. We have a lot of great ideas in terms of investments to drive that topline revenue growth, but we needed ways to fund those.

In order to fund the investments, we decided that it was really important to do a transformation exercise, look for ways to gain efficiencies and effectiveness across our processes and procedures, and then use those efficiencies to fund the growth investments.

Getting everyone to speak the same language

One of the benefits that we've really seen as we've gone through these first two years of our journey is what happens when we get everyone speaking the same language. We started function by function, looking at individual deployments across our different groups in the company. As we've done that, everyone has started to speak the same language, whether it's talking about going to huddles, doing process confirmations, conducting one-on-one coaching, or maybe doing floor walks. That's really enabled a lot more collaboration across groups. Teams that may not previously have interacted with each other are now doing floor walks with each other.

The benefits of floor walks

One of our most important tools is the floor walk. This entails a leader or a manager being on the floor with people doing their day-to-day jobs, just observing the way they work. It's not done from the perspective of correction or a negative consequence. It's more about having the manager understand how the work actually gets done on the floor.

We do that both in-line, so you as a manager go and visit your own organization, but also visit other functions. And that could be at an operation site or it could be more of a frontline thing like a sales executive.

But it's really all about allowing the manager to observe the way their employee works, what's easy about that job and what's hard about that job. And being with the people that are actually doing the work really helps the management get a better sense of where they can use their leadership and influence to make that process easier for the employee and better for the customer.

When people from different departments do these floor walks together, they're realizing that they actually have a lot more in common with each other or notice areas where they can collaborate that they didn't realize before. And when that happens, they start to see further opportunities for continuous improvement, leading them to new ideas about things they can do to improve efficiency or effectiveness.

Transforming the culture and the processes

When we started the transformation project, we came at it from the perspective of this being a cultural transformation just as much as a process transformation. So we established a set of what we call market-shaper practices that we wanted to focus on. These are things like rewards

and recognition, top-down innovation, and consequence management.

There are 13 of these practices, and that's really how we're assessing success with the transformation across the organization. Behind those market-shaper practices are the lean tools and behaviors we develop and encourage. These are more tactical, day-to-day ways to implement lean across the organization. They can include creating strategy placemats (one-page strategy overviews that are easily shared), frequent team huddles, one-on-one coaching, and process confirmation.

The idea is to orient the company around improving these market-shaper practices, really getting the health of our organization strong, and becoming confident that if we can improve the health of the organization, the financial results will follow.

We scored ourselves as an organization on these market-shaper practices when we started the transformation in 2016. Every year or two we rescore ourselves in a company-wide exercise to see where we're making progress and where we're falling behind. That helps us refocus on the particular market-shaper practices that we need to double down on in order to continue improving during our transformation journey.

The 'Western Union Way' to drive the change

We built the Western Union Way team, or the WU Way team as we call it, with ten high-potential individuals from around the company. How do you start there and end up with a fully embedded transformation across a company of 12,000 people? The way we approached it was to use the central WU Way team for capability building. We teach employees, and then they execute.

As we get the pilots completed, the idea is to turn the WU Way team into more of a center of excellence. They'll be there to help you stay on track or course correct when you have troubles. But it becomes more self-driven, and that really enables the scale. That allowed us to go from ten people to about 50 change agents in the first wave, which will be able to support 2,500 employees and 4,000 vendor full-time employees within two years.

As the transformation gets embedded into the organization, the businesses start to run their own agile deployments. The center of excellence keeps things on track and makes sure we follow a framework and are tracking the results, so that we can measure the impact of the transformation across the whole organization.

Lean deployments and agile methodologies

Lean deployments are a big piece of our overall transformation program. The second aspect is our agile work, where we spin up teams that have learned and are now experts in using agile methodologies for product launches or IT development.

People are enthusiastic about the results of the pilot, and they want to see that in their own area. They essentially sponsor a team and loan the resources that are necessary. The central transformation team helps do the capability building in training those resources up, and then they run their own scaled-out deployment.

Now that these pilots are winding down, it's been easy to get the support across the organization to find the resources necessary to establish teams that can scale it out in different areas across the company. So we'll go from maybe four pilot teams to a plan to scale out across 400 people and maybe 30 teams next year.

All of that is dependent on people in the organization putting resources behind this kind of an agile transformation. The pilots help get buy-in

across the organization, and then once we have that buy-in, it provides the resources necessary to scale.

The impact of executive buy-in

From the CEO down through his executive team, you see a real commitment to this transformation exercise and a real commitment to finding ways to optimize our processes, to get efficiencies, and to fund those investments that will drive topline revenue growth.

So it's a real imperative across the top of the organization. And when you have that, it becomes easier to have a stronger level of influence than you might otherwise expect with a small team, because everyone in the organization is clear that, whether you're working directly with the WU Way team or not, your job is to find ways for continuous improvement.

You're expected to find ways to optimize your processes and drive value. You're expected to come up with new ways of innovation to drive revenue growth across the organization. The executive team has done a great job of making it really clear across the company that this is something that's expected of you. That support has made it a lot easier to have the influence we need to make the transformation successful.

Game-changing results

Looking back at the results of our work over the last couple of years across all of our deployments, you see some really impressive gains. We're talking 30 percent, 40 percent, and, in some cases, deployments with a 70 percent return on capacity. So you're really talking about game-changing differences between how processes worked before and after.

What's really nice about that is that it's so visually obvious. People who knew how a team or a group worked before can come in and see it's night-and-day different. That makes it much easier to go into other areas of the organization and say, "We did this in this part of the company. Imagine what we can do if you let us work with your team as well."

You're starting to see that happen culturally. Maybe it started out as more of a push, where we were looking to come in and work with a team. Now it's more pull. People are asking us, "Hey, can you come help me? I want to see those same results in my organization." I think that's an indication of how well it's really working across the company.

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A bank transforms itself by transforming its culture

Putting its people first has been the key to a Brazilian bank's successful transformation.

Transforming a financial institution *set in its ways offers a number of daunting challenges. One of the biggest is the need to attract and integrate new talent whose methods, mind-sets, and motivations often differ greatly from those of existing employees. But if done successfully, this process can take on a life of its own, as the entire enterprise buys in and shifts to autopilot. Cristiano Malucelli, CEO of Brazil's Paraná Banco, discusses his bank's transformation with McKinsey's Julia Broide.*

Overcoming the talent challenge

Talent has always been an important pillar in our culture, so we had to have the capacity to attract people, develop them, and keep them motivated.

But bringing these people in was quite a challenge. This new talent, with a very different culture, meant we had to adapt as well. Unlike former generations, who were more concerned about generating profit and results, these people want something more from their work. They demand an environment that offers challenges but is also engaging and meaningful, in a company that has a purpose they identify with. That is why our value proposition—to offer clients a superlative experience—helped with recruitment.

The first hires were particularly important. As we successfully put together the first team, we took advantage of their technical knowledge and networking ability to form the other teams. This allowed our recruiting effort to build on itself and helped us to overcome the challenge of recruiting the right people, which turned out to be far more difficult and complex than we thought it would be when we started this journey.

Culture by osmosis

Our first agile team had a clear mission to build a minimum viable product (MVP). This 16-week learning process was a long and winding journey, but we needed to see it in action and do it with people from other divisions of the bank that were not yet as agile as they could be. Over time, this team began to positively influence their colleagues, and little by little, the mind-set of the bank started to change.

What's interesting is that when the culture within a company starts to change and that change gains in strength, it effectively spreads across the business organically. People buy into it, and things start running naturally. You don't need managers constantly certifying and controlling, since people are clear about their missions. People improve their communication with other areas of the company. All of a sudden, the transformation starts gaining momentum and spreads throughout the organization. And, in fact, the company goes on autopilot in the best sense of the word.

As a result, your role as leader is much more about articulating the vision, facilitating between the areas and the team while creating the skills required for the transformation. And before you know it, the culture is positively permeated with the vision, by the agile way of doing things.

Satisfying a need for personal and professional development

I think people have a natural desire to learn. They like a challenge and want to develop themselves professionally. This is what drives them.

People realized from the moment the bank embraced the challenge to transform itself that they were going to be part of that transformation and, in fact, the most important part of the change. They understood that the bank was giving them an enormous opportunity for professional achievement by allowing them to help the bank transform itself.

The employees really started to understand and experience this transformation when they convinced themselves it was possible to provide

clients with greater satisfaction by offering them a more pleasant and simple experience than before. It also really helps employee morale, because it's satisfying to help a client.

Doing things differently with the benefit of hindsight

Looking back, if there were something that I would do differently, it would be involving senior management earlier in the process.

Since a transformation affects the status quo, it naturally gives rise to concerns, particularly for the people leading the organization. This generates some degree of anxiety. I didn't give this issue enough importance, because I thought what we were doing and why we were doing it was clear to them.

This was the major lesson. Right from the first conversation, I should have been more transparent with senior management, making it clear that the transformation was for the good of each individual and the greatest good was for the company. I should have let them know that they also had a lot to contribute and reassured them that certain decisions would migrate to more-junior positions because those closest to the client have the most information. Fortunately, there was time to resolve the problem.

Unexpected fringe benefits

The most pleasant surprise of the transformation was how people bought into this initiative and how much it improved their motivation. As a bank, we have always focused on improvement, challenges, and fostering a pleasant environment, but this is different.

You have a purpose that people can identify with. It becomes an incredibly collaborative working environment, even as there's extreme pressure to produce results. It brings together the best you have in organizational culture and makes people feel that everyone is on the same page and willing to help.

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Scaling and accelerating a digital transformation

Putting customers at the center of its digital transformation helped IAG build trust within the organization and accelerate the change.

Digital transformation *is often most challenging when it comes to scaling change, reinventing processes, and choosing a relevant approach. Mark Drasutis, chief digital officer at IAG, spoke with McKinsey's Jonathan Michael and David Pountney to discuss how he has been thinking about, influencing, and implementing change to overcome these challenges and transform a legacy business into a digital one.*

Organizing for transformation: Customer journeys and business goals

Over the past 15 years, the business has been transforming itself, and there was an ambition to change the business model from being purely insurance to aligning with our purpose: "To make your world a safer place."

It's no longer about the insurance products; it's about predicting and protecting the world around customers. Digitizing the business means that we can actually interpret the right signals for our customers to predict and protect their world.

We started with the motor-recovery-claims journey, as this was where there was the most benefit for the customer. In addition to standing up a journey team, we also set up a "journey accelerator," a small central team focused on codifying the methodology and setting the program up to scale.

That accelerator function was really critical. We were learning from our past and how we tried to do transformations previously, moving away from a project-, product-, and brand-specific approach to a horizontal customer approach.

It started slow, as is common with many of these changes. You have to get the right people in the right room. There were a lot of questions from the business: Is it the right thing to do now? Is it part of our simplification journey, or is it part of our growth journey? And could we really achieve the projected financial benefits? This is the critical thinking required to ensure we're on the right path.

The accelerator: Traffic control for a successful transformation

The accelerator is a vital team that sits across all the journeys. It operates like a control tower at an airport, looking across all the activities to understand and direct priorities. It brings together expertise across the business to deliver on its objectives.

It owns and codifies the 20 journeys that we are embarking on within the business. They look at the benefits, which journey is next on the runway, who in the business is best to lead (the business sponsor), and how best to deploy the playbook.

It's not a traditional project-management office (PMO). It doesn't operate within tight guardrails. It's a lean, fluid governance model, which means it can move quickly and still manage risk, tracks all of the data reporting, and has the ability to quickly escalate for resolution.

The accelerator also owns the communications for each of the journeys to the wider business. Overcommunication is never really an issue on digital transformations. Consistent and constant communication is required to take people on the journey, which plays an important role in creating the mind-set shift and buy-in to continue the momentum.

A repeatable process for transformation at scale

Scaling and codifying are the two principles that underpin journey transformations. We've created a repeatable, 16-week process, with teams located across all our journey points, that can be scaled across all brands in Australia and New Zealand. For

each one, we also have a clear value proposition for the customer.

We are building these journeys using APIs [application programming interfaces] to connect them to core insurance technologies. We build customer technologies and the platform once for the whole business, but we've included the ability to configure the front end instead of building it new every time. These are the principles we've applied to all the journeys, and the first journey is already seeing the benefits materialize.

We had a number of releases recently from our first journey team, which was focused on tracking and managing motor repair and digitally lodging a single-vehicle claim end to end. We launched this on one of our brands in Australia, and within four weeks we had configured it for New Zealand, which is on a different core-insurance platform tailored to local regulations, rules, and systems. We did it within a number of weeks, where it would've taken us a number of months in the past.

As digitization produces results, trust in the process grows

Part of the challenge and part of the opportunity within the digital transformation was to look at how we were changing the mind-set of a traditional business. We wanted to move people who were operating in an assisted-first way to a digital-first business—and eventually to a business driven by cognitive capabilities. We needed to provide proof of trust. Embedding experts from key business areas into these cross-functional journey teams built that proof of trust.

Leaders in those insurance businesses have embraced this journey approach, because it's changing their processes and they are seeing the benefits grow. It's making them more efficient. It's basically driving their change.

We are tracking the benefits with a regular cadence to ensure that, if we are using digital to reduce, for example, the touchpoints with a customer for a single-vehicle motor claim, we're reflecting those back into the budgets and the impact on the operating rhythm of the business.

Leading a digital transformation starts with understanding your people

You have to tailor your leadership style based on the people you're working with. Someone coming to the table who's been an actuary for 25 years requires a different approach than someone who is a digital native. I think we need to have empathy and a level of emotional intelligence to understand that this is a fundamental shift in the way we do things. A whole business transformation can't be done within a quarter. Persistence and strong leadership are required.

We try to have diversity of thought among our leaders. For example, the leaders on our customer-labs team are more than traditional financial-services people. Our CMO comes from Saatchi & Saatchi New York, our chief analytics officer has a background at Ford and Walmart. We're bringing a lot of different thinking to our business because we want to move beyond insurance to making the world a safer place for our customers.

Key elements in accelerating a transformation and making it stick

I think having the full business view right from the start sets you up to understand the ground. You need to also have a clear line of sight around the economics, benefits, value, and which direction is the north star.

Be prepared to break the rules, but for the right reason. If there's a sacred cow in the business, make sure you challenge it thoughtfully and with

data. I think also that driving results and showing benefits to illustrate traction are important.

But I think finding the best people to build the right team is the main lesson. Don't be afraid to have diversity of thought in the team. Ensuring everyone has an equal voice regardless of their area of specialization is key.

For us, having some industry knowledge was vitally important, because you can't transform without knowing the current state. But you also need to balance this with having experience outside the industry to ensure you encourage the expansion of people's thinking.

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Finding talent and speed to transform a credit-card company into a digital native

A successful digital transformation means a lot more than new technology. You need to go all in, for the long haul.

Apart from the adoption of new technology, *the digital transformation of a legacy company requires new methodologies, a new value proposition, new skills, and the passion to go "all in." Miguel Peña, vice chairman of Argentine credit-card issuer Naranja, recently discussed with McKinsey the challenges and successes of his company's ongoing digital transformation.*

A digital-transformation journey that never ends

We serve five million customers, but we realized we weren't reaching our full potential. We understood that a digital transformation could allow us to reach more people and offer them new services.

Two years ago, we started going all in into our digital transformation. We've been developing a digital factory, creating advanced-analytics teams, digital-transformation teams, and digital-marketing teams. The results are really remarkable: we've greatly improved many of our customer and financial indicators.

This journey will not end, because it's not a journey anymore—it's forever. We will continue our digital transformation. And in the end, we feel that after transforming ourselves from a physical to a digital company, there will be no difference between us and a digital native.

Getting the workforce to adopt agile

Moving people from the traditional way of working to the new way of working is actually very easy. And why is that? Because the new way of working is better than the old way. But first, you need to give your people new skills.

So we put in place a digital academy to give them the basic tools to succeed in agile teams. The on-the-job training was very fast. We now have 300 people in 14 teams working in the agile way. It wasn't so hard. But you have to empower your people. When you change, you don't want to go back.

Finding the 'fast' mind-set

First of all, our competitors, the digital natives, are going so fast that you have to go all in. Half-hearted is not enough. You have to focus not only on methodologies and people but also on the passion to transform your company, and you have to transmit that passion to your associates. That's what we've been doing the past two years or so.

Now, we are moving faster than we ever have before. But the competition and the customers are demanding more. We can do huge things in three to four months now. And in the past, we got very little done in three to four months. That's the pace we are moving at. But we need to go faster.

Achieving dramatic results by embracing agile

For me, digital transformation is not only about technology. It's about a new value proposition for customers, and a new way of doing things. If you combine these three things—technology, value proposition for the customer, and a new way of doing things—you will go all in, and you will have big results.

The way we do things now is really different from the way we did things in the past. In the past, it took us a year to produce one release. Now, we are already seeing results in two or three months, with lower costs.

Technology also helps you to do things less expensively, and if you use sophisticated technology at scale, things that once took years may take only weeks. But you need the right skills and the right people. You also need to decide which technology will help you to embrace a new way of doing things.

One of the initiatives that we are pursuing is creating new digital financial services. To do it, we needed a new core banking system. The old system took three to four years to install. But thanks to new technology, it took us only six months to put together a new core banking system that's fully cloud enabled. That's what speed means. If you don't use the technology, and the opportunities it gives you, you cannot compete in the digital world.

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