

McKinsey South Africa

Digital reinvention can spur South Africa's economy

If companies in the country embrace digital, they could outpace peers and see an increase in profitability and revenue growth.

by Tawanda Sibanda



The case for digital reinvention across all industries and sectors has been clear for some years: companies that embrace digital will outpace their peers financially and benefit from greater profitability and higher revenue growth.

The pace of change, however, is slow. Research published by McKinsey in 2017 showed that, despite the apparent ubiquity of digital technologies in day-to-day life, industries were less than 40 percent digitized on average. Even with relatively deep penetration of technology in media, retail, and high tech, traditional industries contributed to the lag and continue to do so today (Exhibit 1).

The global findings pointed to pressures on revenue and profit growth as a result of the reduced economic friction and the competition that digitization enables (Exhibit 2). In 2017, digitization had already taken out, on average, up to six points of global annual revenue and 4.5 points of growth in earnings before interest and taxes (EBIT).

The impact on revenues and profits will persist with further digitization, widening the gap between the bottom quartile of companies and those at the top that are capturing disproportionate gains through their digitization efforts.

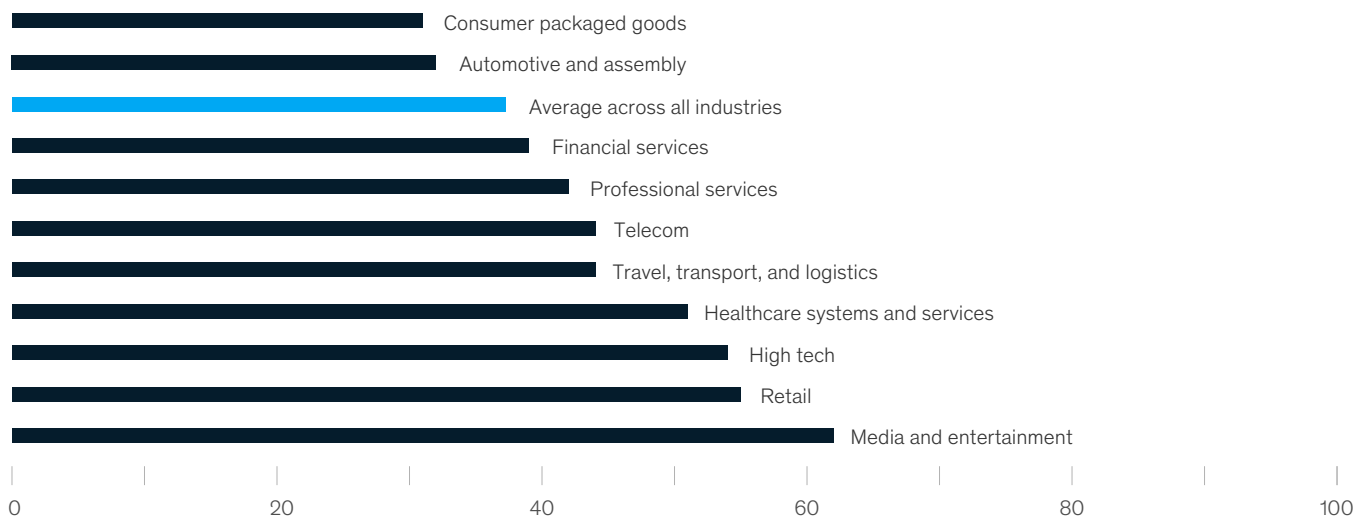
Exhibit 1

Digital is penetrating all sectors, but to varying degrees.

Perception of digital penetration by industry,¹ % of respondents

No change	Minor secondary change	Some core change	Digital reaching mainstream	Predominantly digital	Fully digitized
10	30	20	24	12	4

Perception of digital penetration by selected industry,² % of respondents



¹Data, published in 2017, reflect average of respondents' ratings on degree of change in the preceding 3 years within each industry across 5 dimensions (products, marketing and distribution, processes, supply chains, and new entrants at the ecosystem level).

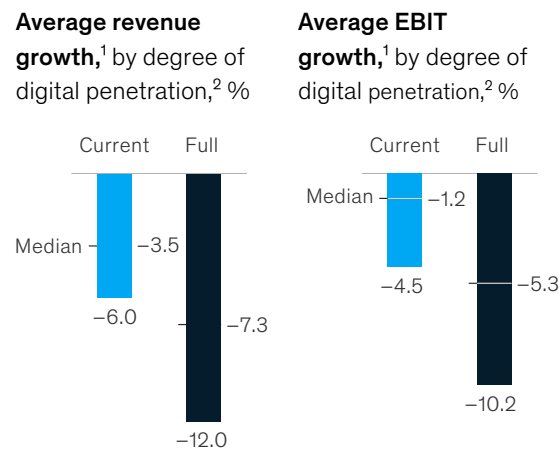
²For consumer packaged goods, n = 85; automotive and assembly, n = 112; financial services, n = 310; professional services, n = 307; telecom, n = 55; travel, transport, and logistics, n = 103; healthcare systems and services, n = 78; high tech, n = 348; retail, n = 89; and media and entertainment, n = 86.

Source: McKinsey analysis

One of the biggest differentiating factors between the top economic performers and others is how quick and adaptable they are in setting, executing, and adjusting their digital strategies.

Exhibit 2

Digitization is putting pressure on revenue and profit growth.



¹ We based our model of average growth in revenues and earnings before interest and taxes (EBIT) at current and full digitization on survey respondents' perceptions of their companies' responses to digitization, postulating causal links, and calculating their magnitude through both linear- and probit-regression techniques.
² Digital penetration estimated using survey responses published in 2017; average digital penetration across industries currently = 37%.

Source: McKinsey analysis

Accelerating the pace of digitization

Most companies, it seems, are not sufficiently bold in the magnitude and scope of their digital investments.

Two pathways exist depending on where businesses find themselves on their digitization journey. The

“disruptors”—those that initiate digital disruptions—receive the biggest payouts, whereas the “fast-followers”—those with operational excellence and superior organizational health—are not far behind (Exhibits 3 and 4).

Fast-forward two years: McKinsey finds that companies, on average, have made little progress in their efforts to digitize their business models. Those that have made strong gains from digitization have followed either the disruptor or the fast-follower model.

It's safe to say that the landscape in South Africa is no different.

Many of South Africa's large corporates, outside of banking, high tech, and telecommunications, which sit ahead of the pack, are in the early stages of their digitization journey. From the mining and chemical industries to retail, many traditional businesses are only just beginning to implement digital strategies.

Four steps South African businesses can take, borrowing from the global winners

1. Increase agile practices to accelerate digitization

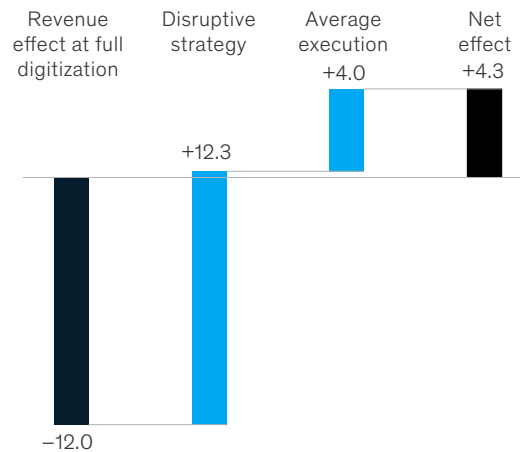
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There is much discussion across all industries about the various ways to speed up digital delivery

Exhibit 3

Disruptive strategies are a powerful response to intense digitization.

Revenue-growth profile, %



Source: McKinsey analysis

and drive closer alignment between business and IT in South Africa. While most organizations are in the early stages of implementing agile at scale, financial-services firms lead the charge.

Standard Bank's announced IT Transformation Program, for example, encompassed an agile transformation across its 6,000 IT professionals to enable faster software updates and rollouts. The changes involved breaking down silos. Instead of developing software in isolated teams and work

streams, teams now work together to develop software in small batches.

2. Take advantage of ecosystems

The companies that outperform on revenue and EBIT also take advantage of new digital ecosystems to become more embedded in the lives of their customers.

By 2025, McKinsey expects 12 distinctive ecosystems to emerge around fundamental human and organizational needs and that these ecosystems will account for roughly 30 percent of all global revenues.

Although few companies can mount disruptive strategies at the ecosystem level in the same way as Alibaba, Amazon, Google, and Tencent, which have radically pushed digitization on their respective platforms, some are doing this well (see Exhibit 5 for more on companies investing in new digital businesses).

South African insurer Discovery is at the forefront of ecosystem thinking with its Vitality platform. Today, millions of users track their health using Vitality and participate in activities to earn loyalty points with Discovery's extensive network of partners, including British Airways, Emirates, and Europcar. By partnering with local providers, the insurer was able to penetrate international markets.

3. Use mergers and acquisitions to build new digital businesses and capabilities

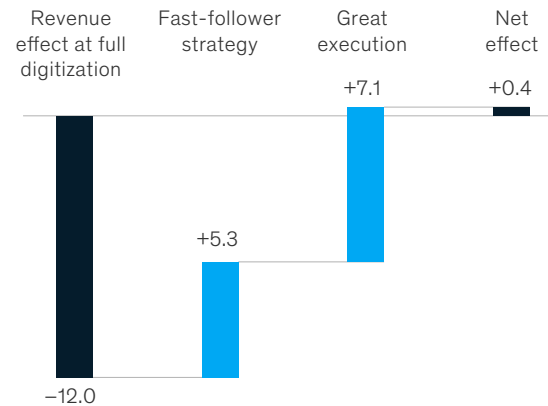
M&A activity is another differentiator between the

A correlation exists between the pace of technological change and the availability of talent to deploy and manage such change.

Exhibit 4

Fast following and great execution are the next best thing to disruption.

Revenue-growth profile, %



Source: McKinsey analysis

top-performing companies—which leverage M&A to help build digital capabilities, rather than trying to build them through a slower, organic approach—and everyone else.

Not only are the leading businesses spending more than others on M&A, but they are also investing in different types of M&A activities (Exhibit 6).

South African companies would do well to step up their level of M&A activity.

One constraint, however, is the lack of a vibrant start-up landscape. Most examples are anecdotal and include warehouse retailer Makro, which acquired a majority stake in South African last-mile-delivery start-up WumDrop, in a move to speed up deliveries. In the real-estate industry, Pam Golding Properties acquired an online digital estate agency, Eazi, as part of its strategy to adopt an online hybrid estate-agency model.

4. Invest digital talent ahead of peers

A correlation exists between the pace of technological change and the availability of talent to deploy and manage such change. A lack of digital talent is a significant constraint on digital reinvention in South Africa.

Companies like BCX, Cisco, Google, and Microsoft have made headlines for their investment in digital capability building in South Africa. Cisco, for example, invests in the development of the

Exhibit 5

Top-performing companies have invested a higher share of their digital capital in new digital businesses than their peers.

How organizations' digital capital was allocated, by objective, past 3 years, %



¹ Respondents who say their organizations have a top-decile rate of organic revenue growth (ie, of 25% or more in past 3 years), relative to other respondents; n = 123.

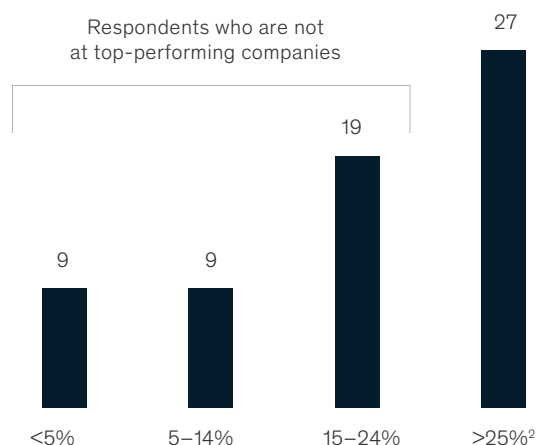
² n = 1,125.

³ Includes respondents who answered "developing digital businesses in your primary industry" or "developing new digital businesses in an adjacent industry."

Source: McKinsey analysis

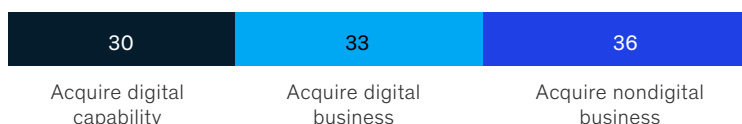
The top performers spend more on M&A and take a more digital-oriented approach than other companies do.

Share of organizations' annual revenue spent on M&A,¹ % of respondents

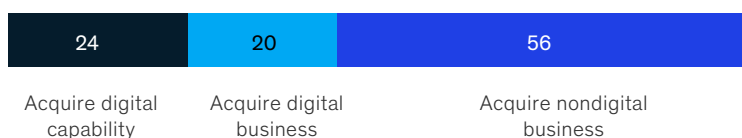


How organizations' M&A investments were dedicated to types of activities, past 3 years, %

Respondents at top economic performers²



All other respondents³



¹ Excludes respondents from publicly owned companies, who were asked how much their organizations invested in M&A as a % of market capitalization over past 3 years.

² Respondents who say their organizations have a top-decile rate of organic revenue growth (ie, of 25% or more in past 3 years), relative to other respondents; n = 38; figures may not sum to 100%, because of rounding.

³ n = 513.

Source: McKinsey analysis

advanced information and communications technology (ICT) talent pool through its networking academy, and BCX has announced a partnership with the Cape Innovation and Technology Initiative to grow scarce digital skills in ICT infrastructure and software programming, cybersecurity, fintech and artificial intelligence.

Elsewhere, Andela, one of Nigeria's best-known start-ups, continues to attract big-ticket funding thanks to its business model of providing companies with outsourced engineering teams.

Meeting the demand of South African business will require many more such initiatives, however.

Private-sector partnerships or scalable service providers that mirror the Andela business model, for example, would help to drive talent development at scale and power the digital economy.

Every CEO in South Africa accepts the impact digitization can have, yet few companies have taken concrete steps to turn rhetoric into reality. Those who execute dynamic strategies by building and participating in ecosystems and investing in talent and capabilities early and aggressively, will be rewarded—with as much as a 16 percentage point increase in revenue growth, according to McKinsey's research.

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