

Facing up to digital disruption: Reinventing the core with bold business strategy

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A solid, industry-specific digital strategy and cutting-edge execution can set the stage for increased revenue growth and a better return on investment.

Going digital is now a core strategy for many organizations around the world. Our new research sheds light on how digital is slicing across industries and the potential approaches companies can take to integrate digital where it makes the most sense for their business. In this episode of the *McKinsey Podcast*, McKinsey senior partner Paul Willmott and senior expert Laura LaBerge speak with McKinsey Publishing's David Schwartz about ways companies can think about digitization within their sector and the potential impact of their digital strategies on the bottom line.

Podcast transcript

David Schwartz: Hello, and welcome to this edition of the *McKinsey Podcast*. I'm David Schwartz of McKinsey Publishing. Today we're going to be talking about digital reinvention, starting with some new research that illuminates how far digital technologies have penetrated different industries and what companies can do to avoid being left behind. Joining me to discuss the issues are Laura LaBerge, a senior practice manager in our Stamford office, and Paul Willmott, a senior partner in our London office. Laura and Paul, thank you for joining us today.

Laura LaBerge: Thanks for having us.

Paul Willmott: You're welcome.

David Schwartz: Paul, I'd like to start with definitions. People tend to use "digital" and "digitization" interchangeably. Do these terms mean the same thing?

Paul Willmott: For some people, the word "digital" tends to refer to a channel. So I interact with my bank digitally, meaning, I use an app or a website. We tend to use a much broader definition. And as we think about digital or digitization, we think about it in a number of different frames.

So first is the digitization of marketing and distribution, which is the channel but also all of the marketing around it. Second, products and services: so, for example, that would be taking

a product and adding a digital service to it. Digitization of ecosystems—aggregating many other businesses and creating ecosystems—is what we’re seeing going on with the likes of Amazon and Alibaba.

Digitization of processes—so replacing labor with software. There’s supply chains, which is thinking about different places to hitch your supply chain to. And in aggregate, these things lead to a complete picture of digitization. And we think it’s important to look at all of them.

David Schwartz: Laura, what other findings are people finding surprising?

Laura LaBerge: The first was just the size of the economic hit of digitization—you know, the fact that there was this tremendous overall decrease in EBIT and revenue growth. Despite the fact that digital does create a lot of pockets of high growth, on average it was going down. And that really, more than 75 percent of companies surveyed were not currently on a viable path to ride this through economically.

I think the second thing was the degree to which the winner takes all was really kind of concentrated amongst first-movers and the fact that this was concentrated—was spread, actually—across all different types of digital disruption, rather than focused more narrowly in maybe one or two that you would have thought at the outset might be harder to replicate. I think the third thing that surprised them was how much strategy actually still matters.

David Schwartz: Right, and I understand you looked at them in a number of ways. Laura, can you describe your analysis and what’s unique about how you went about it?

Laura LaBerge: What we really wanted to do was to get a sense across regions and industries of what are different companies experiencing in terms of digital—how are they thinking about it, and how are they reacting to it?—and to really try to tie that to their economic performance.

So we ran a survey of over 2,000 CXOs and other business leaders, asking a mix of sort of opinion and fact-based questions. We ran a bunch of economic models based on this data to really understand what the economic impact of digital is. How are companies responding? And do certain responses pay out better than others? And if so, which ones?

David Schwartz: What opportunities leap out from the research?

Laura LaBerge: I think that the first big opportunity that we see for companies is that there are a lot of companies that are really focused quite narrowly on just one of the digital elements that Paul mentioned. And I think that there’s a huge opportunity for companies to broaden the lens, because we found that there were several areas of digitization that were frequently underfocused on or that frequently performed better.

So, for example, supply chain is one that very few companies appear to be looking at. And products and services was one area a lot of organizations were looking at; it’s one that has pretty significant payout in terms of digitization and digital innovation. So this obviously varies

by sector, but I think there are a lot of interesting opportunities for companies to pursue.

Paul Willmott: The headline here that I find most striking is the idea that fast following may actually not be such a viable strategy. One of the things that comes through from the research is that those companies which are bold in their response to digitization affecting their sector will outperform and, overall, do well.

Those who are slower and less effective in responding may overall suffer a downturn in their performance as a result. The commonly held strategy of wait-and-see in this instance may not be viable.

Laura LaBerge: When we looked at the research and we tried to define who the digital winners were [you know, who were a success], consistently performing well in terms of EBIT growth, revenue growth, and ROI on their digital investments—it was less than 10 percent of the 2,000 companies we surveyed.

And when you look at the economic pressures that the models showed digitization was putting on sectors, it appeared to indicate that a large percentage of companies would struggle to remain economically viable once digitization reaches its full progression.

David Schwartz: Let's talk about those tactical takeaways, then. What should executives listening to this think about doing differently?

Paul Willmott: For me, the first and most important thing is to really understand what is going on in the environment. I think our experience is that many executives tend to wait too long before taking digital seriously. One of the things I've witnessed is the kind of magic 10 percent or 20 percent number—meaning, once your percentage of sales in the digital channel starts to shift up to that kind of number, then people tend to wake up and think about it as an important thing to manage.

Our view is that that's not necessarily the only indicator. There are whole sectors or subsectors which we're seeing under threat. For example, if you happen to be a distributor in a market where direct distribution from the manufacturer straight to the end buyer is possible, then your business model may be fundamentally threatened. And waiting to see a change in channel may mean waiting too long.

The second thing is really thinking about the strategic direction. There's a mantra around digital, which is that as long as you're running quickly, it's a good thing. The reality is, of course, if you're running in the wrong direction, it's actually worse than standing still.

So we believe that both a clear strategy which is well thought through and grounded in economic reality and in context is as important as the new, faster, more agile execution and organizational capabilities which go along with this additional territory.

David Schwartz: There's been a lot of discussion about execution versus strategy.

Obviously, both are important. But do you have a point of view on which is more important?

Laura LaBerge: I think what our research showed was, when we actually looked at what separated the digital winners from the pack, strategy was one of the strongest factors.

So they [winners] had very big, bold strategies that were connected to the core elements of the organization. Now, they still had to be fast enough organizationally to execute on those strategies. But it turned out that actually having a good strategy that enabled you to spot the, you know, quote/unquote “where to play” places first was on the margins more important than having the most cutting-edge ability to execute agilely.

David Schwartz: What does the research tell us about the organization and culture needed to get the most out of digitization?

Laura LaBerge: We had interviewed several CEOs who’d led major transformations in the past, and one of the things that we frequently heard was that culture was something that they really felt was one of the largest barriers to achieving impact from their digital initiatives. And the research that we did in this survey actually bore that out quite strongly.

Culture, of all the organizational elements, correlated the most strongly with economic performance. And in particular, there were three elements of culture that appeared to be important actually, regardless of the flavor of digital disruption or digitization that they were focused on.

And those three were having less risk aversion, avoiding siloed mind-sets and behaviors, and being more customer centric. And those elements are ones that sometimes large incumbents tend to struggle with, but ones that digital natives tend to be quite strong on.

Paul Willmott: The point around the organizational silos is particularly important. We’ve seen that the organizations that mobilize themselves very effectively to respond to digital challenges and opportunities are those that are able to act in a cross-functional manner—so bringing together resources and capabilities from across the value chain in harmony.

For example, that might include bringing people from marketing, distribution, operations, manufacturing, and supply-chain functions all together to work out how data analytics and digitization can improve the end-to-end planning process. And for many organizations, that’s actually an unnatural act and takes quite some effort to get people to work in that truly collaborative way on an ongoing basis.

David Schwartz: Does the research suggest that companies that aren’t digitizing need to try to ape the Amazons or Googles and to shoot for industry-shaking disruptions?

Laura LaBerge: I think what the research shows is that it’s important to be a first mover in the area of digital that matters to your industry.

Paul Willmott: One of the interesting things we’ve found is that in pretty much every

industry, there is some potential here through digitization. So if you take a less digitizable industry, such as mining, there's a lot that can be done—for example, using big data analytics and a census for predictive maintenance so that machine uptime increases, to give one example.


Laura LaBerge: It's really important to have whatever your digital plays are to be aligned with your overall business and corporate strategies. So if the main pain points in your industry are around manufacturing R&D, applying digital technologies to those elements of your business model rather than focusing exclusively on digital marketing and sales, for example, will tend to have the biggest payouts, because they're enabling your entire business operations, rather than just a narrow slice that might be defined as purely digital.

And the converse is often true, wherein the areas where marketing and sales are customer touchpoints [and] are currently the biggest pain points, focusing on digital on those opportunities, versus cost cutting and digitization of processes, can often have bigger payouts as well.

Paul Willmott: For many companies going through a digital transformation, there seem to be a number of different phases, at least in the mind-set of the executive team. Quite often, we see a phase of denial at the beginning, which is a kind of a recognition that something is changing but a lack of willingness to really confront it and understand that perhaps some quite-challenging shifts in strategy or execution or organization may be required.

Once that's through, you're often in a zone of confusion where executives start to realize that there are many, many opportunities for digitization and that they could invest in many different ways. And that's, we feel, the critical point at which winnowing down to a pointed strategy which really hits the value levers for your industry is important.

There's often a zone of frustration which is around "Why can't we execute quicker?" And one of the lessons we've learned from that is that it's really important to start building the right capabilities early on, either through acquisition or through hiring, because once you get into your stride with digital, having the right people with the right experience in the building tends to be the critical success factor.

David Schwartz: Laura and Paul, again, terrific. The flagship piece is called, "The case for digital reinvention." It's very exciting work, and I encourage everybody to learn more and explore the findings on McKinsey.com. 

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