How to start building your next-generation operating model

Joao Dias, David Hamilton, Christopher Paquette, and Rohit Sood

Each company's path to a new operating model is unique. But successful transformations are all constructed with the same set of building blocks.

A North American bank took less than two years to shift 30 percent of its in-branch customer traffic to digital channels and dramatically reduce its brick-and-mortar footprint. A European cruise line redesigned and relaunched five core products in nine months to increase digital conversions by three to five times and sales by 150 percent.

These companies have been able to transform because they have developed next-generation operating models that provide the speed, precision, and flexibility to quickly unlock new sources of value and radically reduce costs. The operating model of the future combines digital technologies and process-improvement capabilities in an integrated, sequenced way to drastically improve customer journeys and internal processes.

Lean management has already played a significant role in putting in place processes, capabilities, and tools to improve how businesses operate. But the digital age has increased both the opportunities for businesses who know how to react and the difficulty of getting it right. For one thing, tasks performed by humans are more complex, whether it's accessing information in multiple formats from multiple sources or responding to changing market and customer dynamics at ever-increasing speeds. And as an increasing number of tasks become automated or are taken over by cognitive-intelligence capabilities, companies will need to take many of the lessons learned from lean management and update them. Like a sprinter who needs all her muscles to be finely tuned and working in concert to reach top speeds, fast-moving institutions must have a system to continually synchronize their strategies, activities, performance, and health.

But how? Many institutions understand the need to change how they work and have embarked on numerous initiatives, yet few have been able to get beyond isolated success cases or marginal benefits.

We have found that companies that successfully build next-generation operating models do two things well. They focus on putting in place the building blocks that drive change across the organization, and they select a transformation path that suits their situation. These practices don't apply only to companies that have yet to start their digital transformation. In our experience, even companies that are well along their transformation journey can pivot to putting in place a next-generation model that delivers massive value while significantly reducing costs.

Building blocks of the next-generation operating model

Whatever the path companies choose to develop their next-generation operating model (a subject we return to later), we have found there is a set of building blocks of change that successful leaders put in place. Think of them as the mechanics of change—elements needed to underpin the development of the operating model. Given the dynamic nature of digitization and the fast pace of change, it's important not to think about perfecting the implementation of each building block before the operating model can function. The process is highly iterative, with elements of each building block tested and adapted to grow along with the model through a constant evolutionary cycle.

Building Block #1: Autonomous and cross-functional teams anchored in customer journeys, products, and services

Successful companies constantly rethink how to bring together the right combination of skills to build products and serve customers. That means reconfiguring organizational boundaries

and revisiting the nature of teams themselves, such as creating more fluid structures in which day-to-day work is organized into smaller teams that often cut across business lines and market segments. This approach includes empowering teams to own products, services, or journeys, as well as to run experiments. These organizations are also becoming nimble in how they build skills across their teams by making "anchor hires" for key roles, setting up rotational and "train the trainer" programs, and committing to ongoing (often weekly) capability building and training for key roles.

Many insurers, for example, are dismantling traditional claims and underwriting units and reconstructing them to embed subject-matter experts such as lawyers and nurses into service groups. In the best companies, these teams also work side by side every day with technologists to design the tools and technology to improve efficiency and effectiveness.

Iteration is crucial to making this approach work. Leaders test various team configurations and allow flexibility in response to changing customer needs. One credit-card company, for example, shifted its operating model in IT from alignment around systems to alignment with value streams within the business. Cross-functional teams were pulled together to work on priority journeys and initiatives to deliver on the value stream. These changes dramatically simplified the operating model, lowered direct leadership expenses, and contributed to a 200 percent increase in software-development productivity within three months.

Building Block #2: Flexible and modular architecture, infrastructure, and software delivery

Technology is a core element of any next-generation operating model, and it needs to support a much faster and more flexible deployment of products and services. However, companies often have trouble understanding how to implement these new technologies alongside legacy systems or are hampered by outdated systems that move far too slowly.

To address these issues, leaders are building modular architecture that supports flexible and reusable technologies. Business-process management (BPM) tools and externally facing channels, for example, can be shared across many if not all customer journeys. Leading technology teams collaborate with business leaders to assess which systems need to move faster. This understanding helps institutions decide how to architect their technology—for example, by identifying which systems should be migrated to the cloud to speed up builds and reduce maintenance.

This approach both accelerates development and prioritizes the use of common components, which in turn leads to development efficiency and consistency. Another important reason for building more flexible architecture is that it enables businesses to partner with an external ecosystem of suppliers and partners.

Similarly, leaders are investing heavily in DevOps and combining people, process, and technology changes to automate software testing, security, and delivery processes as well as infrastructure changes.

Building Block #3: A management system that cascades clear strategies and goals through the organization, with tight feedback loops

The best management systems for next-generation operating models are based on principles, tools, and associated behaviors that drive a culture of continuous improvement focused on customer needs. Leading companies embed performance management into the DNA of an organization from top to bottom, and translate top-line goals and priorities into specific metrics and KPIs for employees at all levels. They make visible the skills and processes needed for employees to be successful, put clear criteria in place, and promote the sharing of best practices.

The best institutions are evolving their management systems to create feedback mechanisms within and between the front line, back-office operations, and the product teams that deliver new assets. They are also using their management systems to harvest the surfeit of data generated by day-to-day activities to create user-friendly dashboards and reports, some of them in real time.

Performance management is becoming much more real time, with metrics and goals used daily and weekly to guide decision making. These metrics are supported by joint incentives—not just for individuals—that are tailored to each level of the organization and reinforce behaviors to support customers regardless of organizational boundaries.

One North American insurer struggled to make the predictive analytics models developed by central teams relevant to its front-line claims adjusters, who therefore failed to adopt the new capability. Knowing it was leaving significant value on the table, the company established daily feedback sessions between the central development team and the claims adjusters and embedded analytics specialists into customer-service teams to develop better insights into customer issues. The teams created shared goals based on customer value that were consistent with the organization's strategy and the daily work of adjusters. Under this new management system, the analytics specialists and claims adjusters shortened cycle times and dramatically improved the effectiveness of assignment. This freed up time for leaders to coach, problem solve, and iterate on the next opportunities for the teams to pursue.

Building Block #4: Agile, customer-centric culture demonstrated at all levels and role modeled from the top

Successful companies prioritize speed and execution over perfection. That requires agility in delivering products to customers and quickly learning from them, as well as willingness to take appropriate risks. The best organizations have already made agility a cornerstone of how they work beyond IT. One credit-card company brought together law and compliance personnel to sit in with marketing teams to intervene early in processes and have daily conversations to identify and resolve issues. Law and compliance functions have also begun to adopt agile methodologies to change their own work. As functions and teams collaborate, they are on track

to reduce effective time to market by 90 percent for some core processes while also reducing operational risk.

Critical to success is leading the change from the top and building a new way of working across organizational boundaries. Senior leaders support this transformation as vocal champions, demonstrating agility through their own choices. They reinforce and promote rapid iteration and share success stories. Importantly, they hold themselves accountable for delivering on value quickly, and establish transparency and rigor in their operations. Many manage the change aggressively, often changing performance incentives, mothballing outdated processes, assembling communication campaigns to reinforce culture, and writing informal blogs. At one asset-management company, the top team jettisoned its legacy budgeting process and asked leaders to be aggressive about capturing more value. They established an ongoing process for redistributing funding to the highest-value experiments that were working.

Defining the path for your organization

There is no one way to develop a next-generation operating model. It depends on a company's existing capabilities, desired speed of transformation, level of executive commitment, and economic pressure. We have seen four paths that leading companies take to drive their transformation, though organizations often move to a different path as their capabilities mature. These paths offer a guide for the first 12 months of a transformation journey.

An innovation outpost is a dedicated unit set up to be entirely separate from the historical culture, decision-making bureaucracy, and technical infrastructure of the main business. It creates inspiring products that illuminate the digital art of the possible (sometimes with questionable economic impact), and hatches new business models in informal settings such as over foosball tables. This path has traditionally been popular as a first move, but is now less common.

One retailer with an ineffective online business chose to open such an outpost. It introduced next-gen analytics, focused on customer experience rather than technology, and drove the mobile interface. Staying largely separate from the main business, the outpost created a buzz around innovation, attracted better talent, and repatriated many of its creations into the broader organization.

This path works well when there is limited alignment among executives on the importance and value of transformation, a need to move very quickly in response to market pressures, and significant legacy culture challenges to overcome. However, it is less effective as the "tip of the spear" for changing the culture or building sustainable capabilities, and often yields a low return on investment.

A fenced-off digital factory is a group of groundbreakers that works in partnership with businesses and functions (such as IT infrastructure and security, legal, compliance, and

product development) while enjoying a high degree of autonomy. It typically houses specialized capability groups in technologies such as robotics or analytics, and deploys them to support the development of specific journeys in concert with business and functional partners. It both models a new way of working and integrates developed capabilities into the main business. As such, it focuses internally on integrating with and shifting the culture of the organization.

This is the most common starting point, as it balances the need for incubation with that of broader transformation. One European bank built a digital factory in a building on a campus. Each of the lower floors is dedicated to a separate journey, while the top floor is dedicated to creating reusable components and utilities—such as customer identification and verification or esignature—that the other journeys can deploy in a modular way.

Business and functional colleagues come together to work with teams in the factory. Each of these teams develops products and services, moves them quickly from prototype to deployment, and then transfers them into the main business. As part of the management system, the team continues to monitor and iterate the product or service based on economic performance and customer feedback.

This path works well when there is a broad-based belief in and commitment to transformation, and a need to incubate a critical mass in internal capabilities. Many organizations have used this approach to attract digital talent, combat large-project inertia within IT groups, and speed transformation. Culture change is slower within the rest of the organization, but it happens over time as business and functional specialists partner with the factory for each journey. It can, however, also create a "have and have not" split within the business if not managed appropriately, and can require significant initial C-suite support and funding. (For more on the digital factory, see "Scaling a transformation culture through a digital factory.")

A business-unit accelerator is a scaled-down digital factory that incubates a transformation inside a business unit to tackle local customer journeys and business functions. The business unit builds its own skills, such as process-redesign and robotics capabilities, and has control over specific capabilities and investments. This means it doesn't need central funding or organization-wide agreement on a host of issues to get going.

One North American bank shifted to a business-unit accelerator model after the first few years of its transformation. It found that this move gave it more control and a closer connection to business strategy and the customer—benefits that outweighed centralized scale and capability building. The bank invested heavily in talent and tools with the aim of building a reputation among customers as a digital business that happens to produce banking products and experiences.

This path works well for organizations with large business units that operate independently. It's also a good starting point when one business unit is particularly far ahead in its thinking and belief, or where digital services have disproportionate value-creation potential. However, companies that

choose this model must mitigate several risks. When business units choose their own digital tools and processes, for instance, complexity and costs increase for IT teams managing maintenance, licensing, and enterprise architecture. This model can also make it harder to build and share capabilities across the organization since the skills developed are specific to the business unit.

A full-scale evolution is a comprehensive transformation in which the enterprise reorganizes itself almost entirely around major journeys. This is the natural operating model for many digital natives, as technology, digital services, and product delivery are basically inextricable. Companies focus on specific digital initiatives that deliver on business priorities, deploying specialized talent and cross-functional teams to support each one. The model is highly attuned to the customer, and rapidly develops, tests, and iterates on new products or services. Team members may be managed through a center of excellence or by business-unit leaders. This path is the aspiration for many incumbents, especially those that deliver services rather than physical products.

In one European bank undergoing a full-scale evolution, agile has become the default way for people to work, with colleagues from multiple functions including IT sitting sit side by side. Results are measured by value streams—the sources of the value being generated—and journeys, flowing from the customer need back to the performance of the bank. Prioritization and resourcing take the form of active daily and weekly conversations about the next most important thing to work on. This approach is initially almost like shock treatment, but it offers important benefits, allowing companies to shake up the traditional management system and achieve culture change quickly and at scale. The organization builds agile skills broadly, identifies high and low performers, and pinpoints valuable and missing skills.

This path works well when there is a broad and top-down organizational mandate for change. Given the time it takes to move the needle, there should be no pressing near-term economic imperative. Companies that choose this model need to mitigate several risks, such as ensuring that best practices are shared across the operating model rather than being confined to individual teams. In addition, organizations must share any scarce resources across business functions to drive impact, and ensure coordination with IT as it seeks to keep up with the technical architecture.

No-regret steps leaders should take

Every organization's transformation journey will be different. However, a simple set of immediate, no-regret steps can help leaders shape their first set of priority decisions and provide clarity on the way forward. These often include:

- Creating clarity on enterprise strategy and on where digital services can quickly enable sustainable value creation. (For more on this, see "The next-generation operating model for the digital world.")

- Challenging the board to be explicit about the importance of the transformation and its support for investment; or, as a board, making this decision and challenging the executive team for a bold vision.

- Building top-team excitement and belief in change through visits to leading digital natives or incumbents pursuing their own transformation paths.

- Assessing the maturity of the management system using benchmarking against other organizations to identify strengths to build on and risks to mitigate.

- Investing in targeted capability building, especially for the top 50 leaders in the organization. Exploring core concepts such as digitization, agile, design thinking, and advanced analytics can create a shared vocabulary and spur action.

- Making an honest objective assessment of talent and capabilities within the organization, benchmarked against peers and cross-sector leaders. Disruption often comes from outside an industry rather than within.

- Surveying the cross-sector landscape for ideas and inspiration. It's easier than ever to learn from others, and a rapid inventory of ideas can shed light on potential execution challenges to resolve.

- Assessing the level of change that the organization can realistically absorb in the near and long term given its other priorities.

▼ ▼ ▼

Most companies recognize the need for a next-generation operating model to drive their business forward in the digital age. But how well they actually develop it makes all the difference between reinventing the business and just trying to do so.

Joao Dias is a partner in McKinsey's Cologne office; David Hamilton is an associate partner in the Detroit office; Christopher Paquette is a partner in the Chicago office, and Rohit Sood is a partner in the Toronto office.