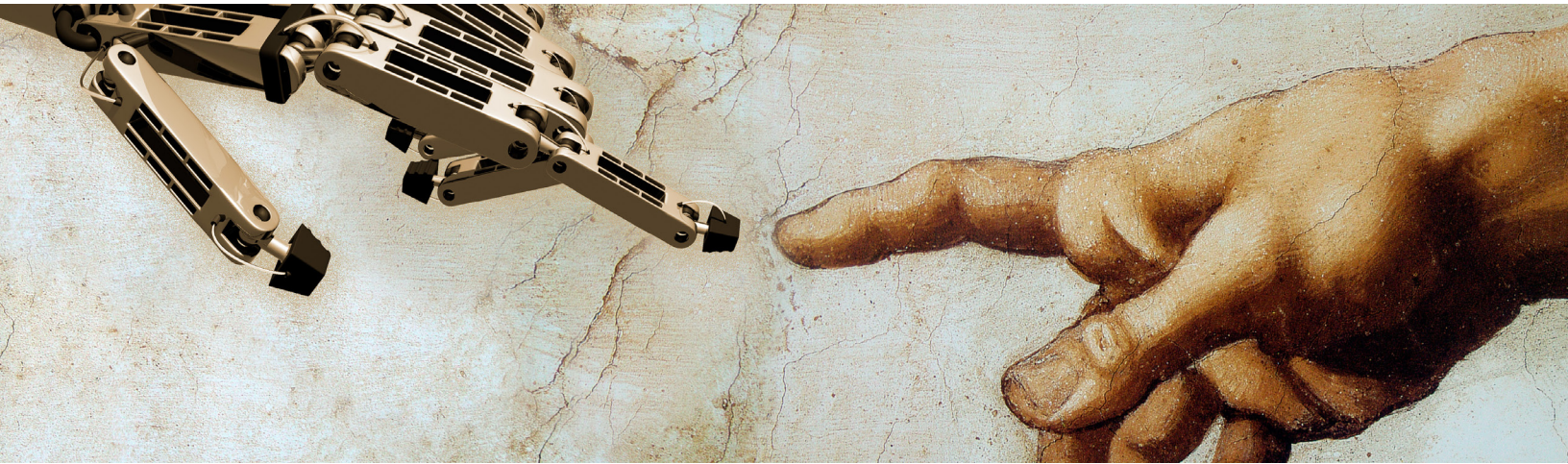


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BUSINESS TECHNOLOGY OFFICE

Acquiring the capabilities you need to go digital

Some of the talent and tools won't necessarily be found in-house. Here's how to create a sustainable strategy for sourcing the right people and products.

Matthias Daub and Anna Wiesinger

Digital capabilities are now a prerequisite to compete in the long term.¹ Yet many companies seeking to go digital are still unclear about the best way to set up their IT organizations and develop the tools and talent required to manage digital information and establish and maintain online services and automated processes.² What most don't properly acknowledge at the outset is that many of the critical resources required to facilitate this transition will not be available in-house.

The right talent, for instance, may be in short supply. The distinctive experts required to develop successful digital offerings and channels might include product managers who are literate in cutting-edge technologies that can be used to reshape the consumer decision journey,³ experienced business and data analysts who can extract useful insights from customer data, and user experience

experts and design-oriented content managers who can ensure that the offerings will appeal to target audiences. But technology-services companies are often better positioned to win the battle for professionals with these skills because they can offer more diverse career paths and personal development in the field.

And while in many sectors the time to go digital has come, developing the required capabilities in-house can take years. The IT department in one major travel company, for instance, recently embarked on a digitization initiative—a move prompted in part by increased competition from online players and eroding margins. The goal was to scale up quickly, but in assessing their needs, leaders realized they lacked necessary expertise in a number of critical technology areas, including user-interface design

Takeaways

Companies need to move quickly to go digital, but building in-house capabilities can take years.

A dynamic approach to accessing expertise from outside the organization can help them compete.

To take full advantage, players need to reconsider their digitization targets and redefine their operating models and capability-building efforts.

and agile software development. The company's existing IT organization was equipped enough to manage smaller-scale digital projects but not a full-on digitization initiative. Hiring, developing, and retaining the appropriate talent would require a sustained effort.

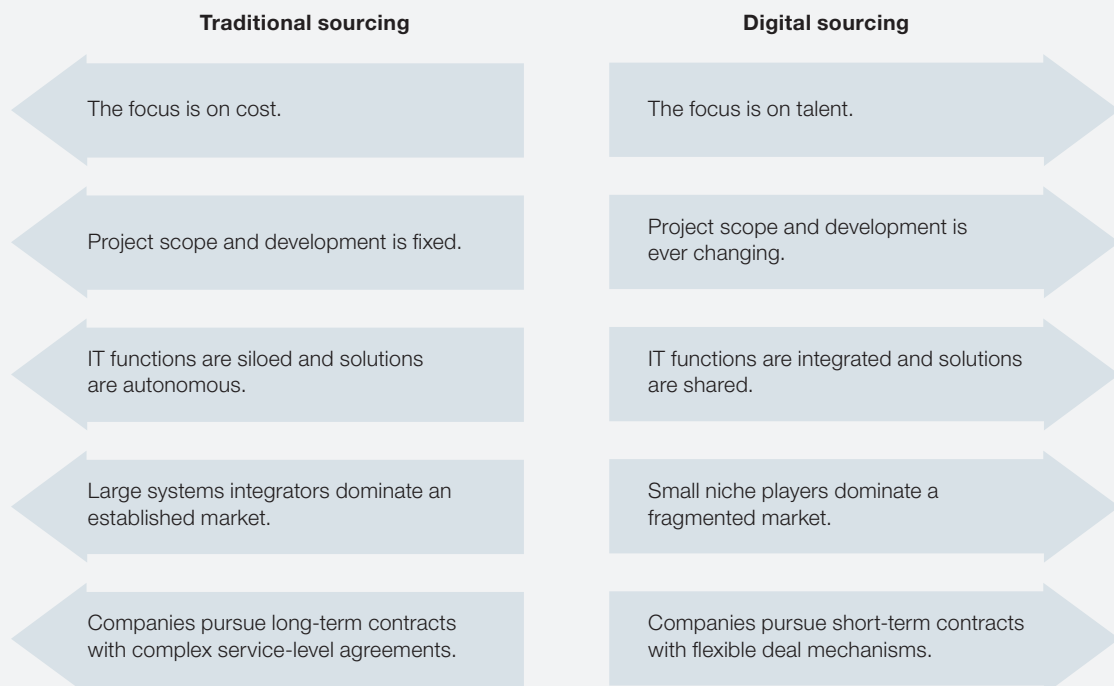
To better compete, the travel company and others like it need to adopt a dynamic approach to accessing digital capabilities from outside the organization. In large part, this will require learning to balance the two speeds at which IT organizations must operate—integrating slowly changing legacy transactional back ends with more dynamic customer-facing front-end systems and applications.⁴ Specifically, we believe

companies must take a closer look at their digitization targets, operating models, and capability-building practices in the context of this two-speed architecture. In this way, they will be able to scale up nascent digital initiatives quickly and sustainably: accelerating the use of emerging technologies, aligning the fragmented activities being pursued by individual business groups, and developing vendor relationships that can evolve with customers' changing needs.

Sourcing for digital is different

In the fast-moving world of digital, finding the necessary tools and talent can be challenging for several reasons (Exhibit 1).

Exhibit 1 Sourcing for digital differs in a few key ways.



Talent has become more important than cost

Traditionally, companies have realized competitive advantage from technologies that support a specific business requirement at the lowest cost possible. The travel company, for instance, might rely on simple Excel spreadsheets to assess internal data sets in a limited way rather than rolling out more-expensive systems to capture and analyze data. In a digital environment, however, having cheaper technologies is much less valuable than having the right talent behind them. Companies must factor into their digital transformations greater investments in talent despite the potential increase in overall IT costs. For those that do, the payoff can be significant. For example, the travel company might be able to predict customer demand with greater accuracy—and get a leg up on competitors—by investing in an advanced data-capture system that incorporates multiple external and internal data sources and by hiring the analysts required to make sense of the collected information. Our work with global companies suggests that in creating and rolling out cutting-edge technologies, “top talent” developer teams are between five and ten times more efficient than “average” developer teams of a similar size.

The scope of projects is ever changing—and must be managed that way

Companies undergoing traditional business transformations have tended to adopt a sequential approach to acquiring the skills and tools they need. Talent and technologies are brought in based on software-release initiatives that are rigidly scheduled; nothing is rolled out to customers before it is fully complete. This approach is inadequate for digital transformations; by nature, these projects are iterative and call for continual clarification of targets and hence updates to internal requirements. One of the important advantages of digitization, after all, is that companies can capitalize on opportunities for end-to-end customer-centric innovation, where targets are constantly refined and experimentation is encouraged. Using this approach, for instance, a company might want to update its online offerings with new functionality more frequently (say, every

week) and introduce them one by one—gathering feedback from customers and revising its website in a test-and-learn fashion—rather than launching all front-end and back-end changes at once.

Integration and accountability are more critical than ever

A large financial-services organization had empowered a number of teams to launch their own digital businesses. However, instead of working with the bank’s IT organization to find the required talent and resources, each of the project teams went out on its own to negotiate deals and forge relationships and alliances. The result was a confusing web of suppliers operating under different contracts. Because there was no adherence to a central sourcing strategy, there were inevitable compatibility, security, and productivity issues when new code was introduced in production environments. For successful digital transformations, companies must ensure that the IT department is looped in and accountable for the delivery of sustainable, integrated solutions that meet the business’s needs regarding time to market and flexibility.

The supplier market is fragmented

Digital transformations rely heavily on the use of emerging technologies and specialized tools, many of which are being developed by innovative niche players and start-up companies rather than the established systems integrators that currently dominate the market. Consider the number of small niche players who have already built extensive experience in big data analytics, for instance, versus the number of large systems integrators who are only just beginning to traffic in big data. The provider market, therefore, has become increasingly fragmented, less transparent, and, in many ways, is still quite immature—all of which complicates sourcing decisions for companies looking to go digital quickly. (See sidebar, “Picking the right digital vendor.”)

New deal mechanisms are required

The processes by which companies have traditionally struck deals with external providers

Picking the right digital vendor

The market for digital suppliers is dynamic and, to this point, has been characterized by a large number of smaller and younger players. These boutique players provide innovative, specialist services—for instance, user-interface design; analytics, business-specific platforms, services, and application programming interfaces; and cloud services. They are widely perceived as better able (and willing) to embrace digital trends. However, some incumbent players are entering the market, either because they've developed their own innovative digital offerings or acquired platforms, technologies, and talent from the start-ups. Because of this volatility in the marketplace, it is critical for companies to carefully assess vendors and products, looking beyond price. Specifically, when selecting a partner for their digital transformations, companies should consider the following:

Long-term prospects. It is important for companies to provide long-term perspectives and

incentives as part of partnership agreements, especially when the contracts involve smaller industry players that can disappear from the market quickly or be targeted and taken over by larger companies. Agreements should contain financial incentives that reward positive relationships and that provide predictability for smaller players.

Ability to cocreate. Suppliers must be able to collaborate with companies' IT and business stakeholders and cocreate products that will work with legacy systems. To assess whether potential suppliers are a good fit, companies can launch experimental pilots to get to know different providers.

Supplier flexibility. Ambiguity is part and parcel of most digital transformations. Vendors must therefore be able to adapt to ever-evolving requirements but also adhere to agreed-upon architecture-design principles. In this way, companies can create sustainable products and

systems that can factor in contributions from multiple suppliers.

Lock-in requirements. Technologies and platforms are rapidly evolving, and it is not clear yet which ones will emerge as future standards. When selecting a product or platform today, there is always the risk that it is based on a niche technology that will become obsolete. And if a company depends on a supplier's proprietary technology, this can become a major business risk. Using open-source solutions can mitigate this risk; many suppliers offer corporate editions of their open-source products and services, and some companies may decide to open up their proprietary solutions for input from the open-source community. However, lock-in risk cannot be avoided entirely: some service providers tend to customize open-source solutions to an extent that creates de facto lock-in. It is therefore important to consciously select the products that suppliers prefer to use as part of the sourcing process.

may not be fully applicable in the case of digital transformations. Such vendor deals are often focused on specific solutions and predefined deliverables, and contracts can last for years—longer than the entire life cycle of some new and emerging technologies. Instead, companies will need to explore new deal mechanisms, such as risk-sharing agreements and innovative pricing schemes that reward experimentation and collaboration.

Finding the capabilities you need

The companies that recognize and strategize for these digital differences can scale up their online capabilities at short notice. To successfully pull in new talent and tools from the market and better manage the varying speeds at which digital transformations can occur, companies must deploy a more dynamic sourcing strategy. Specifically, they must reconsider their digitization targets and redefine their operating models and capability-building practices accordingly.

Digitization targets

Companies need to identify the business domains and activities that would most benefit from rapid digitization, and they should manage those projects separately from their conventional IT projects.⁵ These will typically include customer-facing applications and internal systems that involve a high degree of employee interaction (for example, intranets and employee self-service tools). Companies may also want to reassess their attitude toward sharing critical knowledge (for example, sales data and advanced analytics expertise) with vendors to accelerate their development of digital capabilities—such as, being able to price products based on customers' purchase histories.

Operating models

Once target areas for digitization have been identified, companies will want to determine the best-fit suppliers and the appropriate engagement model required for each. Taking a close look at their operating models can help companies account for the ever-shifting scope as well as the integration and accountability issues that are unique to digitization projects. The usual staffing and service models, which emphasize rigid communication channels and objectives, may still apply, but for each supplier, the project-management model may need rethinking. Consider the financial-services company we described earlier: its various digitization projects require an agile software-development approach, so the company may need to build formal and informal meetings with vendors and the central IT group into the development schedule to allow for frequent feedback loops. The supplier, the financial-services company, and the central IT organization may not be able to agree on a fixed set of deliverables up front, due to the iterative nature of lots of digital projects blooming at the company. But all parties may be able to standardize some basic metrics to judge performance. Agile teams working on each of the initiatives could rely on “story points,” for instance—the development team's estimation of the difficulty of meeting a requested business need—or the amount of work expected to be delivered over certain periods of time.⁶

Another important success factor is making clear the activities that external vendors will provide versus the activities that will be performed in-house. Traditionally, the tasks required from suppliers are usually specified in a service catalog, which would include descriptions of critical activities and clear distinctions about which party owns which tasks—for instance, the supplier might be responsible for testing certain new system components, while the client might be responsible for running tests to ensure that its customers actually like the new features.

This philosophy also holds true in digitization efforts: vendor relationships will be much more successful, and there will be less friction, if there is explicit collaboration between companies and suppliers. Both sides must follow rapid and flexible delivery practices, and within the customer organization, IT must play a central role in bridging the cultural differences between providers of new technologies and providers of established legacy and back-end solutions.

Best practices in supplier management

When dealing with new suppliers, companies must acknowledge the market-fragmentation and deal-mechanism challenges described earlier. They must be able to articulate the IT demands from various business units, specify requirements but be willing to revise them periodically, manage integration efforts, assess (and occasionally reassess) the suitability of vendors, evaluate the stability and future support of solutions from small vendors (including the use of open source), make frequent decisions to stop or continue with relationships, and dynamically manage the capacity and capabilities required from external vendors. Small players providing new products, platforms, and programming interfaces tend to have narrow, specialist functions; few can provide end-to-end integration or complete solutions as a service. Therefore, experimental deals are becoming the standard—that is, contracts with short time frames and a narrow performance scope but that rely on both quantitative measures (such as the speed of development) and qualitative measures (such as collaboration style).

When dealing with established suppliers, companies must adjust their existing contracts to ensure that these often larger vendors are working in sync with smaller, more nimble players—maintaining and enhancing legacy systems while simultaneously allowing for rapid front-end changes. Existing contracts may need to be rewritten to allow for seamless and timely interactions between the two.

Companies will want to build and continually update repositories of potential digital-resource

providers, noting the suppliers’ experiences, locations, and differentiating capabilities (Exhibit 2). Before committing to digital-service providers fully, companies can engage them in small, low-risk pilot projects to assess fit. And to build relationships and expand their contact lists, companies can get involved in open-source and other technology communities by participating in conferences, roundtables, and other industry-convening events.

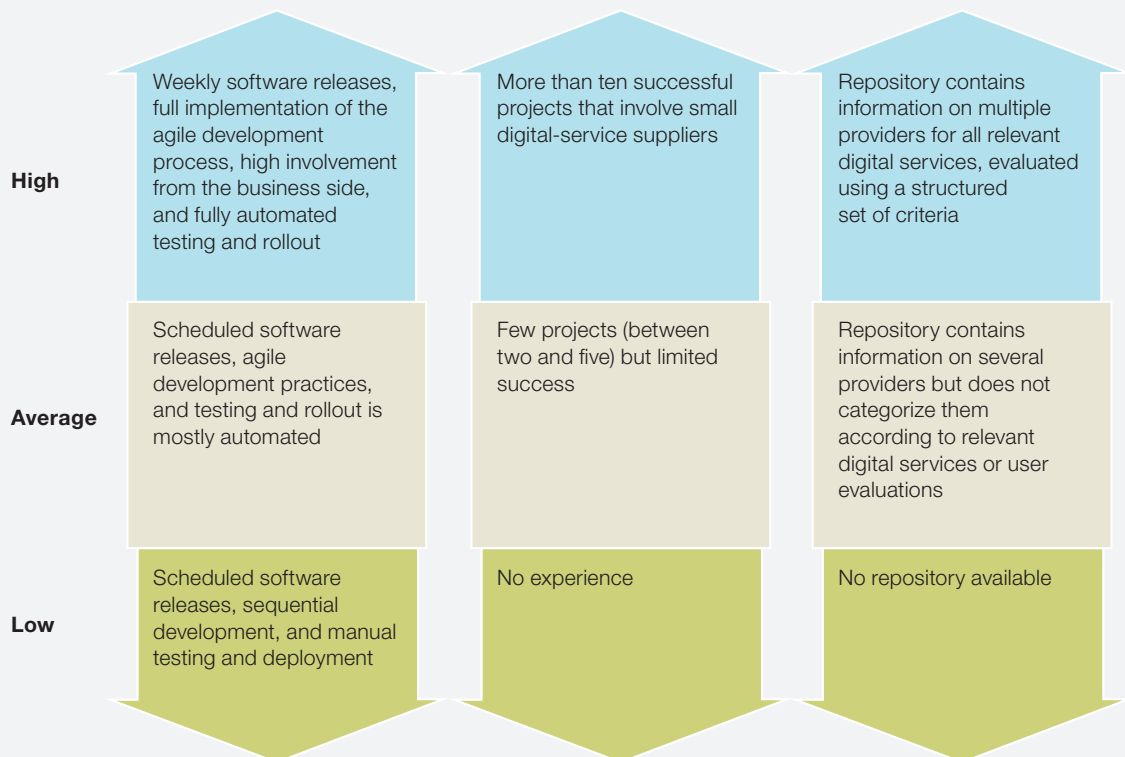
Exhibit 2 How ready are you to source digital capabilities?

Companies can look at a number of organizational elements to determine how prepared they are to undertake sourcing for digital, but these three are particularly critical.

End-to-end change-management processes: How flexible are they?

Comfort with niche players: What is your level of experience with small, boutique providers of digital services?

Existence of a supplier repository: How exhaustive is your go-to list of digital-service providers?





Sourcing for digital is merely one building block for going digital—albeit a critical one that can fill the talent and tool gaps often faced by those that are not digital natives. To start a successful digital journey, companies need to fully embrace the idea of a transformation that extends across all parts of the organization. This means establishing rapid decision-making and escalation processes to match the digital way of working and exploring the use of new standards for contract elements and terms and conditions.

The sourcing journey won't be easy; looking outside for digital capabilities likely will involve a number of starts and stops. Over the long term, however, this approach can help companies meet the challenges of innovating and competing more effectively online. ■

¹ Martin Hirt and Paul Willmott, "Strategic principles for competing in the digital age," *McKinsey Quarterly*, May 2014, mckinsey.com.

² Henrik Andersson and Philip Tuddenham, "Reinventing IT to support digitization," May 2014, mckinsey.com.

³ The consumer decision journey refers to the process by which consumers research and buy products. It is a circular journey encompassing four phases: initial consideration, active evaluation, closure, and postpurchase.

⁴ Oliver Bossert, Chris Ip, and Jürgen Laartz, "A two-speed IT architecture for the digital enterprise," *McKinsey on Business Technology*, November 2014, mckinsey.com.

⁵ Ibid.

⁶ Michael Huskins, James Kaplan, and Krish Krishnakanthan, "Enhancing the efficiency and effectiveness of application development," August 2013, mckinsey.com.

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