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How companies become digital leaders

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The global digital transformation has only just begun. McKinsey's Paul Willmott and Jay Scanlan discuss how senior executives can raise the Digital Quotient of their companies.

Just about every industry is undergoing some level of digital disruption, and the transformation is only in its infancy, according to McKinsey Digital global leader Paul Willmott, and Jay Scanlan, leader of McKinsey's Digital Strategy Practice. In this episode of the *McKinsey Podcast*, they speak with *McKinsey Quarterly* executive editor Lang Davison about the simple metric McKinsey has developed—Digital Quotient—to measure the digital maturity of companies, and how learning from the best digital performers can help companies find their own ways to excel. An edited transcript of their conversation follows.

Podcast transcript

Lang Davison: Hi, I'm Lang Davison, executive editor for *McKinsey Quarterly*. We're here today to talk about digital performance in big companies and what senior executives can do to improve it. Joining me from London is the global head of McKinsey Digital, Paul Willmott, and Jay Scanlan, head of McKinsey's Digital Strategy Practice. Gentlemen, thanks for joining.

Paul Willmott: Thank you.

Jay Scanlan: Thanks, Lang. Great to be here.

Lang Davison: So you've got a single, simple metric to measure the digital maturity of a company. You're calling it DQ, or Digital Quotient. What are you finding as you apply that? Is everybody doing equally well, or is there more of a range of performance?

Jay Scanlan: We're still in the very early days of the digital transformation that is sweeping through our global economy. As a consequence, it's unsurprising that digital leaders massively outperform their digital followers and digital laggards in the sophistication and quality of their Digital Quotient. And, in fact, there are a few things that digital leaders seem to do right that digital followers and digital laggards struggle with significantly.

The first is the alignment between overall corporate strategy and the digital initiatives that they're pursuing in order to transform their core business system and to pivot their business model toward growth and away from the headwinds that digital can create.

The second thing they seem to really be able to do is drive a fast and agile culture. And the third is to get the right organization factors in place—that's the talent, people, processes, structure, and systems that really make a difference when it comes to performing in this new world.

Lang Davison: And is that a result of . . . I mean, we can run through the gamut of reasons—digitization, increasing globalization, companies looking well beyond their traditional borders, short-term thinking. Is it just a confluence of factors?

Jay Scanlan: No, Lang, I don't think that every company can, nor *should* they aspire to be an Uber. Uber has its own business model, and it's got a very specific set of things that allows it to make money. And it's very similar to other pure-play digital disruptors: Spotify, Netflix, and others. But each of these is quite unique, and our incumbent organizations and our incumbent clients have a broader range of concerns that they need to address. And they have a broader range of customer needs and consumer demands that they want to fulfill.

Paul Willmott: Yeah. In some ways, incumbents have a lot of benefits over new players, over start-ups. They have customers, they have great data, they often have a brand. They have financial resources, which a start-up may not have. The question is, can all of those capabilities and assets be deployed in a way that allows you to defend against new attackers as digital disrupts your industry? Or even to prosper and move into new areas of growth?

Lang Davison: So what questions should big incumbent companies be asking themselves when it comes to their digital strategy?

Paul Willmott: I would start with [asking], who are my competitors in the new world? Your traditional competitive set may no longer be the competitive set going forward. To give an obvious example, if you're in financial services there are many technology players who are starting to encroach on your world and eat parts of your lunch.

Secondly, understand how fast you need to act. One of the things we're learning is that when disruption happens, sometimes it actually takes quite a long time, and you have time and a pace to react. Other times, it can be very swift, and therefore bold moves are required early on.

And managing that trade-off between sustaining the status quo and shifting quickly to a new model is critical if you're going to maximize the amount of value.

Jay Scanlan: Paul, those two questions are critical. I think incumbents, particularly laggards and followers, sometimes reflexively try to drive digital marketing and sales. They mistake the world of digital for the world of online-selling success. And that narrow set of levers and aspirations for digital transformation is often unsatisfying and unsuccessful. Because there is a lot of opportunity unlocked by digital: the ability to fundamentally change how productive your assets are, the ability to leverage data and your consumer base in a different way, and the ability to actually develop innovative new propositions that you could never have offered before—the world of universal connectivity and ultracheap and ultrafast processing power. The ability to do these things is often actually a lot more powerful than trying to get a laser-like focus on pure digital-marketing and -sales performance.

Paul Willmott: There's a third question suggested by that, which is, where exactly is the value from digital? Is it in using your assets more effectively by using data? For example, if you're running a fleet of vehicles, understanding and predicting maintenance schedules, and so on, can actually significantly improve your productivity. But for other companies, it's around a better or different type of connection to the customer.

Lang Davison: Jay, you mentioned agility, the ability to change rapidly. How does that fit in once you've got your strategy all lined up?

Jay Scanlan: The first dimension is speed. Many people look at pure-play disruptors and start-ups with great envy because [these companies] seem to be able to move very, very fast. But the other part of agility is stability of the core process, so that you actually have a foundation on which you can build repeatable, high-quality experiences for your customer or your consumer.

And so what we talk about when we talk about organizational agility is not just the ability to move very fast, it's the ability to move very fast while at the same time keeping a very stable business system so that you are consistently delivering what your consumers want, when they want it, and at the quality, cost, and time that they demand it. Those two things taken together are really what we mean by organizational agility.

Lang Davison: Right. There's a nice tension to that—you need to be both stable and speedy in order to be agile and in order to deliver what customers need. That delivery of the value proposition would go to this notion that you also have brought up, gentlemen, about capabilities. What capabilities do companies need in the digital age?

Jay Scanlan: There are probably four essential capabilities that great digital leaders have. The first is decision making: robust, but high-speed decision making that allows you to make decisive moves about the opportunities and threats that you face. And an understanding of the speed, as Paul said earlier, that you need to make them.

The second thing is the ability to connect the business system. In a world where you are building a platform on which you offer new products and propositions and connect to your consumer in a very different way, the linkage between product go-to markets and technology has never been more important. And that integrated approach to the marketplace is really characteristic of those companies that do best in this new world.

The third is radical cost reduction. It is not only the digitization of processes but the outright elimination of them through the use of digital technologies, so that you are not only faster to market but at a higher quality and with substantially or radically lower costs.

And the final thing is this notion of having a two-speed IT architecture so that you can keep the lights of the core IT systems on while at the same time overlaying the new capabilities that are required to succeed in the world of digital in terms of data insight and transparency, consumer analytics, and new-customer propositions.

Paul Willmott: If I could just build a little bit on that, Jay. I think on your first point, on decision making, the focus should be on the big, bold decisions, as well as on making the hundreds of little decisions around direction. And it's the big, bold decisions that are hardest and that really differentiate between the leaders and the less successful.

Specifically, what is the quantum of investment that you need to make in digital? And at what time? We've seen numerous examples of executives who were not bold enough and invested too late. And then as a result, they had already lost market share and position by the time they made their investments.

Lang Davison: And that notion of a two-speed IT goes back to your notion of agility, Jay, that one part of the organization moves quickly while another stays a bit more stable. Listening to this list of capabilities, it strikes me that not every company's going to have all the capabilities that they need. How can they address the shortfalls that they might find within their organizations?

Jay Scanlan: This may be one of the biggest single challenges in the world of digital. Through our DQ diagnostic tool, we've been trying to analyze how companies have been filling the need for new capability development. There are a few things that digital leaders don't do.

The first thing they do not do is repurpose huge swaths of people from their existing organization to go try to compete and win in this new world. The second thing that they don't do is they don't seem to outsource radically. Instead, they actually seem to build capabilities within themselves, particularly the strategic ones that are going to differentiate them and their strategy from those of their competitors.

And the way they build those capabilities, of course, is through normal hiring practices. But also through much more programmatic M&A activity in order to gain the small sets of capabilities to be bolted together into new groups that allow these new capabilities to actually change the business model over time and to transform the core business system as necessary.

Paul Willmott: A couple of points. One is, bringing in talent from other industries seems to work, typically, but only up to a point. If you think that you can replace your team with a team from another sector or other sectors and that they will drive additional agenda, you can go too far with that. Really, a mix of people who are trusted and know the business [and who collaborate] with talent [recruited from] outside seems to work well.

The second point is, we've found that by creating a new environment, a new decision cadence, and by providing the right kind of cultural guidelines you can actually shift the way that an organization is working and develop some of these new capabilities in time, in-house. But they do require incubating in a dedicated, semiseparate unit.

Lang Davison: I can imagine to some senior executives that some of what we're talking about might seem to have some risk associated with it. What kind of appetite for risk is required to move forward in the digital age?

Paul Willmott: Well, it's interesting because the stock answer here is you need to be more willing to take risks. And I would give a slightly different view, which is you need to think much more carefully about the risks you're taking and then be prepared to back the winning strategies that you have wholeheartedly.

Specifically, doing lots of experiments with new propositions or products and business models can be a very effective way of learning about your customers, learning about what can work in the market. That's a good way of de-risking what you're doing.

The important bit is putting all of your resources behind the winning strategy when you find it. And that is what, in theory, is a more risky bet because you have to place your resources in one place rather than smearing around. But we have found that companies that are successful are very targeted about how they're investing. And they're planning their strategy for digital rather than trying to be too broad-brush.

Jay Scanlan: If you, as an organization, are very disciplined about understanding both the speed and potential magnitude of transition or disruption that is likely to happen within your industry, there is a mistaken notion that not acting somehow reduces risk.

But I think, as Paul has suggested, and I have as well, that's a mistake. The status-quo bias of managers does not actually make that decision to stand still any less risky. In fact, if you can convince yourself that the world is going to change around you, the choice to stand still is actually the single biggest risk you would take.

Lang Davison: Right. Not doing anything may be the riskiest move of all. When it comes to reallocating resources from parts of the business that are perhaps lagging and toward places in the strategy where there are opportunities to be had, is there anything you'd like to say with regard to reallocation of resources?

Jay Scanlan: I think there are actually three observations about the reallocation of resources. The first is that digital leaders appear to aggressively seek external opportunities through both alliances and partnerships, but also through M&A. And therefore, the reallocation of resources through inorganic means is very helpful.

The second thing is that choosing what you discontinue and moving resources purposefully and aggressively away from the areas that are going to be less successful in the world of digital to the areas where you think you are going to be more successful is also very important and very, very common among the best-performing digital leaders, particularly in those industries that have been most disrupted in the past.

And then the third thing is backing winners with scaling investments so that you can build a virtuous circle of returns and brand and network effects, so that once you begin to win in the marketplace, competitors find it harder and harder to keep up. That is a winning success formula through reallocation that seems to characterize those companies that are out in front.

Lang Davison: What else comes into play when you look to get your strategy right, your culture right, your capabilities right?

Jay Scanlan: You have to find coherence in whatever organizational model you choose. And that coherence is not just in the lines and boxes of the organizational structure but in the way in which your processes align and drive cross-organizational collaboration, as well as the organizational practices around talent, including the incentives, role modeling, and behavior that drive the very best out of new digital talent.

There are few things, though, that digital leaders seem to do [differently]. The first thing is they [avoid] creating internal competition within business units. So those organizations that truly believe they need to cannibalize their core business model, they almost always carve out that business unit into an independent and stand-alone entity.

The second thing they tend to do differently is they drive accountability and empowerment. It is not in the culture. It is not the ping-pong tables and Friday-afternoon beer that drive talent to really succeed in this world. It is the ability to give them very challenging problems and both the empowerment and accountability to go solve them.

And the final thing, and I think this is by far the single most important thing within an organization, is around leadership. And this leadership question around digital is one for the board of directors and the CEO and cannot be easily delegated below that level.

Paul Willmott: Most industries are going through some kind of disruption due to digital. It varies in terms of timing and it varies in terms of degree, but most industries are going through some level of disruption.

Secondly, getting the direction right and knowing exactly how you will react to that and how your strategy is going to play out in this new world and being very certain about it is important. That is surprisingly hard to achieve. It requires the executive team to spend a lot of time really understanding how the world is shifting around them, and then to take some very bold calls on exactly how to reallocate resources and how to do it quickly.

Jay Scanlan: I think that's right. Like so many things in companies, it's the honest and thoughtful application of leadership, and then the right application of time, talent, and capital resources that distinguishes those companies that ultimately win in their competitive environment from those that are less successful. And those evergreen lessons about great corporate performance are just as much in the world of digital now as they have been in decades past.

Lang Davison: All in all, a daunting set of challenges to address what is a big opportunity in the digital age for big, established companies. Gentlemen, thanks for joining today.

Paul Willmott: It was a pleasure. Thank you.

Jay Scanlan: Thanks, Lang. □

Jay Scanlan is a principal in McKinsey's London office, where **Paul Willmott** is a director. **Lang Davison** is a member of McKinsey Publishing and is based in McKinsey's Seattle office.