McKinsey&Company

A winning operating model for digital strategy

Digital is driving major changes in how companies set and execute strategy. New survey results point to four elements that top performers include in their digital-strategy operating model.

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For many companies, the process of building and executing strategy in the digital age seems to generate more questions than answers. Despite digital's dramatic effects on global business—the disruptions that have upended industries and the radically increasing speed at which business is done—the latest McKinsey Global Survey on the topic suggests that companies are making little progress in their efforts to digitalize the business model.[1] Respondents who participated in this year's and last year's surveys report a roughly equal degree of digitalization as they did one year ago,[2] suggesting that companies are getting stuck in their efforts to digitally transform their business.

The need for an agile digital strategy is clear, yet it eludes many—and there are plenty of pitfalls that we know result in failure.[3] We have looked at how some companies are reinventing themselves in response to digital, not only to avoid failure but also to thrive. In this survey, we explored which specific practices organizations must have in place to shape a winning strategy for digital—in essence, what the operating model looks like for a successful digital strategy of reinvention. Based on the responses, there are four areas of marked difference in how companies with the best economic performance approach digital strategy,[4] compared with all others:

- The best performers have increased the agility of their digital-strategy practices, which enables first-mover opportunities.
- They have taken advantage of digital platforms to access broader ecosystems and to innovate new digital products and business models.
- They have used M&A to build new digital capabilities and digital businesses.
- They have invested ahead of their peers in digital talent.

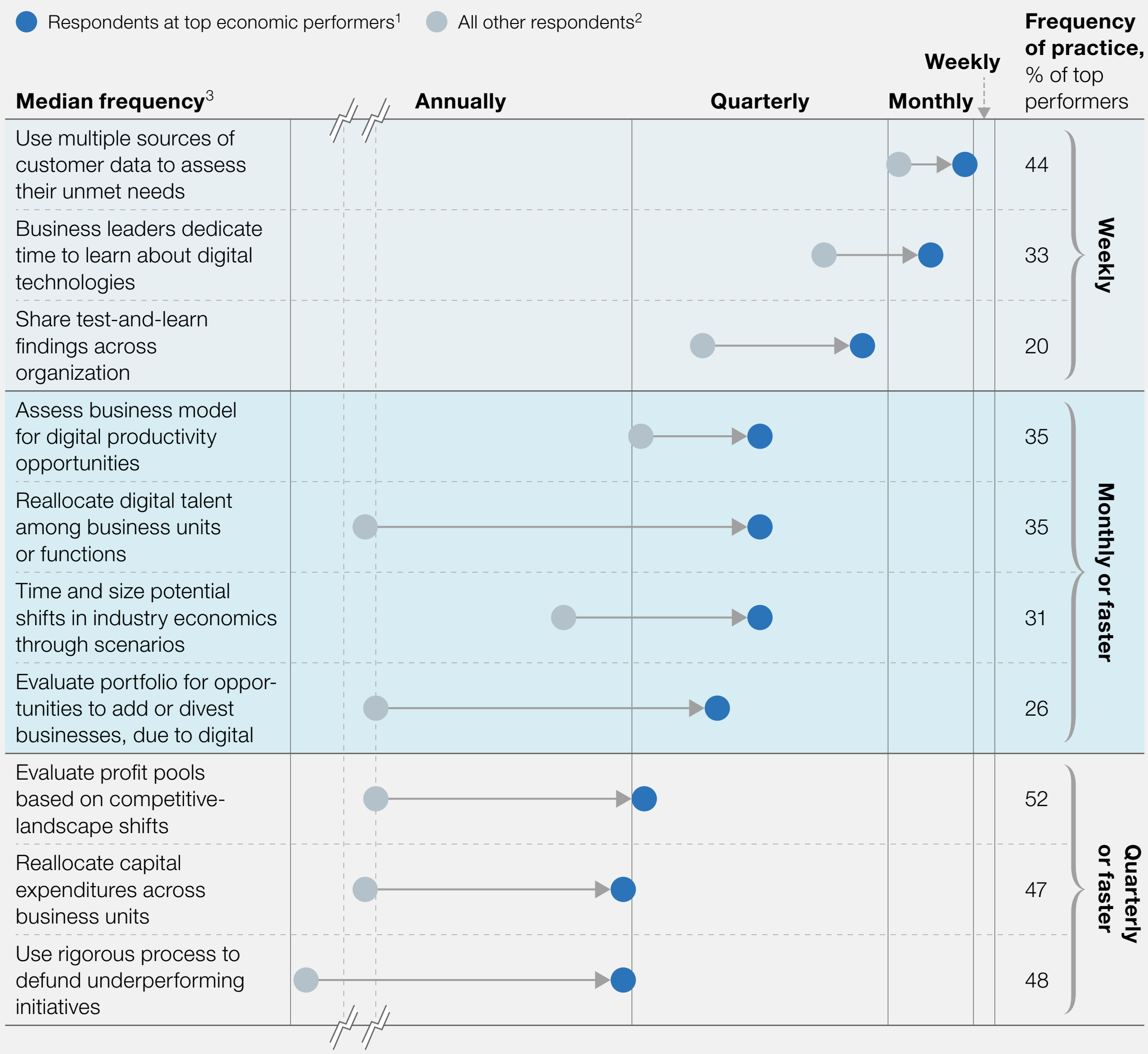
Increase the agility of creating, executing, and adjusting strategy

One of the biggest factors that differentiate the top economic performers from others is how quick and adaptable they are in setting, executing, and adjusting their digital strategies—in other words, the velocity and adaptability of their operating models for digital strategy. Both are necessary for companies to achieve first-mover (or very-fast-follower) status, which we know to be a source of significant economic advantage.[5] So how do they do it? We looked at the frequency with which companies follow 11 operational practices of digital strategy. With the exception of M&A—which typically requires a much longer time frame than the other ten, often due to regulatory reasons—respondents in the top revenue decile say their companies carry out each one more frequently than their peers (Exhibit 1). The link between frequency and performance also holds up when looking at earnings before interest and taxes (EBIT).[6]

That speed in strategy links with financial outperformance is not surprising and is consistent with our other work on strategy planning.[7] As the pace of digital-related changes continues to accelerate, companies are required to make larger bets and to reallocate capital *and* people more quickly. These tactical changes to the creation, execution, and continuous modification of digital strategy enables companies to apply a "fail fast" mentality and become better at both spotting emerging opportunities and cutting their losses in obsolescent ones, which enables greater profitability and higher revenue growth.[8]

Exhibit 1

The top economic performers set, execute, and adjust their digital strategies at a faster frequency than everyone else.



[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 = 138.
[2] n = 1,304.
[3] Frequencies shown are the median values from a histogram, which was constructed by assigning "weekly" responses a value of 1, "monthly" responses 2, "quarterly" responses 3, "annually" responses 4, "every few years" 5, and "never" 6. The question also asked about the frequency of evaluating M&A opportunities as part of strategy-setting discussions. These responses are not shown, because M&A typically requires a longer time frame than the other 10 operational practices tested, often due to regulatory reasons.

Invest in ecosystems, digital products, and operating models

The companies that outperform on revenue and EBIT also differ from the rest in their embrace of the economic changes that digital technologies have wrought. Based on the results, they have done so in three specific ways: taking advantage of new digital ecosystems, focusing product-development efforts on brand-new digital offerings, and innovating the business model. We know that digital platforms have enabled the creation of new marketplaces, the sharing of data, and the benefits of network effects at a scale that was impossible just a few years ago. As these factors have converged, the digital ecosystems created by these platforms are blurring industry boundaries and changing the ways that companies evaluate the economics of their business models, their customers' needs, and who their competitors—and partners—are.[9]

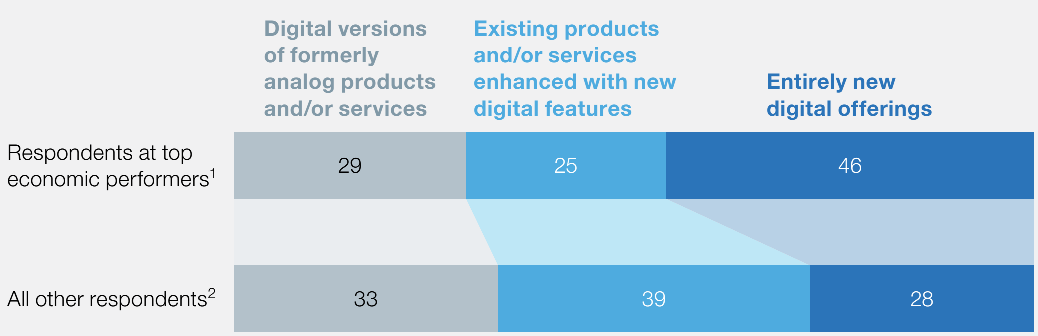
The top EBIT performers are taking better advantage of these ecosystem-based dynamics than other companies—namely, by using digital platforms much more often to access new partners and customers. Respondents at these companies are 39 percent more likely than others are to say they do so. And while the share of global sales that move through these ecosystems is still less than 10 percent, other McKinsey research predicts that this share will grow to nearly 30 percent by 2025,[10] making platforms an ever more critical element of digital strategy.

The needs of customers become broader and more integrated in an ecosystem-based world, and the companies that are already active in their respective ecosystems are better positioned to understand these needs and meet them (either on their own or with partners) before their peers do. It makes sense, then, that the top performers seem to be developing much more innovative offerings than their peers. On average, companies' digital innovations most often involve adjustments to existing products. Yet respondents at the top-performing companies say they focus on creating brand-new digital offerings (Exhibit 2). What's

Exhibit 2

Being bold on innovation gives companies a bigger economic advantage, according to respondents.

% of organizations' digital offerings, by category



[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 = 101.
[2] n = 906.

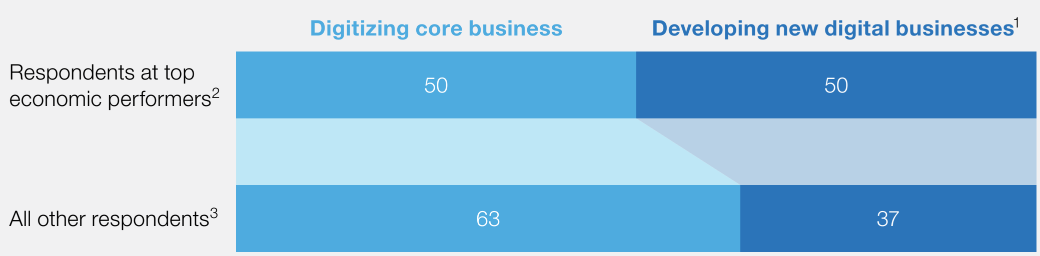
more, these respondents are about 60 percent more likely than others are to agree that they are more advanced than peers in adopting digital technologies to help them do so. This result is consistent with our previous findings that first movers and early adopters of digital technologies and innovations also outperform their peers.[11]

Last, innovation of the business model is more common at the top-performing companies. In our past survey, only 8 percent of respondents said their companies' current business models would remain economically viable without making any further digital-based changes. In the newest survey, we see that the companies that have embraced digital are well ahead of their peers in their preparation for digital's new economic realities. At the top performers, respondents say they have invested more of their digital capital in new digital businesses, compared with all other respondents (Exhibit 3). Our research also shows that companies overall invested a greater share in new digital businesses as the overall digital maturity of their sectors increased. The more successful companies appear to be the ones that made these moves earlier than their peers, rather than being forced into making such investments late in the game.

Exhibit 3

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

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



[1] Includes respondents who answered "developing digital businesses in your primary industry" or "developing new digital businesses in an adjacent industry."
[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 = 123.
[3] n = 1,125.

Use M&A to build digital capabilities and businesses

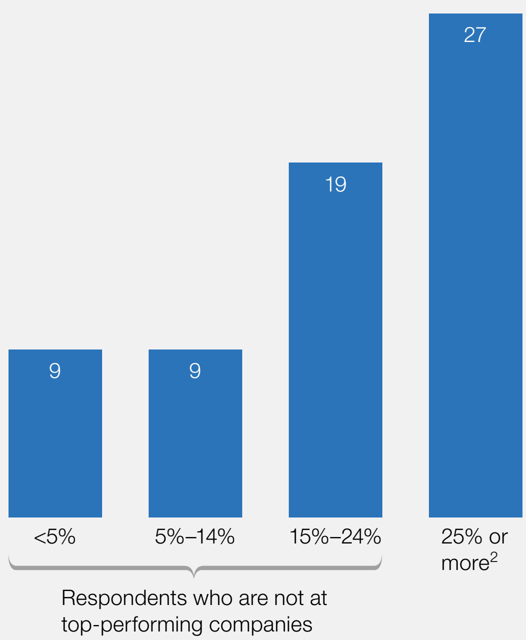
According to the results, M&A is another differentiator between the top-performing companies and everyone else. Not only are they spending more than others on M&A, but they are also investing in different types of M&A activities (Exhibit 4). At the winners, respondents report spending more than twice as much on M&A, as a share of annual revenue, as their counterparts elsewhere.[12] The same is true of respondents reporting top-decile EBIT growth, relative to respondents at other organizations.

Given the pace of digital-related changes and the challenges companies face to match that speed through organic growth alone, this isn't so surprising. What *is* surprising, however, is that top economic performers take a different approach to their M&A activities. While top performers and their peers have used some part of their overall digital investments to acquire new digital businesses in recent years, the top performers

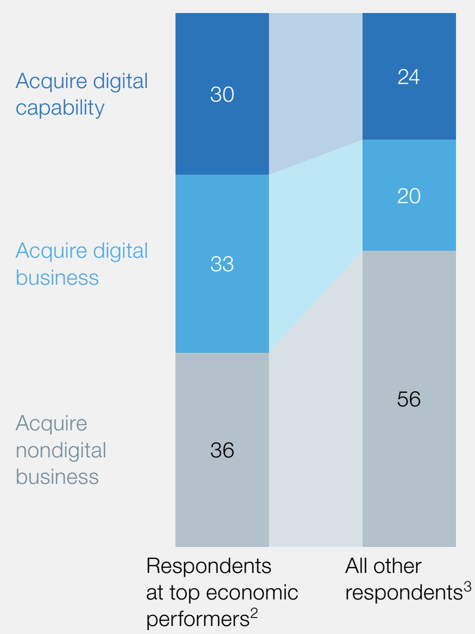
Exhibit 4

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, by rate of organic revenue growth in past 3 years



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



[1] Excludes respondents from publicly owned companies, who were asked how much their organizations invested in M&A as a percentage 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.
[3] n = 513.

are investing more in acquiring both new digital businesses and new capabilities. By contrast, other respondents say their companies focus most of their M&A spending on nondigital ventures—an area where lower-performing companies seem to be doubling down.

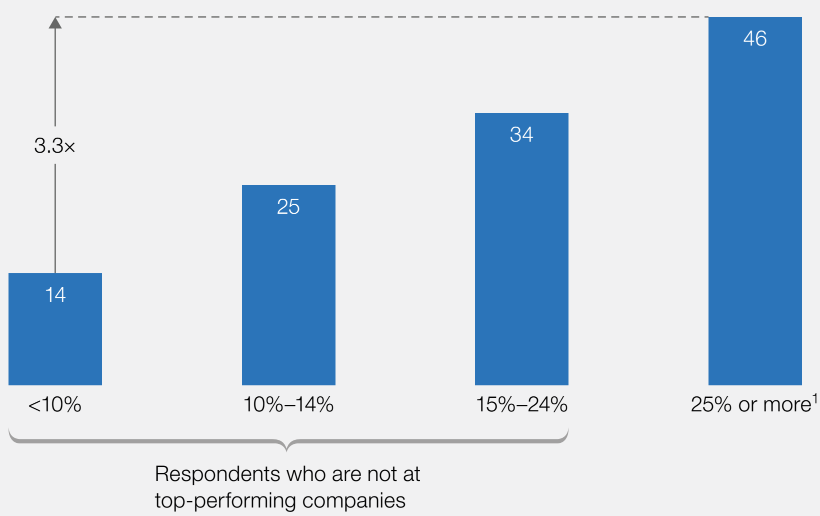
Invest ahead of peers in digital talent

From earlier work,[13] we know that getting the right digital talent is a key enabler for digital success—a point that our latest findings only reinforce. Talent is also a major pain point: qualified digital talent is a scarce commodity, as the pace of digital still outstrips the supply of people who can deliver it.[14] But the top economic performers are making a greater effort to solve this problem. Compared with others, these respondents say their companies are dedicating much more of their workforce to digital initiatives (Exhibit 5). It's not just the degree of investment that distinguishes top performers, though. They are also much nimbler in their use of digital talent, reallocating these employees across the organization nearly twice as frequently as their peers do. This agility enables more rapid movement of resources to the highest-value digital efforts—or to clearing out a backlog of digital work—and a better alignment between resources and strategies.

Exhibit 5

Top-performing companies have allocated much more of their overall workforces to digital.

Share of organizations' overall workforce dedicated to digital initiatives,
% of respondents, by rate of organic revenue growth in 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 = 131.

Looking ahead

- *Make your strategy process more dynamic.* By definition, a digital strategy must adapt to the digital-driven changes happening outside the company, as well as within it. Given the breakneck pace of these changes, such a strategy must keep up with the pace of digital and enable first-mover opportunities by being revisited, iterated upon, and adjusted much more frequently than strategies have been in the past. Companies need their digital strategies to act as a road map for ongoing transformation—a living organism that evolves along with the business landscape. In other work, we laid out the four main fights that companies must win to build truly dynamic digital strategies.[15] Organizations must educate their business leaders on digital and foster an attacker's perspective, so people are more likely to look at their business, industry, and the role of digital through the eyes of new competitors. They must galvanize senior executives to action by building top-team-effectiveness programs. Organizations also must leverage data-driven insights to test and learn—and correct course—quickly. And they must fight the diffusion of their efforts and resources—a constant challenge, given the simultaneous need to digitalize their core business and innovate with new business models. These steps will put companies in a better position to move first in delivering new products and meeting customers' and partners' evolving needs in the new ecosystems that platforms are creating.

- *Invest in talent and capabilities early and aggressively.* Talent is already known as one of the hardest issues to solve as companies transform themselves in their pursuit of digitalization. The results confirm that companies need to embrace this reality and then look at how they can solve it best, whether through smarter, more dynamic allocation of these resources or the use of M&A to accelerate the building of new digital capabilities. Digital is driving an ever-faster pace of innovation, and companies can take advantage of the potential benefits only if they have the capabilities to harness it. For the survey's top performers, one way forward is leveraging M&A to help build their digital capabilities, rather than trying to build them through a slower, organic approach. These companies are also getting the most from their digital capabilities and investments by deploying them in much more agile ways and creating a more flexible, responsive operating model.

- *Redefine how you measure success.* The digital era requires that companies move nimbly in order to succeed. Yet many are still measuring performance with the same metrics they used previously—which were designed for a slower pace of business and a rigid strategy-setting process. Companies must move away from old metrics (market share, for example) that are no longer meaningful indicators of economic success. With markets becoming ill-defined due to shifts in industry boundaries and shrinking economic pies within a given sector, market share is no longer a gold-standard metric or even relevant. Companies need to hold themselves to new standards that will indicate whether or not they are truly leading the pack on innovation, productivity, and the adoption of digital technologies. In our experience, outcomes such as being first to market with innovations, leading on productivity, and working with other businesses in the ecosystem (that is, moving from an "us versus them" mind-set on digital to one of partnership) are better indicators of future digital success. ■

[1] The online survey was in the field from May 15 to May 25, 2018, and garnered responses from 1,542 C-level executives and senior managers representing the full range of regions, industries, company sizes, and functional specialties.

[2] As measured by the shares of the organization's sales from products, services, or both sold through digital channels; of core products, services, or both that are digital in nature (for instance, virtualized or digitally enhanced); and of core operations that are automated, digitized, or both, as well as the volume in the organization's supply chain that is digitized or moves through digital interactions with suppliers. The previous survey was in the field from June 20 to July 10, 2017, and garnered responses from 1,619 C-level executives and senior managers representing the full range of regions, industries, company sizes, and functional specialties. Of those who completed the survey in 2017, 345 also completed the 2018 survey.

[3] Jacques Bughin, Tanguy Catlin, Martin Hirt, and Paul Willmott, "Why digital strategies fail," *McKinsey Quarterly*, January 2018, McKinsey.com.

[4] We define a top economic performer as one that has, according to respondents, a top-decile rate of organic revenue growth (that is, of 25 percent or more in the past three years), relative to other respondents. We also looked at respondents in the top decile for growth in earnings before interest and taxes (EBIT) and have made note of any practices for which the top-decile revenue and top-decile EBIT results correspond or differ.

[5] Bughin, "Why digital strategies fail."

[6] In our analysis, we looked at the relationship between frequency and economic performance in multiple ways. The results indicate that when these digital strategy practices are carried out more frequently, revenue and earnings before interest and taxes (EBIT) are greater. The inverse also is true: when companies carry out these practices more slowly, their revenue and EBIT performance is worse.

[7] Chris Bradley, Martin Hirt, and Sven Smit, "Eight shifts that will take your strategy into high gear," *McKinsey Quarterly*, April 2018, McKinsey.com.

[8] Jacques Bughin, Laura LaBerge, and Anette Mellbye, "The case for digital reinvention," *McKinsey Quarterly*, February 2017, McKinsey.com.

[9] Tanguy Catlin, Laura LaBerge, and Shannon Varney, "Digital strategy: The four fights you have to win," *McKinsey Quarterly*, October 2018, McKinsey.com.

[10] Venkat Atluri, Miklós Dietz, and Nicolaus Henke, "Competing in a world of sectors without borders," *McKinsey Quarterly*, July 2017, McKinsey.com.

[11] "How digital reinventors are pulling away from the pack," October 2017, McKinsey.com.

[12] Includes only respondents working at privately owned companies, n = 767. Respondents working at publicly owned companies (n = 318) were asked how much their organizations invested in M&A as a percentage of market capitalization over the past three years.

[13] "Unlocking success in digital transformations," October 2018, McKinsey.com.

[14] Susan Lund, James Manyika, and Kelsey Robinson, "Managing talent in a digital age," *McKinsey Quarterly*, March 2016, McKinsey.com.

[15] Catlin, "The four fights."

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