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A Portfolio Strategy to Execute Your Digital Transformation

By Didier Bonnet, Senior Vice President, Capgemini Consulting

> ***Should we prioritize short-term improvements at the expense of potentially larger strategic shifts?***

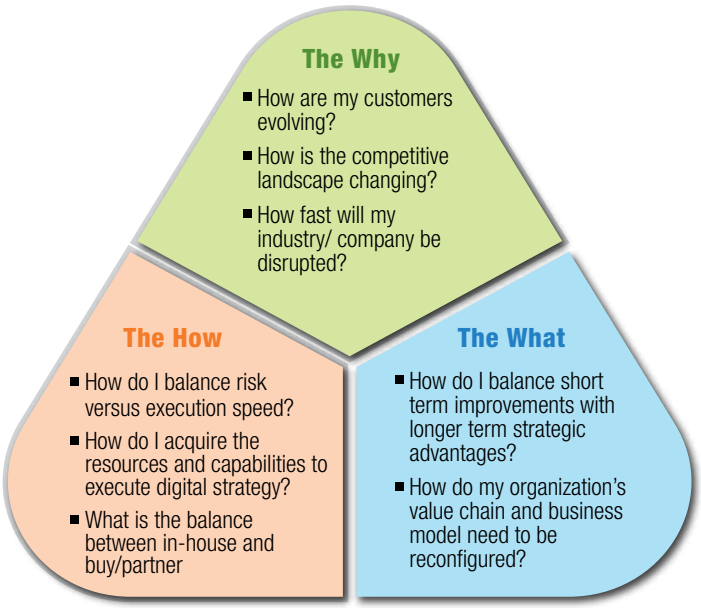
Senior Executives in pretty much all industries have now elevated digital transformation to the top of their strategic agenda. And they're right to do so. The risk of falling behind the curve is so great that senior leaders are not debating whether digital technologies will affect their competitive position, but rather how to conduct an effective digital transformation and how fast it can be done.

However, an organization's determination to get on the front foot with a bold digital strategy often falters when it comes up against the multi-dimensional complexity of the questions it faces and the risks it must manage. Should we prioritize short-term improvements at the expense of potentially larger strategic shifts? How fast will our industry be disrupted: months, years, or even decades? What level of risk are we willing to take on innovative new business models? Can we deliver our digital strategy in house or do we need to partner? The list goes on. Senior leaders are struggling to craft digital transformations that provide a balanced approach between strategic risk and speed of execution.

Part of the problem is that many digital transformation roadmaps are designed as if every digital initiative has the same impact, time horizon, or risk level. That is not the real world. Success comes from consciously managing your digital transformation as a strategic portfolio over time. This requires addressing three areas in an analytical and consistent way (see Figure 1):

- **The Why –** Insight and foresight about how the competitive digital landscape is affecting your industry and your business. This is about new sources of value creation as well as threats to your current position.
- **The What –** Designing a portfolio of initiatives that will balance the need for short-term improvements with longer term strategic and business model evolution and allow you to respond within a risk profile that you and your stakeholders are comfortable with.
- **The How –** The ability to execute on your strategy at the right tempo, balancing risk with the need for speed, and making the right trade-offs between in-house and external capabilities.

Figure 1: Formulating and Executing Your Digital Transformation Strategy



The Why: High Stakes for the Digitally Unprepared

Getting a clear picture of how digitization will affect your industry, organization, and competitive position is a complex exercise. It is about both offense and defense.

Offense is about understanding how digital transformation can help the organization create more value. Do you understand how the customer experience can be enhanced through digitization? What step changes in productivity are possible through digitizing our operations and connecting our workforce efficiently? Can we disrupt our industry or an adjacent industry using our digital competencies?

Conversely, defense is about understanding where your organization's vulnerabilities and risk exposures are in this stage of digital transition. How is digitization impacting the company's value chain or the business model it operates in? How is it changing products, services, pricing, or distribution? Are there opportunities for new entrants and lateral competitors to disrupt the established business model? Do we have the right skills and competences to respond? What is the likely time horizon for these changes?

The forces at play are complex, and you will not be able to predict everything. But you can proactively shape your digital transformation program around three types of scenarios:

- Digital trends where there is a significant level of certainty. For instance, if you are in retail banking today, you can safely assume that millennial customers will demand a seamless and intuitive way of connecting with your services in digital ways.
- Digital trends where there is a strong likelihood. Once again, with retail banking, it is likely that your branch network will reduce in size over time and/or will be revamped to cater for different needs of the digital generation.
- Digital trends and discontinuities where there is uncertainty about the outcome. For instance, recent development in crypto-currency could have a profound impact on the banking world, be it positive or negative.

Once the digital landscape has been analyzed and mapped, you need to shape your digital transformation program accordingly—tackling the scope of the change needed and the speed of execution that would maximize value creation and/or minimize the risk of being outflanked or disrupted. Balance is key. Too much focus on reconfiguring the existing operations or the short-term gains, and you might not get the organization ready to face the real digital threats. Too much focus on the reinvention and you might end up in constant discovery with little impact, or misread the timing of disruptions and increase the risk profile of the transformation.

> ***"Success comes from consciously managing your digital transformation as a strategic portfolio over time."***

The What: Balancing the Scope of Your Digital transformation

With a clear picture of the digital landscape, you are in a position to shape your digital transformation program. As you design the program, it is essential to frame your digital initiatives according to their impact on your current operations. As Figure 2 illustrates, two dimensions are critical:

- **The breadth of reconfiguration required within the current value chain.**

  There are large pockets of value that digital technologies can help to unlock in your current value chain. These days, pretty much every core process and every function of the firm can be reconfigured more effectively using the power of digital technologies. For example, specialized technologies are available today to automate many of the end-to-end core processes of an HR or a finance department. The increasing availability of customer and operational data has also opened up many opportunities for value creation, such as hyper-personalization or predictive maintenance.

- **The level of reinvention necessary in the core offering or business model.**

  Digital technologies have also opened up myriad opportunities to fundamentally alter the way your business is traditionally conducted. This requires vision, creative skills, and more often than not, opening up your organization to an ecosystem of innovative partners that can support you in this reinvention. Reinventing the business model can be a "bet-the-ranch" strategic move, such as moving to a platform-based model. GE, with its "industrial internet" is a good example of such a radical move[1]. But it doesn't need to be a make-or-break play. Many enhancements to your service offering or business model can be done without creating massive shifts and risk to current operations, while still generating significant business returns.

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Let's look at each dimension of the portfolio in turn.

Digital Reengineering.

Some initiatives will have a narrow scope within your value chain (e.g., a single function or process) and will not fundamentally change your existing offerings or business model. Although reengineering has had bad press, the opportunities that digital technology creates to reconfigure processes and functions are numerous. Often there is a need to virtually zero-base an existing process and digitally reconfigure it end-to-end. The focus is on improving operational efficiency or sales effectiveness, or both. Schindler, a world leader in elevators and escalators, provided its workforce with access to real-time updates from sensors embedded in elevators. It helped them proactively respond to outages and schedule service visits efficiently, thus saving 40 million kilometers of driving and preventing 4,435 tons of emissions per year[2]. Lily Pulitzer, a US-based fashion retailer, increased its same-period sales by close to 25% in 2014 by rolling out mobile point-of-sale capabilities in its stores[3]. Some of these initiatives will be harder than others depending on the level of change management required, but all should provide a reasonably short time frame to value. These initiatives are therefore essential portfolio components to fuel investment and demonstrate early successes.

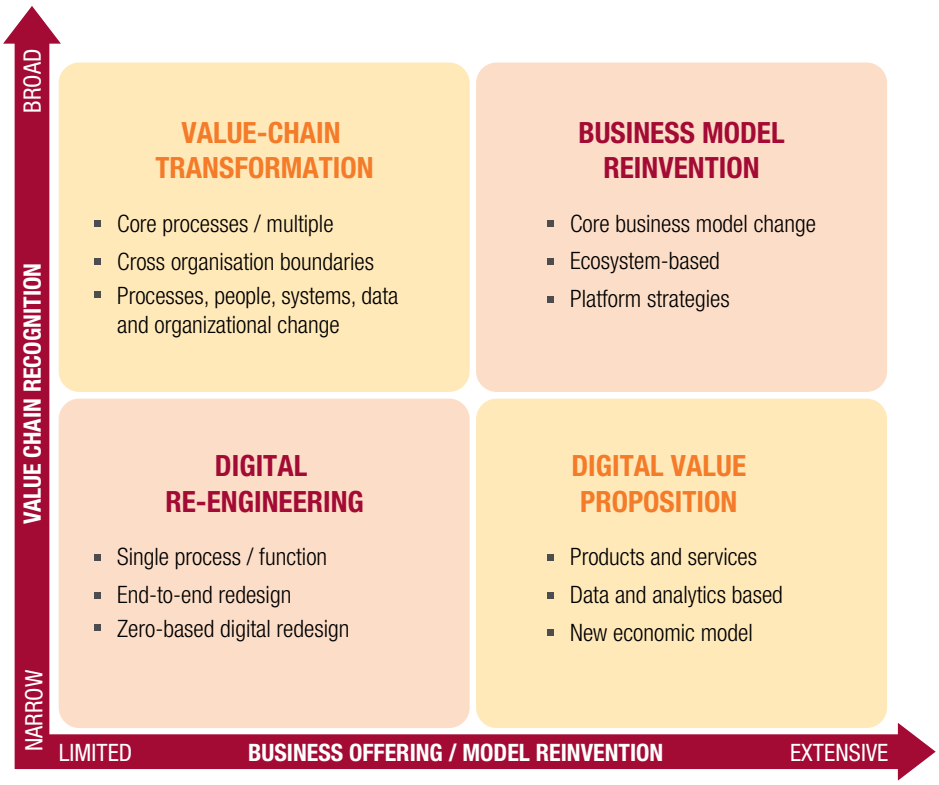
Value-Chain Transformation.

These initiatives often cut across organizational boundaries (e.g., functions or geographies) and the change management can be substantial. The risk profile and the time to value are therefore greater. US retailing giant Macy's launched an ambitious omnichannel fulfillment program[4] to digitally locate and make available for sale even the last remaining item from a line of stock. Macy's conducted a pilot to test the new fulfillment process on a limited range of products and stores. Then, with a massive transformation effort, extended it across its supply

$1 billion

reduction in inventory at Macy's thanks to omnichannel fulfillment program.

Figure 2: Mapping the Digital Initiatives - The "What" of Your Digital Transformation Portfolio



chain network. The company rolled out the program to all of its 775 stores across 45 states in the US. Macy's estimates that the program helped it reduce $1 billion of inventory from its stores that would otherwise have been marked down or not sold. Value-chain transformations are complex endeavors that will invariably impact processes, systems, data, people, and organizations.

Digital Value Proposition.

Reinventing offerings or business models need not be disruptive; it can be about combining products and services in new and innovative ways, making better use of analytics, designing new economic models, or repackaging an existing offer. Property and casualty insurer, Tokio Marine, augmented its traditional business by launching One-Time Insurance in partnership with mobile operator Docomo. The app-based offer allows customers to buy insurance in narrowly defined periods (a day, a week) for lifestyle events such as borrowing a car or going skiing for the weekend. These innovative services can be developed in a reasonable time frame, as they do not necessarily demand a fundamental restructuring of the existing value chain. The risk can also be managed by using proof of concepts and experimentation.

Business Model Reinvention.

Reinventing your business model is not a decision you will take lightly. It is by far the most challenging of transitions. Organizations will go down this path if they are reacting to a major industry disruption that is threatening the business. Or having identified a major opportunity, it can be about deciding to proactively disrupt the business or industry before someone else does. Such transformation will invariably involve an external ecosystem of partners, a substantial re-skilling and skill acquisition exercise, and more often than not, some surgery on your current organizational model. GE transformed itself from an industrial equipment manufacturer to a seller of software and data-centric services. GE's vision is to be a top 10 software company by 2020. Its digital business—GE Digital—grew by 20% and generated revenues of $5 billion in 2015 with plans to grow this to $15 billion by 2020. By the end of 2016, it is expected to have 200,000 assets under management, 100 applications, and 20,000 developers[5].

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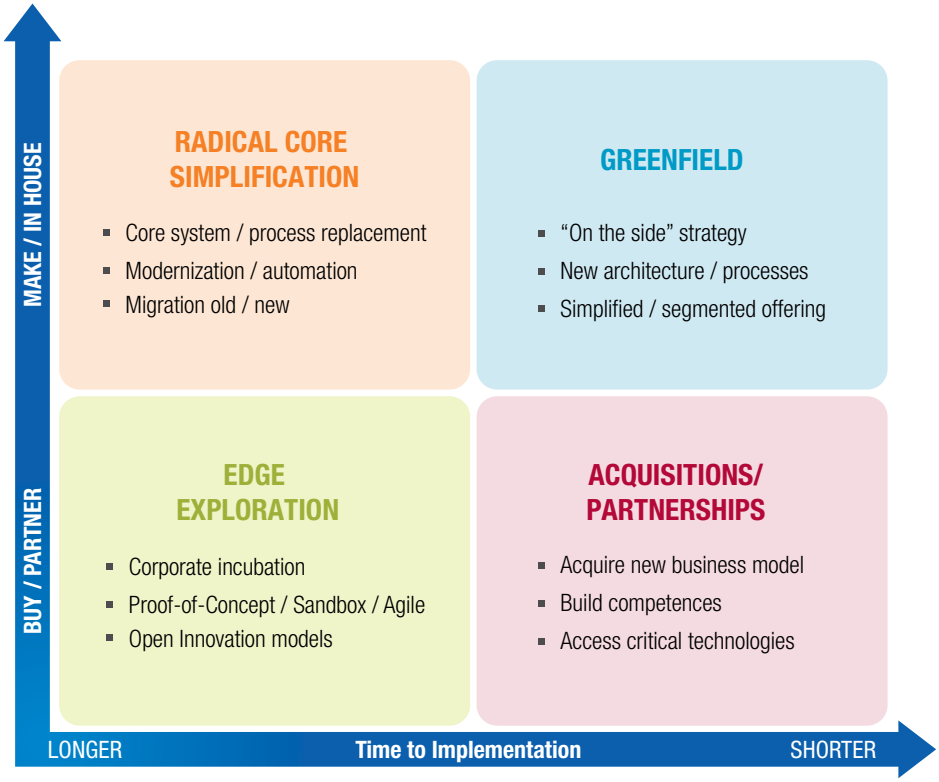
The How: Executing at the Right Tempo

Deciding what digital initiatives are critical to face the new digital future is important. Finding the right tempo and means to execute are even more critical. Why? Because balancing speed, risk, competence building, and financial capacity is difficult, and they are all essential ingredients of a winning digital transformation. The digital transition needs to both protect profitable assets, while making the successful transition to a new digital or digitally enhanced business. When faced with executing on your digital transformation strategy, you will be confronted with competences you do not yet possess; technology you don't know or own; ways of working that are not familiar to your business; new untested business models; and even cultural barriers that will have to be overcome. It is a daunting task. Executives need to focus on two critical dimensions (see Figure 3):

- **Time to Implementation –** Understanding the speed at which each component of your digital strategy needs to be implemented. Speed of execution will be driven by external factors: the rate of technological upheaval, the pace of change in your industry, and the intensity of competition from adjacent or brand new players. But it will also be strongly influenced by internal factors: the current digital competences you possess versus those you need, how suitable your organizational model is versus what is required to be competitive, and your familiarity with the core technologies underlying your digital transformation versus those you need to learn and experiment with.
- **Make/buy/partner –** Assessing your ability to execute with the capabilities you currently possess versus the need to access external resources through acquisitions or partnerships is key to success. This is a big decision that requires a careful analysis of timing and risk and its criticality will obviously be linked with the competitive pressures your company is under.

Figure 3: Mapping the Execution Route – The "How" of Your Digital Transformation Portfolio



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Let's look at each execution path in turn.

Edge exploration.

When technologies are unproven and benefits unclear, the exploration route is appropriate. Building incubation or innovation sandboxes can allow you to test potentially transformative technologies in a controlled environment. This will mean opening up the organization to external parties such as start-ups, incubators and universities. For instance, CVS Health, operator of Minute Clinics and one of the biggest drugstore chains in US, has opened a Digital Innovation Lab in Boston that is intended to "be a source of new ideas that will drive the company into the future"[6]. One of the goals of the Digital Innovation Lab is to connect with start-ups that are developing healthcare-related products and services and to ensure CVS can be an ideal learning lab for early-stage companies[7].

This is a speculative approach, but is a good way to mitigate high costs of failure. However, it is not a fast process, as identifying promising applications takes time in large organizations and scaling up a successful pilot is a lengthy process. James Patterson, Managing Vice President and Head of Capital One Labs, commented: "Creating excellence at small scale is relatively straightforward. Doing so at scale is extremely hard. And that's where most innovation centers struggle."[8] He added, "That's primarily because you are involving a totally different and expanded cast of characters to get to scale compared to just getting to pilot. It's not good enough to just have an idea and to get it in the hands of a few hundred people."

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> ***None of these execution routes are mutually exclusive.***

Radical Core Simplification.

Sometimes what needs to change is more obvious but it requires a radical overhaul of core processes and underpinning technology. These major business simplifications occur, for example, when a cost base has become unacceptably high or when a technology platform has been overtaken by much more nimble, speedier, and easier-to-maintain alternatives. In 2011, the UK's Lloyds Banking Group invested in a four-year technology program that involved automating and simplifying complex manual banking processes. These initiatives helped achieve annual savings of £352 million, and a 7% reduction in total costs. The program reduced the number of unique business processes from 700 to just 23, helping to halve the number of manual errors[9]. These business simplification exercises have one thing in common: they are anything but simple to pull off! Their risk profile is high. To succeed, it requires upmost leadership attention, strong internal program management, and financial commitment to stay the course as the migration to the new core processes can take years to implement.

Acquisitions and Partnerships.

When the competitive pressures are so great that organic development would take too long and put the company at risk, acquisitions or external partnerships become viable options. Several reasons drive this external focus. Your skill or competence gap might be too big, and the skill set you need in short supply. You may be facing a new business model that is not culturally matched to your traditional operations, and in that case acquiring a company for its innovative business model might be the answer. In the case where ownership of a technology or platform can become a true source of competitive advantage it might make sense to go for a first mover advantage by acquiring or licensing the technology base outright. For instance, since 2011, Walmart has acquired nearly 14 start-ups to boost its digital transformation. In the process, Walmart gained crucial access to talent and technology know-how in data analytics, search, mobile, advertising, and social shopping[10]. Acquisitions can also be used to secure an innovative business model. In 2014, BBVA acquired "Simple", a fully digital US bank with no physical branches. Simple's digital-only model eliminates all the fees associated with traditional banking[11]. Acquisitions are of course risky in themselves, and digital acquisitions are no different. They can also be expensive. Wait too long and the strategic importance of the technology or the competence set becomes obvious to all your competitors—leading to a bidding war. Acquisitions can also take time to complete. However, in most cases, it is a relatively shorter route compared to organic developments.

Greenfield.

When simplifying the core business proves too difficult or lengthy, or when a new digital culture is required to succeed, companies go for a Greenfield option. This is about building a new and simplified operation "on the side" of the core business—sometimes branded differently. The aim is to migrate the old into the new over time. The Greenfield option is attractive as organizations can start with a blank canvas, creating a company that is digital from day one and with a highly simplified offering and operations. Essentially, this is about building a start-up within a large firm. It requires a heavy dose of new talent and competences, many from outside the existing firm. It needs to be built with specific customer segments in mind. It also requires strong leadership to protect the Greenfield business. "Antibodies" from the parent business often spring into action to work against the new model, particularly as cannibalization of existing business lines will be inevitable. STC, the Saudi Arabia-based telecom operator has adopted such Greenfield approach. STC recently launched a digital operator, Jawwy, to target the digital-savvy, young mobile consumers of Saudi Arabia with a completely new customer experience. Subhra Das, CEO of Jawwy, explained: "At Jawwy, we are building a digital mobile operator model with the organizational DNA and agility of an internet player."[12] He added, "Our strategy is not about price. It is about designing and launching a best-in-class customer experience that is fully digital end-to-end."

Of course, none of these execution routes are mutually exclusive. Many companies hedge their bets by pursuing multiple portfolio options. For instance, some telcos faced with a long timescale and uncertain outcomes in their core transformation, are both radically simplifying their core operations as well as developing Greenfield operations.

Think Portfolio!

In a constantly disrupted and evolving digital economy, too many organizations are designing transformation roadmaps that are static—not balancing strategic and competitive risks with the speed required for successful implementation and business results. Thinking dynamically about digital transformation execution requires an executive reboot. To succeed, it is crucial that senior executives turn their ambitions and strategy into a balanced portfolio of digital initiatives, with short and longer-term outcomes. They also need to make sure they use the full panoply of execution models available to cope with the pressures and magnitude of the digital transition.

References

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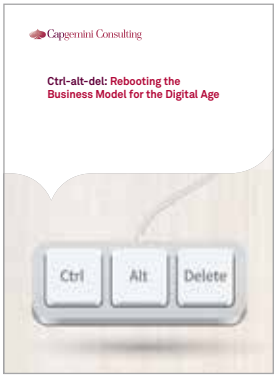

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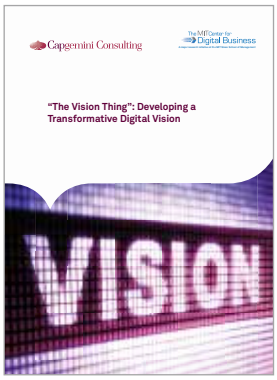

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