[DIGITAL STRATEGY]

Is Your Company Ready for a Digital Future?

There are four different pathways that businesses can take to become top performers in the digital economy. Leadership's role is to determine which pathway to pursue — and how aggressively to move.

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In preparing for the future, many large, established enterprises are embarking on a digital business transformation journey — often without any sense of where they are going. In this article, we will present four viable pathways for transformation and examine their pros and cons. However, the goal isn't digital transformation but rather *business* transformation — using digital capabilities to transform a traditional enterprise into a top performer in the digital economy. We call such top-performing enterprises "future-ready."

In 2015 and 2017, we surveyed several hundred enterprises,[1] examining both the capabilities needed for transformation and the impacts on performance. We also had conversations with more than 50 executives to learn about their experiences with digital business transformation. Respondents represented a wide variety of industries, with manufacturing, financial services, and IT software and services being the biggest groups. Based on our analysis, future-ready enterprises performed much better than their industry peers. But we also found that, even within a single industry, enterprises can take different paths to becoming future-ready. This article looks at four banks that have taken different pathways: Danske Bank, mBank, BBVA, and ING.

Becoming Future-Ready

Becoming future-ready requires changing the enterprise on two dimensions — customer experience and operational efficiency. (See "How Companies Compare on Digital Business Transformation," p. 22.)

Future-Ready Future-ready enterprises are able to innovate to engage and satisfy customers while at the same time reducing costs. Their goal is to meet customers' needs rather than push products, and customers can expect to have a good experience no matter which service delivery channel they choose. On the operations side, the company's capabilities are modular and agile; data is a strategic asset that is shared and accessible to all those in the company who need it. The enterprise is ready to compete in the digital economy and able to work with a wide variety of partners through both

Is Your Company Ready for a Digital Future? (Continued from page 21)

digital services and exposed application programming interfaces (APIs). By these criteria, 23% of the businesses we surveyed were future-ready, shown in the upper-right quadrant of the exhibit. Their performance averaged 16 percentage points better than their industry average, meaning that if the average net profit margin for a company in a given industry was 8%, future-ready enterprises earned 24%.

Silos and Complexity Of the companies we surveyed, 51% were in the bottom-left quadrant, with an extensive catalog of products and services developed over many years. Their products and services are supported by a complex set of business processes, systems, and data. The result is a fragmented, labor-intensive, and frustrating customer experience, often made worse by product silos within the company.

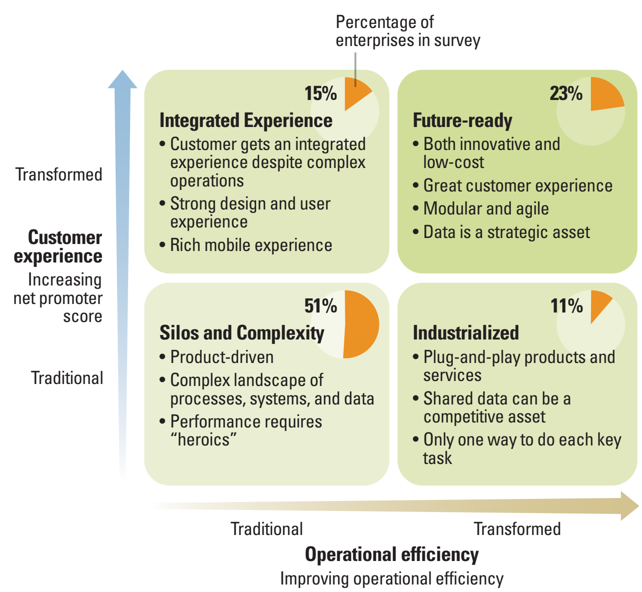
Frequently, the ability of such organizations to provide an engaging customer experience depends heavily on heroics by employees. For example, we watched one bank teller work with an elderly customer who wanted to change her address on six different bank products. The number of keystrokes required to make the necessary changes was dizzying. During a 20-minute encounter, the teller chatted amiably with the customer about the local sports team. An amazing effort, to be sure — but not scalable. It shouldn't be surprising that, in our survey, the profit margins of enterprises from this group were weak; they averaged 5 percentage points below their industry average.

Industrialized Companies characterized by digital industrialization, shown in the bottom-right quadrant, apply the best practices of automation to their operations. They use the features that make them strong as an enterprise and turn them into modular and standardized digitized services. For example, companies in this group picked the best way of handling each key task (processing an insurance claim, on-boarding a customer, or assessing risk) and deployed it across the enterprise. They configured their services into plug-and-play modules to meet particular customer requirements quickly and inexpensively. The consolidated data created from the customer interactions and operations can become a competitive asset that anyone involved in the enterprise can access. Over time, many of these processes and decisions can be automated. Of the companies we studied, 11% were in the industrialized group; their net profit margins averaged 4.6 percentage points higher than their industry average.

Integrated Experience Enterprises offering what we call an "integrated experience," shown in the upper-left quadrant, provide a better-than-industry-average customer experience despite having complex operations. Some of the companies emulated the industry-leading model epitomized by United Services Automobile Association (USAA), the San Antonio, Texas-based financial services group. USAA is organized around addressing a customer's life events (for example, buying a house, having a baby, or preparing for retirement) rather than on pushing products. We have seen companies that want to offer an integrated experience develop attractive websites and mobile apps and hire more relationship managers to improve the customer experience. Many attempt to improve the customer experience by investing in analytics. However, we have found that these enterprises typically are unable to simplify or automate the underlying and complex business processes, technology, and data landscape. As a result, they see their costs of serving customers increase. About 15% of enterprises we studied offered an integrated experience; their net profit margins averaged 3.6 percentage points below their industry average.

HOW COMPANIES COMPARE ON DIGITAL BUSINESS TRANSFORMATION

In 2015 and 2017, we surveyed several hundred enterprises, examining both the capabilities needed for transformation and the impacts on performance. Based on our analysis, companies in the future-ready quadrant performed much better than their industry peers. Becoming future-ready requires changing the enterprise on two dimensions — customer experience and operational efficiency. We found that enterprises can take one of four different paths to go from the lower-left quadrant (Silos and Complexity) to the upper-right (Future-ready).



Four Pathways to Transformation

We identified four different pathways that companies took to become future-ready. Each pathway begins in the bottom-left quadrant (Silos and Complexity), and each involves significant organizational disruption.

PATHWAY 1: Standardize first. Pathway 1 moves enterprises from the Silos and Complexity quadrant to the Industrialized quadrant. This pathway relies on building a platform mindset with API-enabled business services that can be accessed across the enterprise and also externally. It enables an organization to eliminate many of its legacy processes and systems. But, as anyone who's been through an enterprise resource planning, customer relationship management, or core banking project will attest, replacing core processes in an enterprise is an expensive, multiyear undertaking. It also requires putting many other projects on hold. Cloud computing, APIs, micro services, and better solution architectures make this industrialization process quicker, less risky, and less disruptive.[2] However, embarking on Pathway 1 takes time. Among other things, it requires changing the decision rights to emphasize integrated services for customers, rather than focusing on products.[3]

Danske Bank A/S, headquartered in Copenhagen, Denmark, and operating in 16 countries, has been pursuing Pathway 1. The vision it presented on its website in 2012 was: "One platform — exceptional brands." Danske Bank's approach brought some early benefits, allowing it to acquire five banks in six years and to reduce operating expenses. In the past few years, Danske Bank has also revamped its financial products into a set of banking services that can be combined to create products in real time across distribution channels in most markets. In the core banking services, 90% of its applications are shared and standardized. At the same time, it simplified its management structure, slimming down its product owner organizations. Whereas there used to be many executives responsible for credit cards, for example, today there's just one.[4]

Danske Bank's "one platform" approach has also delivered longer-term benefits in terms of its relationships with customers and its reputation among peers. In the five years between November 2012 and November 2017, its share price rose approximately 150%. Although the bank cut its number of retail branches by half between 2012 and 2015, it has seen tremendous increases in e-banking. About 2.2 million of its 3.2 million customers use Danske Bank's e-banking platform for such things as paying bills, accessing accounts, and managing their retirement savings. Moreover, the bank's payment app, called MobilePay, is so popular that it has been embraced by other Scandinavian banks.[5]

Replacing core processes in an enterprise is an expensive, multiyear undertaking. It also requires putting many other projects on hold.

PATHWAY 2: Improve customer experience first. Pathway 2 involves moving from the Silos and Complexity to the Integrated Experience quadrant. Companies choose this strategy when their most pressing strategic goal is to improve the customer experience across the whole enterprise, tackling the problem across multiple organizational silos. Typically, they attempt to do several things at once: develop new attractive offers, build mobile apps and websites, improve call centers, and empower relationship managers — all with the goal of measurably increasing customer satisfaction.

One company following this approach is mBank S.A., headquartered in Warsaw, Poland. The bank's leadership realized back in 2000 that the typical banking customer experience in Poland was far from positive. This led mBank to initiate a series of changes, including opening call centers, offering online services, and adding many new banking products. As it introduced new products and features, it also expanded into new markets in two neighboring countries, the Czech Republic and Slovakia.[6]

Eventually, mBank's leadership concluded that the company's old service platform had reached its limit. Struggling to deliver the desired flexibility and customer experience — and predicting that the problems would only worsen — the bank set out to develop a new banking platform. Created over 14 months, the new platform offers customers a wide range of features, including 30-second loan approvals, mobile payments, video chat, integration with Facebook, peer-to-peer transfers, and cardless ATM withdrawals. The new platform is designed to increase efficiency and reduce time to market. When customers perform transactions or make changes on their mBank mobile app, the information is available immediately to customer representatives and distribution channels.

To grow, mBank has created business channels that tap into its digitized platform, allowing it to offer services to an expanded set of customers via partnerships with other companies. It is thus able to expand the business into new markets or offer its services through noncompeting banks in other countries.

The advantages of Pathway 2 include focusing on the customer first and improving the customer experience, which results in higher customer satisfaction scores and sometimes increased sales. The biggest disadvantage is that the improvements in the

Is Your Company Ready for a Digital Future? (Continued from page 23)

customer experience typically add more complexity to already complex systems and processes, increasing the cost to serve a customer. Employees may still need to perform heroics to deliver what was promised.

PATHWAY 3: Take stair steps. Enterprises on Pathway 3 move toward becoming future-ready by alternating their focus from improving customer experience to improving operations and then back again, shifting the focus back and forth as needed. For example, the first move might be a project to implement an omnichannel experience. After that, companies might improve operations, perhaps by replacing a few legacy processes or creating an API layer. Then, they might attempt to put together a more attractive set of customer offerings by making smarter use of internal data.

With this approach, the difference between success and failure is having a road map that informs everyone's efforts versus taking a haphazard approach. The best way to tell the difference is to ask a manager how a specific project fits into the overall plan. The advantage is that the steps, which consist of tightly coordinated sets of projects, are smaller, reducing risk. The disadvantage is that explaining the intermittent changes in direction can be difficult and can even confuse employees. In some enterprises, we have seen organizational whiplash from changes in direction, with a reduction in employee effectiveness and an increase in burnout.

An example of Pathway 3 can be found in Banco Bilbao Vizcaya Argentaria Sociedad Anonima (BBVA), based in Bilbao, Spain. Responding to challenges he saw in the banking industry, BBVA executive chairman Francisco González announced plans in 2015 to build "the best digital bank of the 21st century."[7] In its effort to reshape the customer experience, BBVA introduced a mobile app in 2014 that offers simple new-customer on-boarding in less than five minutes. It serves as a digital wallet and allows customers to set up appointments and conduct instant messaging conversations with managers. The app also allows easy, automated purchases from a self-service suite of products, including consumer loans and investment funds. The changes have been well-received by bank customers; in early 2017, customers interacted with the bank on average 150 times per year via their mobile devices, compared to four branch visits in the same year.

To improve efficiency, BBVA has worked hard to remove legacy business processes that had been constructed over

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time from many different systems and versions of data, replacing them with scalable, reusable global digital platforms. Today, BBVA offers customers a digital experience via a reliable core banking platform, enabling new developments that combine the bank's open APIs and other capabilities. A big advantage of this approach is that other enterprises, including retailers, telcos, and even startups, are able to tie into the bank's services, thereby enhancing their own products.

PATHWAY 4: Create a new organization. Rather than fight an uphill battle to transform their existing organization, leaders who choose to pursue Pathway 4 start new enterprises that begin life as future-ready. In the automobile industry, for example, German carmaker Audi AG recently created a wholly owned subsidiary to develop experimental mobility services apart from car ownership. In banking, ING Groep N.V., the multinational banking and financial services company based in Amsterdam, has pursued a similar approach with ING Direct.

ING launched ING Direct in Canada in 1997 before expanding into Australia, Italy, Spain, the United Kingdom, the United States, and other countries. By 2006, it had 13 million customers in nine countries. Although ING Direct did have some ATMs, it had no branches. Customers interacted with the bank by phone, mail, or online. After beginning as a monoline bank offering high-interest deposit products, it gradually added multiple new products, including loans and mortgages.

ING Direct's country-based businesses operated autonomously but shared a common set of standardized business solutions and technical platform components. Module reuse kept operational costs low, allowing the businesses to offer higher savings rates and lower-cost loans.[8]

It took several years for ING Direct to establish its brand, culture, products, platforms, and partnerships. In our research, we have seen that the big challenge for enterprises taking Pathway 4 is figuring out how to bring the parent company and the transformed enterprise together.

Everything about them — their business models, their cultures, even the customers they cater to — tends to be different. Like every parent of a Pathway 4 enterprise, ING had to figure out how to deal with a successful spin-off. Complicating matters was the fact that there was no single ING Direct; each country operated a little differently. In the face of difficulties following the 2008 financial crisis, ING sold some of its operations, including ING Direct in the United States, Canada, and the United Kingdom,[9] while continuing to hold on to its businesses in other countries, including Australia and Spain. The company says that it plans to standardize on a single digital banking platform by 2021, with data and support functions shared across countries and product lines.[10]

The advantage of Pathway 4 is that it allows an enterprise to build its customer base, people, culture, processes, and systems from scratch to be future-ready. It doesn't need to deal with legacy systems or silos or culture. The challenge is that once the new entity is successful, how do you — or *do* you — integrate it with the mother ship?

Choosing a Pathway

Leadership's role is to determine which pathway the enterprise (or, depending on the circumstances, the business unit) should take and how aggressively to move. Start by determining where the company is today — based on metrics such as net promoter score and net margin — compared to the rest of the industry.

Another important step is selecting the right executive to lead the transformation.[11] The right choice will depend on the company's circumstances, the industry environment, and the direction management wants to go.

- Pathway 1 makes sense if the customer experience the company provides is around industry average and the threat of digital disruption is not high. CIOs are a good choice to lead Pathway 1.
- Pathway 2 makes sense if the customer experience the company provides is significantly worse than average and you can't wait to improve, or if there are worrisome new competitors. An executive passionate about customer experience who is technologically literate is a good choice to lead Pathway 2.
- Pathway 3 makes sense if the customer experience the company provides is a problem, but you can identify a few limited initiatives that will make a big difference. Start with those and then focus on operations — and repeat in small steps. A chief digital officer is a good choice to lead Pathway 3.
- Pathway 4 — building a new enterprise — makes sense when you can't see a way to change the culture or the customer experience and operations fast enough to survive. The CEO or COO are good choices to lead Pathway 4.

Once the company — that is, the board, the CEO, and the senior management team — settles on a pathway, the difficult work begins. The digital era is a great opportunity for leaders to reinvent the enterprise. The most successful enterprises will need to become future-ready and ambidextrous — constantly innovating to improve customer experience while also working to reduce costs. Those that don't become future-ready will likely suffer a death by a thousand cuts, with startups, players from other industries, and agile competitors slicing bits out of their businesses.

We conclude on a cautionary but realistic note. We recently ran a workshop on digital business transformation with the CEO and the executive team of an international financial services firm. We asked attendees to plot their company's journey over the previous three years using the pathway framework. After the other executives had presented, we invited the CEO to share his version. He drew a series of movements, beginning in the Silos and Complexity quadrant, moving up, then to the right, then down and back, charting a convoluted path that continued for several more squiggles. When the CEO finished, he stepped back and said, "You know, it's not as if we planned to do it that way. But using the objective metrics against our industry, this is the path we followed."

He concluded by expressing his view that leaders need to pick a pathway and then stick to it. Ultimately, we think this is good advice. After all, transformation is difficult. All of a company's stakeholders — including the board, employees, partners, and customers — need to know where the enterprise is going and how it plans to get there.

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