Photo credit: Getty Images

Unlocking Sri Lanka's digital opportunity

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There are enormous growth opportunities in Sri Lanka for companies that boost their Digital Quotients in four critical dimensions.

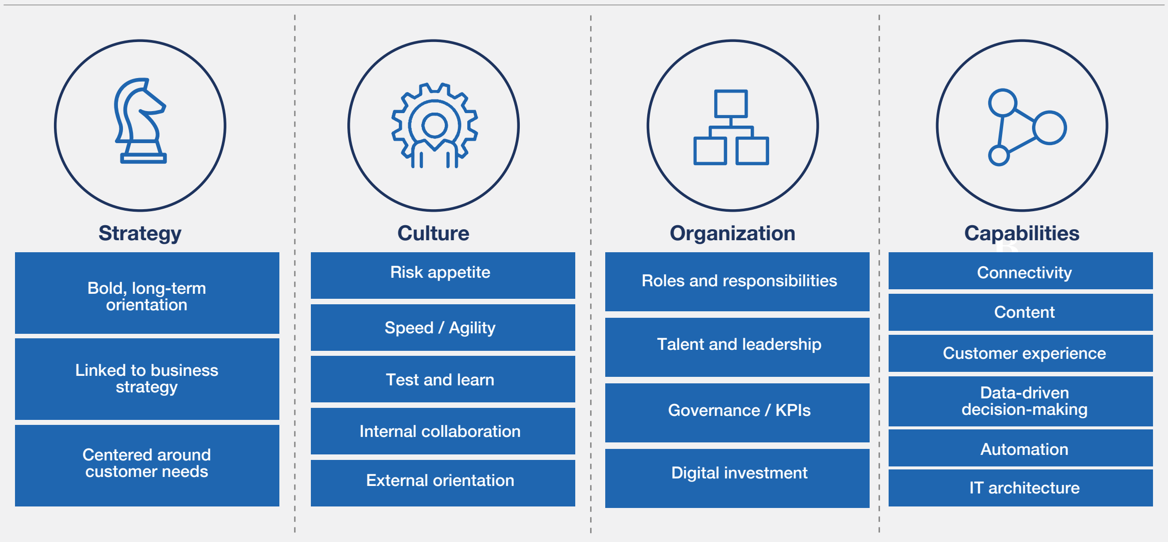
Despite the blistering pace of global technological change, many emerging economies such as Sri Lanka are just beginning their digital revolution. While the annual growth rate of Sri Lanka's Internet population has surged by double digits over the past decade, only about 30% of the population is active online and on social media.[1]

The stakes are particularly high for incumbents. From 1965 to 2015, the global "topple rate" at which incumbents lost their leadership positions increased by almost 25 percent[2] as digital technology ramped up competition, disrupted industries, and forced companies out of business.

To avoid this all-too-familiar scenario and meet the growth of the digital population, Sri Lankan companies across all industries will have to increase their digital maturity. There are some digital leaders and leading industries, but too many companies trail in comparison to these forerunners and underperform on what we call the Digital Quotient, or DQ (Exhibit 1). To develop this global multisectoral benchmark, we conducted in-depth surveys across four core pillars of successful digital transformation—strategy, capabilities, organizational practices, and culture—encompassing 18 management practices, including customer experience, automation and digital talent, at over 500 companies. (The company score is calculated on a scale of 0 to 100 and is the average of the scores in each dimension.)[3]

EXHIBIT 1

The McKinsey Digital Quotient framework includes 4 digital dimensions and 18 digital management practices



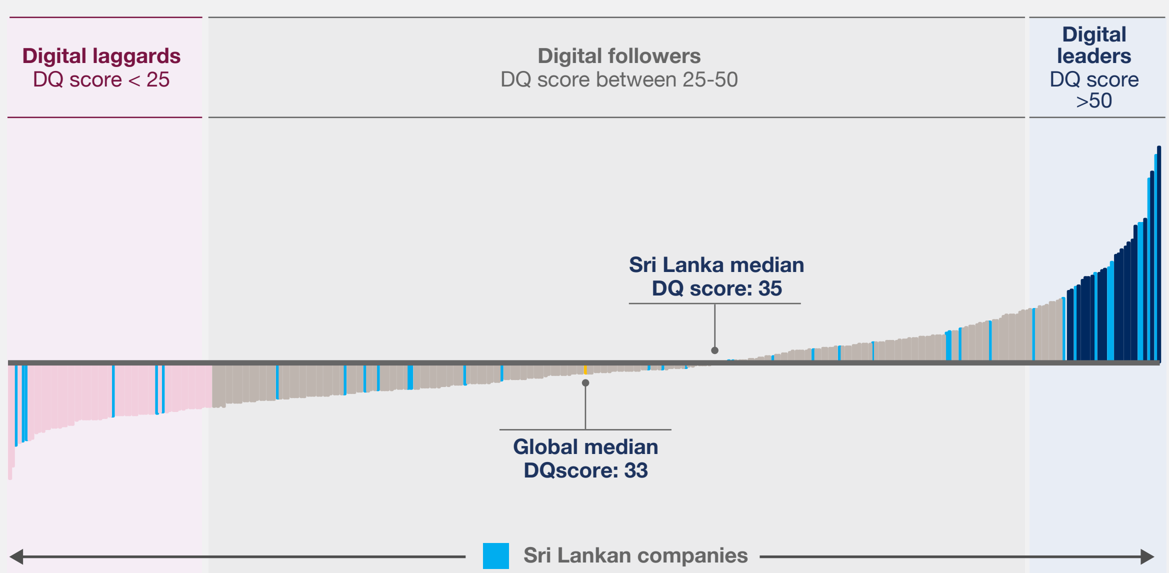
The research found that companies with higher digital maturity (a high DQ score) outperform the market, delivering two to five times more revenue growth and returning value to their shareholders faster than their peers over a five-year period.

Digital maturity in Sri Lanka

In an analysis of about 50 Sri Lankan companies across multiple industries,[4] McKinsey found that the country's DQ score of 35 places it slightly higher than the global median of 33 (Exhibit 2).

EXHIBIT 2

Significant variance in digital maturity of Sri Lankan players



In comparison with other Asia Pacific emerging markets, Sri Lanka exhibits strengths in connectivity, digital marketing, investment in digital initiatives, and the ability to move quickly. Yet when compared with China, India, and more-developed countries, Sri Lanka is well behind. Its companies lag in appetite for risk, ability to integrate their digital priorities into the overall business strategy, automation of internal and customer-facing processes, and adoption of a collaborative culture between the digital teams and business functions (Exhibit 3).

Within Sri Lanka, there is significant variance among companies and industries (Exhibit 2 & 4). Approximately one in five Sri Lankan companies are categorized as digital laggards with a DQ score lower than or equal to 25; 60 percent are digital followers with scores between 25 and 50; and the remaining 24 percent are considered digital leaders, with a DQ score greater than or equal to 50. Most Sri Lankan companies, even in more digitally mature sectors, have compelling opportunities to improve in each of the four pillars of digital transformation: strategy, capabilities, organization, and culture.

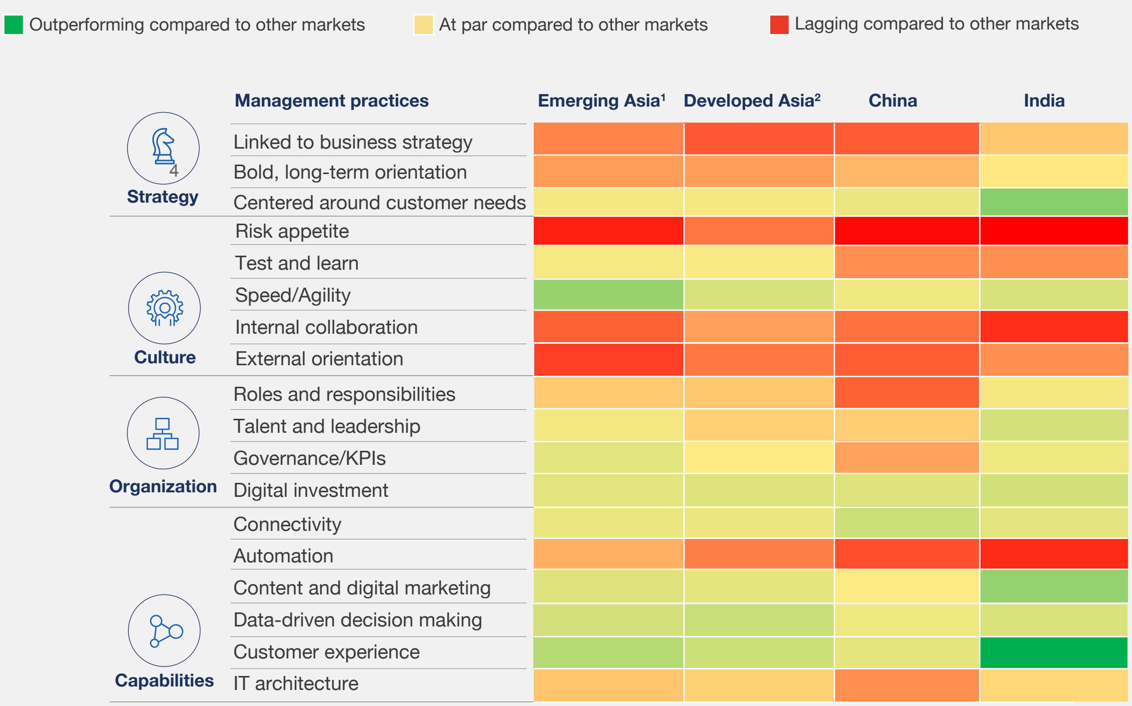
McKinsey's further analysis of the scores of the 18 management practices revealed the following noteworthy trends:

Digital strategy: Despite the fact that many Sri Lankan players have bold long-term digital visions, their goals and objectives could be better integrated across the organization and within the overall corporate strategy:

- 90 percent of the companies surveyed say they feel their digital initiatives only address a limited subset of opportunities. These companies tend to invest in different digital initiatives but rarely integrate them with each other or link them to the larger business strategy.

EXHIBIT 3

Digital maturity heatmap identifies Sri Lanka's strengths and weaknesses when compared with other Asian Markets

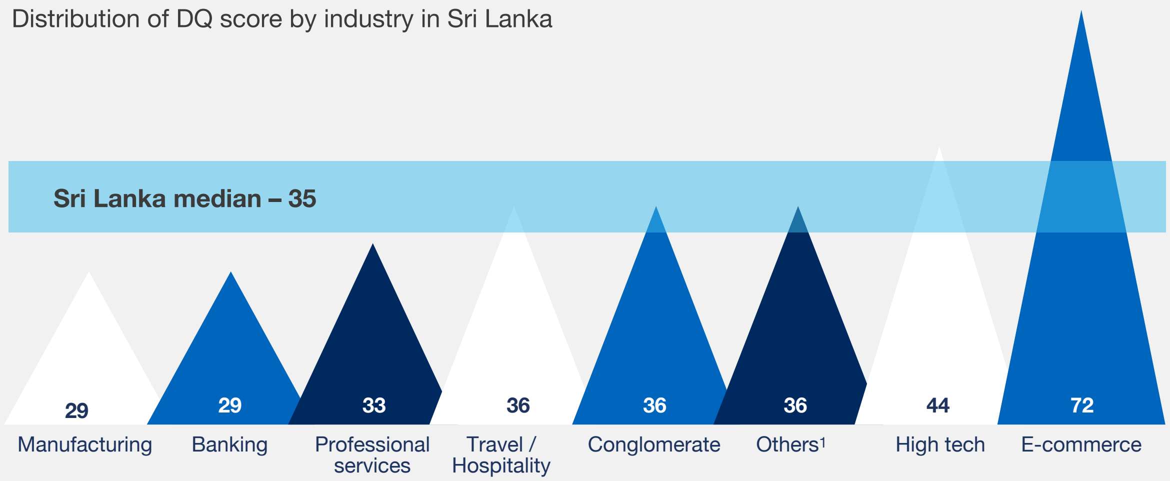


[1] Emerging Asia includes companies from Malaysia, Thailand, Vietnam, Philippines, and Indonesia.

[2] Developed Asia includes companies from Japan, Australia, New Zealand, Singapore, South Korea, and Taiwan.

EXHIBIT 4

Digital maturity varies significantly by industry in Sri Lanka



[1]Other includes transport and logistics, financial services (excluding banking), telecom, pharmaceuticals and medical products.

- Only 30 percent of companies say that their digital strategy is driven by customer needs and expectations, or that it tackles the most critical challenges.

Digital culture: At many Sri Lankan companies, there is a culture well suited to the quick and disruptive nature of digital technology. Organizations have developed cross-functional agile teams and actively seek external partnerships and acquisition opportunities that will help them build digital capabilities.

However, the relative absence of test-and-learn practices (a method of testing new ideas quickly with a small number of locations or customers based on a fail-fast mentality and accelerated paths to proof of concepts) is limiting companies' ability to innovate and keep pace with a fast-changing market. Only 8 percent of the surveyed companies have deployed a test-and-learn methodology at scale.

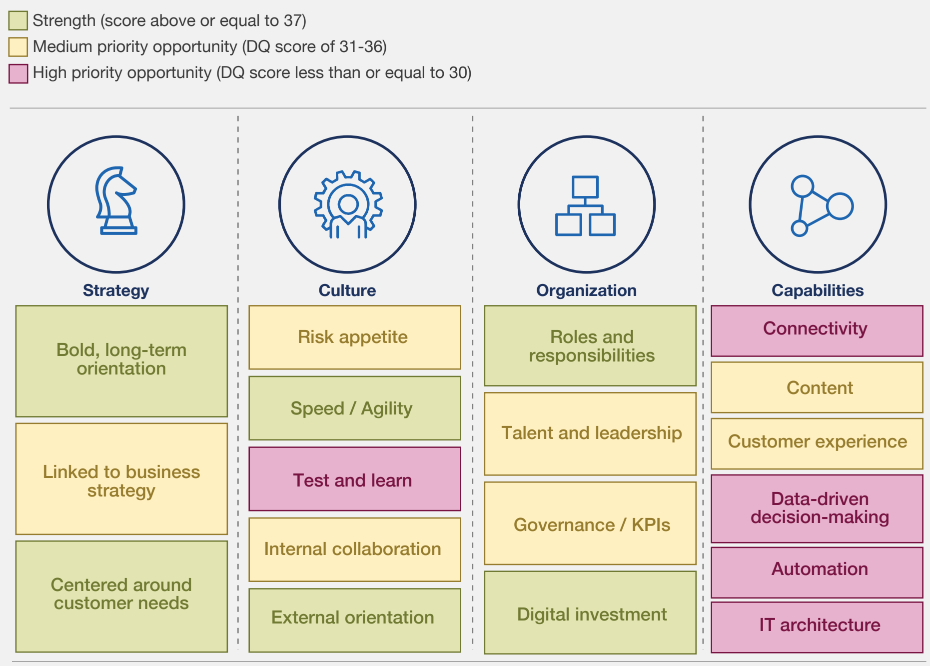
Organizational practices: Most Sri Lankan companies have not established an effective system of accountability and governance for digital goals and targets. Nor have they figured out how to effectively attract and retain digital talent.

- Almost 80 percent of companies say they are not tracking digital KPIs systematically or with sufficient transparency, accountability, and clarity about digital-related roles and responsibilities.
- Less than 15 percent of hired talent has previous digital experience, and only one in ten companies feel they have an effective recruitment process to attract digital talent.

Digital capabilities: This category represents the biggest opportunity for improvement. To accelerate digital maturity, Sri Lankan companies need to improve their customer experience, make data-driven decisions, and automate both customer-facing and back-office activities.

- Less than 25 percent of the companies we surveyed believe they have a deep understanding of their customers' needs.
- Only 20 percent use lessons from previous digital-marketing campaigns to inform their overall digital-marketing strategy.
- Less than 20 percent have robust analytical methods in place, and only 10 percent are using

EXHIBIT 5 **Digital strengths and opportunities among Sri Lankan companies**



Note: Color coding ranges selected based on bottom, medium, and top quartile of the distribution values across all 18 management practices.

data to generate insights about customers or performance.

- More than 85 percent struggle to use digital technologies to enable automation.

The path forward

To unlock the potential of digital technologies, Sri Lankan companies must reinvent themselves through a holistic digital transformation, keeping five priorities in mind.

1. Set big, bold aspirations, and integrate them into the overall business

Companies can't do digital on the margins. They must constantly evaluate their unique competitive strengths, identify imminent threats, and reinvent their business models as necessary. Equally important: they must anchor themselves to a clear digital strategy focused on customer needs.

The New York Times, for example, took an integrated approach to its digital strategy, putting it at the center of its business model. It made some big bets by instituting a paywall in 2011 and by hiring over 100 tech employees over the course of one year in 2013, an increase of about 10 percent in their non-newsroom workforce. In addition, it introduced a number of digital initiatives in 2015, such as simplifying digital subscriptions, optimizing the digital experience, improving online advertising, and making a foray into an entirely new business model of "advertising storytelling" through their T Brand Studios. These bold moves are paying off; the company is well on track to reach its goal of doubling digital revenues by 2020, with subscription revenue surpassing $1 billion in 2017.[5]

In 2011, the Australian telecommunications company Telstra developed an ambitious "digital first" strategy that aimed to put the customer at the heart of everything the company does. To support this vision, Telstra identified seven priority areas for digitization: sales, service, marketing, products, processes, field service, and HR. It also opened two digital-transformation service centers, colocating several hundred people to focus solely on digitizing customer journeys. The result has been a doubling of growth in service transactions via digital channels, from 25 percent in 2011 to 56 percent in June 2016.

2. Build digital capabilities around customer experience

Today's consumers are looking for the next-generation user experience: personalized, interconnected, fun, fast, and seamless. Multichannel is passé; omnichannel is the new reality. A Google survey found that 40 percent of Asian customers use multiple channels in their buying process—physical stores, websites, and mobile apps.[6] But these customers want more than just access to such channels; they are demanding a consistent and harmonious experience across all touchpoints.

Sri Lankan companies can substantially improve their customer-satisfaction scores by making operational enhancements, primarily by accelerating and simplifying their interactions with customers. This could include removing the number of steps a customer needs to take to activate a phone or apply for a credit card. Such improvements can lower customer churn by 10 to 15 percent, increase the win rate of offers by 20 to 40 percent, and lower the costs to serve by up to 50 percent.[7]

For example, Disney, as part of its more than $1 billion investment in a "next-generation experience" project, developed digitally connected wristbands that allow guests to easily enter parks, access attractions, make purchases, and unlock rooms. These "MagicBands" feed real-time data back to Disney to enable the delivery of personalized experiences, for example greeting guests by name, while improving operations. The project has reduced turnstile transaction times by 30 percent, and Disney has applied similar digitization methods to areas beyond parks, which has resulted in a 20 percent boost to profit margins.

3. Leverage data analytics to drive real-time decisions across the value chain

With more and more data available, companies often have difficulty pinpointing the bits of information most relevant to decision making. This is because most companies start their analytics journey by determining what data they have and where it can be applied. Almost by definition, this approach limits the impact of analytics. To achieve analytics at scale, companies should work in the opposite direction. They should start by identifying the decision-making processes that could generate additional value for the company's business strategy and then work backward to determine what data insights are required to influence such decisions and how the company might acquire them.[8]

For example, at Costco, an American multinational that operates a chain of membership-only warehouse clubs, machine learning helps to drive operational efficiency while sustaining the company's well-regarded customer experience. Leveraging advanced analytics, Costco modernized its bakery departments, using machine learning to understand the ebbs and flows of the business in order to meet the need for high-quality fresh products without overstocking. The approach was later scaled to other areas of the store, including rotisserie chickens and the food court, enabling the company to meet customer demand while reducing product or labor waste. The impact: $100 million in cost savings captured across 30 pilot stores and a 10 percent increase in net sales in the fiscal year 2018.

Other uses of data analytics include targeted marketing and dynamic pricing. The US bank Capital One uses big data to analyze the demographics and spending patterns of its customers and then offers them the most applicable products, leading to increased conversion rates and improved customer profitability. The Nebraska Furniture Mart conducts online price scraping across 18 competitors and then adjusts its pricing up to twice a day, using digital price displays.

4. Foster an innovative and agile culture

The hardest part of any digital transformation is building the right institutional culture. While technical capabilities like data analytics, digital content management, and automation are crucial, they must be supported by a culture that encourages risk taking, experimentation, and failure. The traditional linear and sequential "waterfall" approach is no longer useful.

Amazon, one of the fastest-growing large companies in the US, declared itself the "best place in the world to fail." Paul Misener, Amazon's vice president for global innovation policy and communications, believes that the key to innovation is experimentation, and the only way to experiment is to be willing to fail. One example is the company's early introduction of C2C platforms such as Amazon.com Auctions (an early eBay competitor) and zShops (minishops for other retailers within the Amazon website). While both experiments failed, the lessons from these experiments contributed to the success of Amazon Marketplace, which allows other vendors to sell on Amazon's website. This has introduced a whole new class of customers to Amazon. Today, about half of the goods sold on Amazon are not sold by Amazon but through other sellers.

5. Invest in digital organization and talent

Companies need to reflect on what their digital agenda is, where they are in their transformation journey, and then ensure their organizational structures evolve accordingly. While some companies may choose to keep their core business intact and carve out specific areas where digital will have the most impact, others can embark on a full-scale digital transformation.

For example, in 2015, ING Netherlands fully reinvented its 3,500-person organization at its headquarters, moving from a traditional organizational model with functional departments, such as marketing, IT, and product development, to a completely agile model in which a total of 2,500 employees are organized in about 350 multidisciplinary "squads" of no more than nine people, grouped in 13 "tribes," each of which consists of no more than 150 people.[9]

Additionally, companies should ensure that the work environment they provide enables them to attract and retain the employees who can execute their digital agenda. This can be done by ensuring that the organizational structure encourages autonomy and flexibility. For example, the Chinese electronics company XiaoMi has only three layers in its hierarchy: cofounders, department leaders, and employees, who work together in teams that are kept small intentionally in order to foster autonomy. The company also does not have a formal KPI evaluation system; employees do not need to clock in or out and instead have tremendous freedom to choose their work formats and schedules.

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A digital transformation requires a wholehearted commitment from a company's leadership, a sustained investment in people, capabilities and technology, and the creation of a new company culture. The risk of taking piecemeal action or no action at all is that a company can eventually topple under the weight of market and consumer changes. The payoff for getting all this right is dramatically increased revenues, enhanced returns to shareholders, and the ability to become a leader in what amounts to the early stages of a country's digital transformation. ◆

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1 "We are social" | Hootsuite Digital Data for Sri Lanka 2018.

2 Compustat Deloitte analysis. Thomas C. Powell and Ingo Reinhardt, "Rank friction: An ordinal approach to persistent profitability," *Strategic Management* 31 (11), November 2010, pp. 1244–55.

3 Each dimension has the same weight in the calculation of the total DQ score. To calculate a dimension score, we average the scores of the management practices that pertain to that dimension.

4 The companies surveyed were from the retail, high-tech, professional services, travel/hospitality, banking, manufacturing, transport & logistics, telecom, pharmaceuticals & medical products, and financial services sectors, with annual revenues ranging from Rs 1 million to Rs 200 billion, or US $6,000 to $1.2 billion.

5 Sydney Ember, "New York Times Co. subscription revenue surpassed $1 billion in 2017," February 2, 2018.

6 Google Consumer Barometer, 2015.

[7] Nicholas Maechler, Adina Poenaru, Thilo Rudt von Collenberg, and Patrick Schulze, “Finding the right digital balance in B2B customer experience,” McKinsey.com, April 2017.

[8] Peter Bisson, Brice Hall, Brian McCarthy, Khaled Rifai, “Breaking away: The secrets to scaling analytics,” May 2018, McKinsey.com.

[9] Peter Jacobs, Bart Schlatmann, Deepak Mahadevan, “ING’s agile transformation,” *McKinsey Quarterly*, January 2017, McKinsey.com.

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