Digital (r)evolution – a question of organization

Revolution or evolution – how do companies with classical structures organize for digitization? Real-life examples show that while many paths are possible, the success factors remain the same.
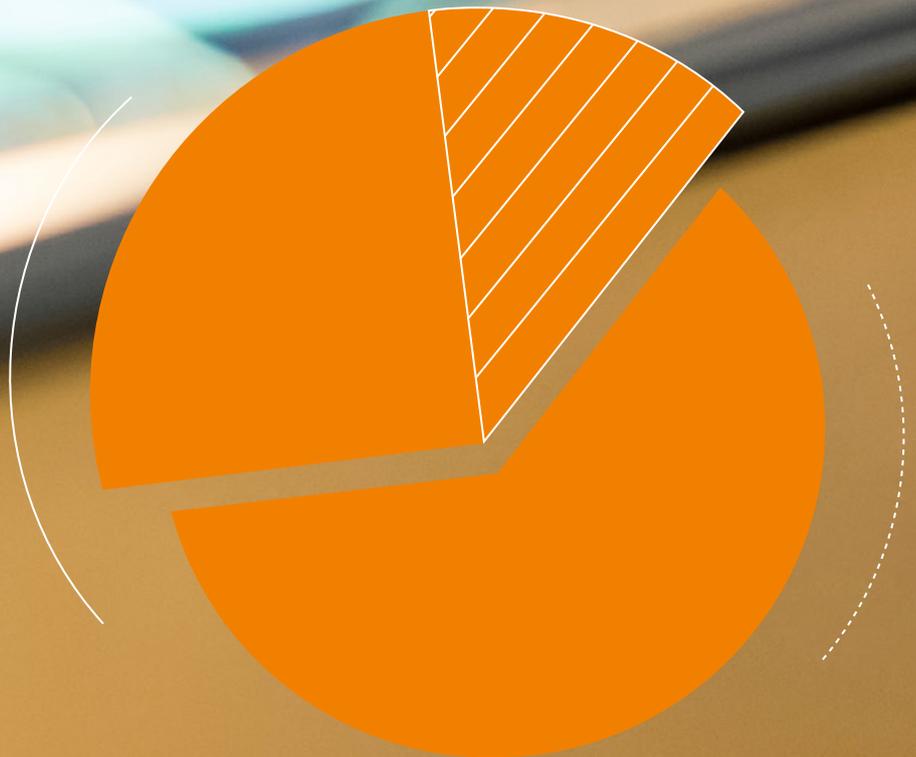
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Digitization is a must for every company, regardless of its industry or size. Any doubt on this point has been resolved. But how extensive should digitization be? Many businesses still hesitate to take a major leap preferring to digitize individual processes here and there. For a good reason: very few classical organizations have grasped the full extent of what the transformation into a digital player – in every dimension – really means.

But those who dare to make the journey have much to gain. Fully digital organizations are faster, more innovative, and closer to their customers. They can use agile methods and modern analytical tools to develop products and services that are perfectly tailored to consumers' needs – and do so in just a few weeks. The result is not only more growth, but a decisive advantage over competitors. Companies can follow two paths to reach this digital reorganization. The first involves a revolution – a direct leap into the desired level of digitization. The second consists of evolution in which they pass through each stage of digitization step by step.

The path of revolution – effective, but risky

For companies looking for fast economic benefits, a sudden digital revolution may be the more appealing route. In this case they opt for "zero-based" organizational design, essentially beginning their digital transformation with a clean slate.

In other words, management does not base the company's digitization on existing structures, but instead starts over largely from scratch. Only a "survival minimum" remains – a basis of nondigital processes and resources that are essential for the company's continued existence. Keeping this core intact ensures that the lights won't go out halfway through the fast track to digitization. At the same time, ambitious milestones and long-term targets provide ongoing momentum for the digital transformation.

The revolutionary approach has a clear advantage: sweeping away old structures creates room for new ones to develop sooner. The organization takes on digital form from the ground up, bringing faster, far more thorough change. The potential economic effects – more growth and profitability, new customers, and better service – are correspondingly large. But no revolution is without risk. Companies choosing this path make a radical break with many of the reasons for their existing success and need to establish new ones. That doesn't normally happen overnight.

A company is in a good starting position for a digital revolution if its size is manageable and its organization is already wired for digitization, with a flat hierarchy, open-door culture, and flexible staff accepting of new ways of doing things. Businesses whose complexity or traditional perspective make them less agile, in turn, are better off evolving toward digitization in stages.

Digital evolution – five typical stages

In the course of its work with clients, McKinsey has identified five typical stages on the journey from a classical organization to a digital one. These stages build on one another in a process similar to evolution in the natural world (Exhibit 1). Companies begin climbing this evolutionary ladder at different points depending on the digitization stage they currently occupy, the type of business they are in, and how traditional their organizational structures have been to date.

1. **Isolated digital projects**. Companies at the beginning of their digital evolution often view digitization as a necessary evil, practicing it separately in peripheral contexts apart from the rest of the organization. The core business in particular remains exempt from digital "experiments" that could threaten long-successful models. The IT department retains its traditional role; its only contribution to digitization is providing the required technology to other organizational units.

   Real-life example: A German consumer goods company saw the benefits of digital technologies at its stores and launched a series of smaller initiatives. The results included a new data management system and several e-commerce solutions. However, the company made no effort to overcome old silo structures or ways of working – and, as a result, certainly missed an opportunity to excite digital specialists about the organization.

EXHIBIT 1

1. Depending on how they are organized, companies can pass through each stage of digital evolution one by one or cover multiple stages in a single leap

Organizational evolution from classical company to digital player
Illustrative

Source: McKinsey
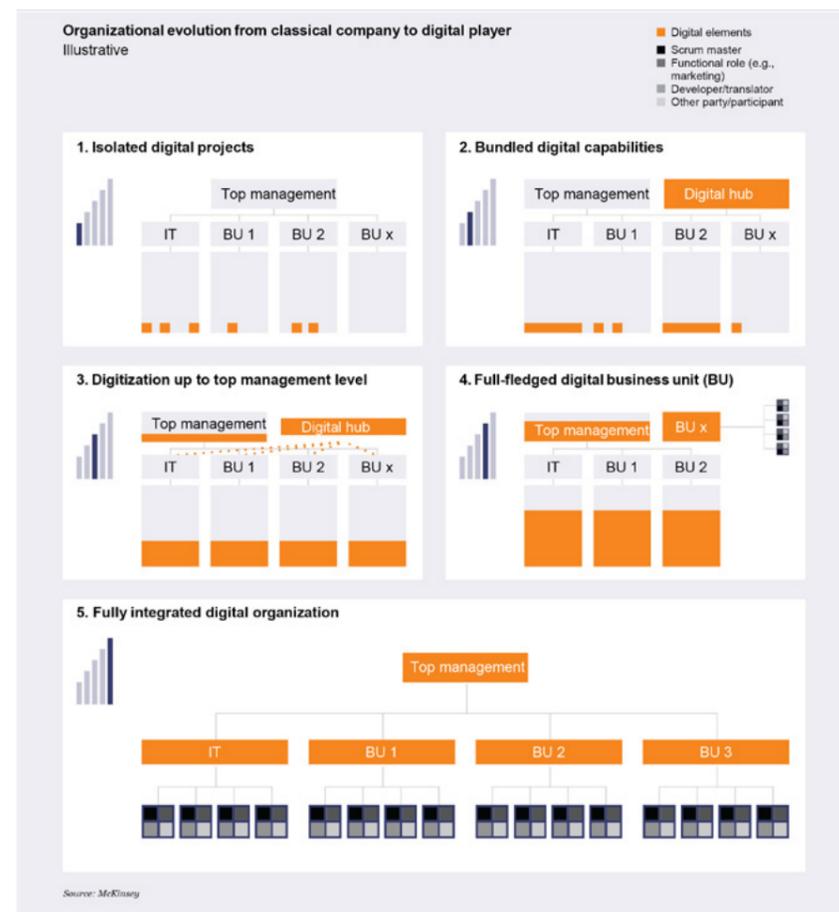
2. **Bundled digital capabilities.** Individual functions within the company have developed digital capabilities, which are bundled in a center of excellence. This new hub further drives the digital agenda and supports progress by the business units. The center of excellence is generally led by a Chief Digital Officer working side by side with the top management team. Agile ways of working and the use of cutting-edge technologies such as artificial intelligence or advanced analytics first come into focus at this stage.

   Real-life example: A global food and beverages group rolled out a range of digital projects to establish new ways of working together at the company. A digital service unit was established to support this effort by identifying the digital maturity of each department and initiating appropriate actions. Soon individual initiatives took shape that approached their digital projects from an entrepreneurial perspective and came together on an ad hoc basis to develop solutions quickly. They became the first "acceleration teams" – and initially represented an exotic species within an organization that otherwise continued to operate in its traditional way.

3. **Digitization up to the top-management level.** As technological capabilities are built within the organization, digitization spreads throughout the structure to reach the top management level. Additional roles beyond the Chief Digital Officer emerge such as the Chief AI Officer, who is responsible for artificial intelligence. Agile project-based work picks up speed. Team setups are professionalized and interdisciplinary expert teams handle training for the remaining departments. With each step along the digital path, the company culture changes as well: the organization becomes more flexible and interactive, while elements from the predigital age gradually die out.

   Real-life example: For one European toy manufacturer, digitization was the key to generating new growth in an increasingly challenging market environment. The company made the digital element the core of its business strategy and focused everything else accordingly – from the product portfolio to marketing and on to employee qualifications. Digital skills became a core capability at all levels, including top management. Now all units of the organization have been digitized and technological knowledge is shared throughout the company, while agile ways of working continue to gain ground.

4. **Full-fledged digital business unit.** At the fourth stage of the evolutionary process, the digital center of excellence has developed into a full business unit in its own right. Its tasks have likewise evolved far beyond supporting other units' digitization efforts. Instead, its focus is driving digital transformation in general. At this point, the Chief Digital Officer loses importance; the digital business unit takes a fully agile approach and uses the latest analytical methods to create optimal teams. As automation progresses, people increasingly work alongside intelligent machines.

   Real-life example: A globally active consumer goods company bet on e-commerce in various markets early on. Its next step was to set up a global center of excellence to further bundle its strengths. As digitization efforts matured, digital best practices were fully integrated into the organization and transferred to regional sales teams. Today the center of excellence concentrates on providing shared services and continuing to promote a culture of digital innovation at the company.

At the fourth stage of digital evolution, humans work side by side with intelligent machines – as in this electronics store, where robots reduce the workload for salespeople.

5. **Fully integrated digital organization.** Organizations that practice digitization at every level occupy the top step of the evolutionary ladder. All things digital have become fixed elements in the company's DNA. While top management lays out a strategy and ensures needed resources are in place, cross-functional teams apply agile methods to further develop products and processes. Many activities are automated, and artificial intelligence and the Internet of Things play a role. Expert teams are set up according to data-based competence analyses and work together for limited periods on joint tasks. The flexible allocation of work capacity to projects is standard procedure, as is regular sharing of data, methods, and tools.

Real-life example: A leading online retailer has successfully anchored a digital model throughout its organization. Instead of a central digital unit, tech specialists exist at all levels and team up effectively with business-function staff: software developers with buyers, CX designers with field sales reps, scrum masters with brand specialists. Digitization is ever-present; everyone in the organization lives and breathes it.

All this is possible because the retailer brought in or built capabilities that go far beyond technical expertise alone to include knowledge of agile methods, prototype development, coding, and design thinking. Modern methods were used to develop skills in problem solving and decision making. At the same time, a new style of management took hold that was based on coaching and collaboration rather than command and control. The result is a work environment that leaves employees enough room to be creative, take responsibility, and show initiative – all prerequisites for s successful digital organization.

Not every company has reached the fifth stage of digital development. But digitization is now at the very top of the leadership agenda for nearly every organization that McKinsey supports. After all, the ultimate goals of any digital transformation – and those involved in them – are long-term market survival and continued profitable growth. McKinsey's Digital Quotient indicator shows that these efforts pay off. The Digital Quotient measures the extent of a company's digitization and shows how it correlates to economic performance. The numbers calculated in a current McKinsey study reveal that greater digital maturity translates into higher growth rates and profits. Digital champions across industries achieve average sales growth of just over 9 percent and nearly 19 percent growth in returns. The performance of nondigital companies doesn't come close (Exhibit 2).

EXHIBIT 2

2. Digital champions vastly outpace other companies in terms of growth

Correlation between companies' digital maturity and financial performance[1]
Percent

5-year sales growth	Digital champions[2]	9.2
	Others	1.8
5-year development in return to shareholders	Digital champions[2]	18.8
	Others	9.2

1 Status: December 2017; n = 164; for more information on McKinsey's Digital Quotient, see www.mckinsey.com/dq
2 Companies with a Digital Quotient of 50 or higher
Source: McKinsey Digital Quotient

While digital evolution is a gentler alternative than revolution, it's hardly an easy path to digitization. As the experience of one fashion company shows, an organization faces a multitude of challenges when existing structures are turned upside down, job profiles near their expiration dates, employees no longer recognize their work processes, and everyone has much to learn (see box, page 9).

Role modeling change, convincing employees, creating momentum: digitization in the fashion sector

A global fashion player decided to comprehensively digitize its business and organizational setup. It was a bold move – and a real challenge in an industry with low acceptance for radical change that still works in traditional structures. As a result, the fashion world offers few examples of success that the company could share to win over employees, suppliers, and business partners for its plans. Undeterred, top management laid out an ambitious vision for a future digital strategy and its implementation.

The company started small with a digital transformation team that reported directly to the CEO. Efforts first concentrated on digitizing a single part of the value chain. But even in this "small" transformation contained problems for the team. Simply finding the right employees with the needed mindsets and skills took far longer than expected.

Additional challenges followed. Resistance to the change program was enormous: hardly anyone in the organization was in favor of the transformation. It was up to the CEO to act. His mission became to convince every single person in the company of digitization's advantages. This personal approach was effective, and gradually the vision of a digital fashion company gained ground.

When the first digitization successes were achieved, they acted as catalysts. Soon other business units followed the example of these internal role models. The organizational transformation was launched in parallel. A new Chief Digital Officer monitored the company's progress and made sure needed external talent came on board. By this point, a shift had taken place in employees' thinking as well: today they take an active part in making change happen and contribute ideas to further support their company's transformation into a digital player.
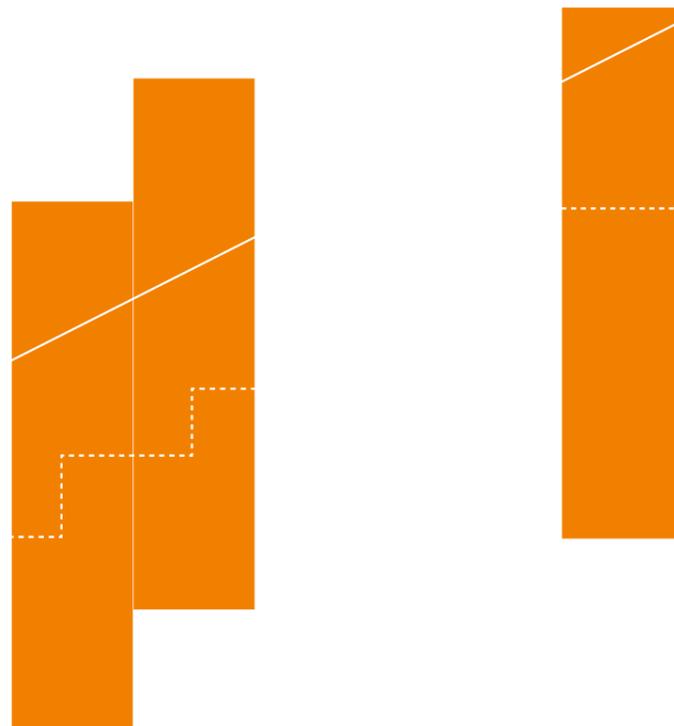
The golden rules of digital transformation

- **Don't expect a one-size-fits-all solution.** The right organizational design in any particular case depends on where the company stands on the evolutionary ladder (digital maturity) and how much higher it wants to climb (digital strategy).

- **Have top management lead the way.** Formulating clear goals and acting as role models of change requires that top management overcome doubt and resistance by successfully transforming itself.

- **Manage the transformation.** A clear change story that everyone can understand and an action plan that guides the organization through the transformation are essential.

- **Get change agents on board.** Digitization programs require the best people with the best capabilities. Putting them at the forefront of the movement from the beginning not only builds trust among employees but also drives the transformation forward.

- **Decide whether revolution or evolution makes more sense.** Some companies see radical revolution as preferable to gradual evolution. But not every organization can handle so much extreme change at once. While abrupt digitization of every business unit can bring faster impact, it also entails more risk and is often less successful as a result. Smaller, more flexible businesses are more suited than large traditional companies to a major digitization leap.

The secrets of transformation success

The first step in a digital transformation is certainly the most difficult. But it becomes easier with a road map that specifies the start and end point, as well as the main elements shaping the path to the goal. On a map like this, the journey begins with a comprehensive check of the existing situation. What level of digital maturity has the company achieved so far? Answering this question should involve scrutiny of not only BUs and country organizations but departments and processes at headquarters, too.

The next point to consider is organizational design: what should the organization look like in the future? Then it is possible to compare this future vision with the current situation at each level of the organization. The distance between these two states provides a basis for determining the sequence of digitization activities and the concrete form the new organization will take – in terms of structural changes, new work cultures, digital talent development, and more.

Once this conceptual framework is in place, the actual digital transformation can begin. Keeping several rules in mind makes it easier to take the right path and avoid typical mistakes (see box). The decision whether to start with individual functions or immediately pursue an overarching approach to digitization depends on the stage of development the company has reached and the details of the organization it seeks to become. But no matter what the specific path entails, strategic skill-building should form the heart of the transformation efforts. In the end, capable and creative employees who understand that "digital" is far more than a question of technology – and realize that it represents a new way of thinking and working – represent the key to a successful digital organization.

Key takeaways

1. Businesses with conventional setups and ways of working continue to balk at committing to the digitization path and run the risk of being left behind

2. Companies can take a revolutionary or evolutionary approach to digitization. Their size and culture determine which option is best for them

3. The success of a digital organization depends on its employees' capabilities. Establishing the agile work structures that ensure long-term competitiveness requires strategic talent management

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