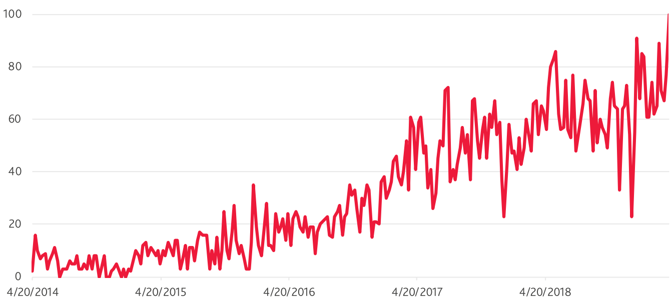
BUILDING A DIGITAL TRANSFORMATION STRATEGY PART 1: DIGITAL BUSINESS

Digital transformation is inescapable—in more ways than one. Searches for “digital transformation” on Google have increased by roughly 1,900% in the last five years alone. And according to BDO’s inaugural [***Middle Market Digital Transformation Survey***](), 94% of mid-market organizations have either developed a digital transformation strategy or are in the midst of developing one. For good reason: Competing in a digital economy requires becoming a digital business too.

INTEREST OVER TIME



Source: Google Trends

Since the turn of the 19th century, American business has been born and reborn on the backs of disruptive technologies. Advances in technology have historically given way to economic revolutions, resulting in massive spurts of growth and boosts in productivity.

Every revolution, however, has both winners and losers: The so-called Gilded Age—the Second Industrial Revolution—saw 47,000 businesses go bankrupt. The “irrational exuberance” of the DotCom era, at the tail-end of the Internet revolution, saw hundreds of Chapter 11 filings from large public companies.

Nearly two decades later, DotCom darling Amazon is now vying with Apple to become the world’s most valuable company.

After a relatively sluggish period of growth in productivity over the last few decades, the convergence of multiple disruptive innovations, from cloud computing to the Internet of Things to artificial intelligence and extended reality, is anticipated to usher in a new era of productivity and reinvention. Disruption is already taking its toll—just look to the rash of retail bankruptcies over the last few years. The Netflix model of TV has put cable on notice. Enrollment in online learning may be impacting revenues for colleges and universities. Even our beloved tax and accounting industry is feeling the pangs of disruption—which is why we’ve added new services like tax automation and streamlined delivery models via the cloud.

What’s different from the past two centuries of business transformation is not only the tools in our arsenal but a fundamental shift in the way value is created and defined. Data is hailed as the new oil—though a more apt comparison might be to a diamond in the rough: Its potential worth is unquantifiable without further refining. The value is there only to those who know how to mine it. Data, however, is neither scarce nor finite, so value is defined not by quantity, but by utility. Just look to data-rich behemoths like Amazon, Google and General Electric that prove it daily.

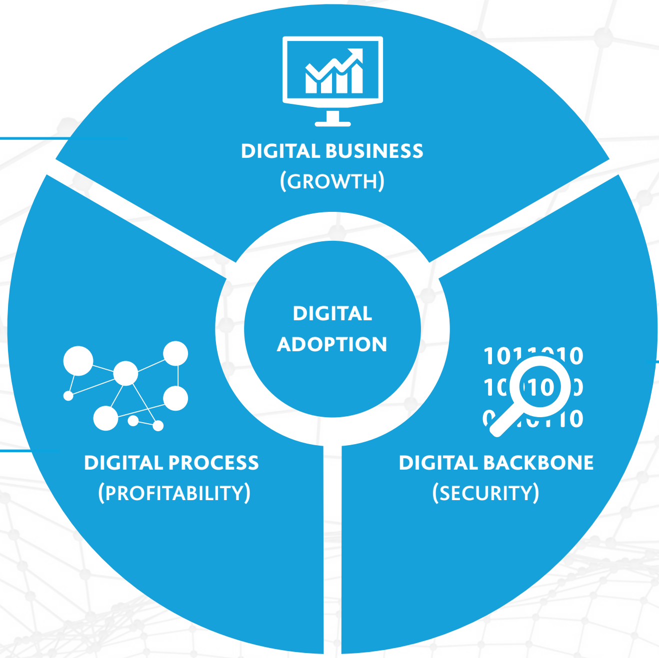
If history is any guide, there will be winners and losers of this new digital economy. We also stand on the precipice of the longest bull market in history—and inevitably, what goes up must come down. Organizations that fail to evolve their business models for the new digital economy may not come out the other side.

DIGITAL 3+1

At its core, digital transformation is the application of today's digital advancements in technology to solve traditional business problems, as well as a tool to combat competitive pressures and economic headwinds. How that actually translates into strategy depends on a combination of internal and external factors that will vary from organization to organization. While every company must follow its own trajectory, we can generally break down digital transformation into three primary strategic drivers, as outlined in our Digital 3+1 approach:

Digital Business is focused on creating new value, market differentiation, and revenue in the digital economy.

Digital Process focuses on operational reinvention by optimizing end-to-end process performance and improving efficiency.



And **Digital Backbone** is the foundation on which all digital initiatives are built, centering on addressing or removing the IT complexities, risks, and barriers to innovation, to meet business and evolving market demands.

Digital Adoption, our +1, is at the heart of our approach: a fully integrated change management program that informs and enables the business's strategic direction, while streamlining user adoption for employees, suppliers and customers.

All three transformational areas drive value for the business—just in different ways. Digital Backbone is focused on reducing IT complexities, risks and exposure, thereby increasing agility and scalability in response to evolving market conditions; Digital Process on optimizing core processes for operational excellence and embedding digital capabilities into the operational fabric; and Digital Business on creating new value via customer-facing solutions.

Digital strategy—the overarching vision for transformation—often resides in Digital Business, but the terms aren't synonymous. Some organizations may see the greatest opportunity in transforming their operations to become more agile and efficient—a strategy rooted in Digital Process.

To figure out if Digital Business should be the North Star of your digital transformation journey, ask yourself:

- What is my organization's current value proposition?
- Will it still be a differentiator in three years?
- Will it still be relevant in three years?

If you couldn't answer the first question, or said "no" to either of the next ones, you may need to reinvent your organization with a focus on Digital Business—delivering new or better value to your customers through innovative channels to market within one of four key growth drivers.

KEY GROWTH DRIVERS

Demand Generation

Goal: Grow revenues through brand awareness, market differentiation and/or personalization

KPIs: Website Traffic, Number of Qualified New Leads, Conversion Rate, New Customer Acquisition, Customer Churn and Engagement

A digital strategy with a goal of generating more demand re-imagines the marketing department as a critical component of sales enablement and an engine of customer data. Essential to winning new business, demand generation is all about increasing awareness and interest in your products and services.

Companies typically struggle with one or more of three main demand gen challenges: brand awareness, market differentiation and conversion. Put simply, your target customers aren't buying from you because they don't know about you and don't know why they need you, they don't know what makes you special or you're failing to engage them effectively. The implementation of new digital marketing capabilities, like email marketing automation or AI-driven product recommendations, can increase agility and responsiveness, improve end-to-end visibility of the buyer journey and enable personalized interactions at scale. Marketing not only becomes data-driven, but it also generates new data that can be used for demand sensing and customer intelligence.

Case Study: McCormick

After years of steady growth, McCormick & Company, a nearly 130-year-old American food conglomerate best known for its spices, hit a snag starting in 2010. Having already exhausted traditional avenues like product and vertical expansion, then CIO Jerry Wolfe sought to not only increase demand for its products in well-established markets, but also to get closer to the consumer to better understand what drives their decision-making. He and a small team of colleagues began working on a pilot for an online marketing tool that was, in essence, a matchmaking service for foodies. Launched in beta in 2013, FlavorPrint leverages predictive analytics to deliver personalized recipe recommendations based on consumers' unique flavor profiles, effectively delivering mass customization. While still in beta, FlavorPrint quickly grew to 100,000 subscriptions and increased sales by 4.9%. Traffic to the McCormick website doubled in the first two months after the service officially went live. And the key to consumers' choices, McCormick discovered, is taste, and a desire for more variety. *"McCormick realized the greatest benefit it would receive strategically for growth was simply helping consumers find amazing food,"* according to Mr. Wolfe.

Given the success of FlavorPrint, McCormick has since spun it off into its own company, Vivanda, in which it retains a small stake.

Reach and Selection

Goal: Generate additional income sources through product or market expansion

KPIs: Price Response, Target vs. Actual Sales, Net Profit, Cost of Customer Acquisition

The bread-and-butter of traditional growth strategies, increasing reach and selection entails either product diversification—introducing new products or services to your existing customer base—or market diversification—targeting new market segments either in terms of geography, demographic or industry—or both. When you add a digital lens, either by leveraging digital capabilities or developing new digital offerings—you can increase the probability of success and shorten the time from insight to idea and idea to deployment.

On the novel product development side, technologies like computer-aided design and 3D printing can enable faster, cheaper prototyping. Agile and design thinking methodologies can be adopted outside the startup and software realm to accelerate the development process. Physical products can be digitized or made "smart" by embedding sensors or software applications. New digital products can be created, or new features can be added to existing applications.

Technology also plays an important role in geographic expansion. E-commerce and software-as-a-service delivery models have already mitigated cost to entry, while new localization models and tools can significantly improve the user interface and eradicate language barriers though national language processing.

Case Study: LEGO

In 2004, LEGO was on the brink of bankruptcy. In the previous decade, Lego had significantly expanded its portfolio into products and experiences only tangentially related to its iconic plastic bricks—launching LEGO clothes and jewelry, video games and even theme parks. Not every innovation was a failure: the company introduced collaborations with the creators of Harry Potter and Star Wars that flew off the shelves. But these successes were not enough to offset increasingly diverse, complex and expensive production costs.

In the words of Wharton professor David Robertson, author of the book, Brick by Brick: How LEGO Rewrote the Rules of Innovation and Conquered the Global Toy Industry, LEGO had gone too far outside the box and needed to go back "inside the brick."

The company decided to return to its roots, and launched a new digital strategy centered on bringing its classic bricks to today's more digitally savvy consumer. In addition to streamlining production processes and cutting underperforming assets, the company launched LEGO Ideas to crowdsource ideas for new product sets directly from their customers. It then introduced the LEGO Boost creative toolkit for creating programmable robots, along with a complementary app, and famously got into the movie business with The Lego Movie, which grossed nearly $500 million on a budget of $60-$65 million. While continuing to cater to their existing fanbase, LEGO also successfully expanded into a new market segment—girls—through its Lego Friends "mini-dolls." The so-called "Apple of Toys" went on to generate double-digit revenue growth for the next 10 years straight.

Customer Experience (CX)

Goal: Improve customer experience to create competitive advantage, deepen customer relationships, understand and influence customer behaviors

KPIs: Net Promoter Score, Customer Effort Score, Customer Satisfaction, Retention Rate, Churn Rate, Customer Lifetime Value, Average Resolution Time

With increasingly low barriers to entry in every industry, product or service availability alone isn't enough to win over a potential buyer. It's not about the best product anymore; it's about simplicity, ease and convenience. Improving the customer experience is key not only to increasing customer satisfaction and brand loyalty, but also to getting closer to the customer and delivering real value.

The focal point of most customer experience transformations is enhancing the end-to-end customer journey—eliminating points of friction, creating consistency or enabling more personalization. Customer experience is also a catalyst of customer-centric innovation. The most successful product and service innovations address a clear problem the customer needs solved—and that requires customer input.

Customer experience is a critical opportunity to gather customer input for a feedback loop.

Improving CX translates into quantifiable ROI: According to the 2018 Temkin Experience Ratings (TxR), which evaluated 318 companies across 20 industries, the correlation between CX and repurchasing is very high (R=0.82). The same study also found that for companies with approximately $1 billion in revenues, moderate improvements in CX increases revenues by an average of $823 million over three years. CX is thus evolving from competitive differentiator to business imperative, cited by more than two-thirds of middle market businesses as one of their top three long-term business goals in the inaugural ***BDO Middle Market Digital Transformation Survey***.

BDO Client Case Study: Luxury Jeweler

The launch of the Apple Watch posed a real threat to traditional watchmakers, combining fashion with technology. According to analyst estimates, Apple Watch sales reached 12 million in its debut year—nowhere near the adoption rate of smartphones, but enough to cut into a significant chunk of luxury watch sales.

To reinvigorate sales, a luxury jeweler tasked our professionals with improving customer engagement. We conducted a design-thinking workshop to co-create a personalized buying experience targeted specifically at high-end clientele, focused on creating an intimate relationship between the representative and the individual customer.

The new in-store digital experience enabled the consumer to customize the watch features, from the face to the band to the inscription, to their personal and unique liking—all while visualizing the watch on their own wrist with augmented reality technology. Billing and order fulfillment could then be done right then and there, without the customer needing to stand in line.

Over a six-month period, the jeweler saw an increase in sales of **38%**. In addition, newly empowered and engaged customers were now open to product upselling and cross-selling, increasing the original average order size by **60%**.

Customer Purchase Process

Goal: Revenue diversification through new payment platforms and digital commerce strategies

KPIs: Traffic, Engagements, Conversions, Returning Customer Visits, Customer Satisfaction

E-commerce is often equated with online shopping—already an ingrained buying behavior by the early 2000s and table stakes for today's retailers. But that's understating the fundamental change e-commerce has wrought in the way products and services are bought and sold, and the unexploited opportunities that remain.

Developing a multichannel sales strategy has become a necessity not only in the B2C world, but also in B2B industries, as millennials become key decision-makers. A growing percentage of B2C and B2B buyers alike are digital natives, with higher expectations of personalization and convenience and differing approaches to research and discovery. The channels they use may vary based on their immediate needs or mindset. Organizations that neglect those channels may lose out on new revenue opportunities, as well as invaluable user data that can help them better understand their customer.

Now, there are of course new digital sales and distribution channels that go beyond a web store. Mobile commerce—spanning shopping, banking and payments—is arguably the next evolution of e-commerce and already a well-established mainstay. Voice commerce is anticipated to take off in tandem with growing user adoption of voice assistants. Social commerce is still relatively unchartered territory. Participating in online marketplaces is another potential sales engine—and an increasingly vital one for discovery as they proliferate and gain popularity with buyers.

An outgrowth of the online marketplace trend is "platformication"—the creation of business ecosystems that exponentially increase value through the network effect; the more participants, the greater the effect. Platform ecosystems reposition businesses as connectors—between customers, partners, vendors or even competitors—facilitating new ways of collaborating and co-creating value and reducing transactional costs. Examples include development platforms like the Apple Appstore, asset sharing platforms like Zipcar, social platforms like Facebook or Twitter, and marketplaces like eBay or Airbnb. Organizations can benefit both from creating a new digital platform or participating in an existing one.

Capturing economic value from an online marketplace or digital platform can happen in several ways: as a data aggregator and source of customer intelligence; as an enabler of more meaningful customer interactions; or as more extensive offering through strategic alliances and complementary solutions. And once you have that captive audience, there are other ways to monetize it: Airbnb, for example, charges a commission for bookings made through the platform, while others charge membership fees or offer "premium access" for additional cost.

Case Study: NYC Yellow Cabs

If any industry demonstrates the power of disruption, it is the taxi cab industry. Ride-hailing apps have completely upended it.

Historically, for-hire vehicles have been tightly regulated, operating on a medallion licensing system that limited the number of vehicles on the road. Once valued at more than $1 million, taxi medallions today are worth just 10% of that. In New York, the number of pickups performed by drivers using ride-hailing apps has surpassed the number performed by yellow and green taxis since early 2017.

But yellow cabs are fighting back. Realizing that what makes ride-hailing apps so addictive to customers is their convenient user interface and mobile payment systems, the Taxi & Limousine Commission approved the use of ride-hailing apps like Curb to "e-hail" taxicabs and pay via the app. First deployed in yellow cabs in 2015, the apps have since been updated to allow carpooling as well as booking in advance, and as of the launch of a new app in August 2018, set fares upfront and even compare pricing. The modern NYC yellow taxi now offers the same convenience of other ride-hailing and ride-sharing apps at better rates.

BRINGING DIGITAL BUSINESS TO LIFE

Top-line growth via Digital Business is the Holy Grail of business innovation, but you can't maximize the results without understanding the impact on current operations, and eventually, your legacy IT system will limit you, if it doesn't already. A comprehensive digital transformation strategy integrates all three—business, process and backbone. The strategy and vision for transformation, however, can be defined more narrowly based on your key business objectives.

The reality is that top-line growth can't be sustained forever without some degree of reinvention. Of course, knowing when and how to reinvent yourself is easier said than done. Too often organizations wait for their fortunes to turn for the worse before taking action—in some cases, past the point of return. Some companies, like LEGO, manage to resurrect themselves and rise from the ashes. But for every LEGO, there are a hundred Kodaks and Blockbusters. No business can afford to rest on its laurels. If the signals of change are clear, it's time to act–even if your business is doing just fine. Disrupt yourself before you're disrupted.

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