Defining the digital organization

Implications of digital transformation on the organization of financial institutions

Digital transformation is one of the most important changes that the financial industry faces these days. This transformation radically changes how banks and insurance companies interact with their clients, what products are offered, how they operate internally, and where and how value is created. In order to prepare for this landslide transformation, companies must adapt their organizations to facilitate change.
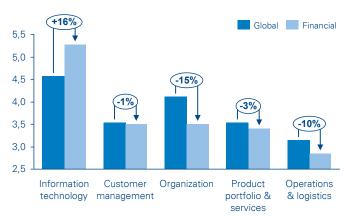
Becoming digital centric is a must

Digital transformation has changed the world. The ubiquity of the Internet and the extremely rapid expansion of increasingly versatile smartphones have disrupted the way consumers interact with several industries. As mentioned in our recent digital transformation study, from entertainment to the car industry, almost no sector of the economy has been left out of the digitalization wave.

Financial services are not an exception. The way customers interact with banks and insurance companies has changed: according to Eurostat and The Financial Brand, as much as 40% of banking customers in the EU are active online banking users. That number rises to 61% in the US. We expect this number to rise to 83%–89% in the EU by 2020.

What we expect from financial institutions has also changed. Brick-and-mortar institutions are becoming obsolete quickly. According to a survey among European youngsters, 70% would rather go to the dentist than visit a bank branch. Today we do most of our transactions online (In Spain, 65% of online transactions versus 35% offline for the average online user, estimated for 2015), but most of our purchasing offline (75%). However, that is likely to change in the future.

In this scenario, banks and insurance companies that are able to transform themselves will be better prepared to ride the digitalization wave. However, the truth is that most companies remain unprepared. According to a 2015 pan-European survey by Arthur D. Little, financial institutions are less adapted to digitalization than the cross-industry average. Although most

companies have undergone considerable investments in order to update their IT capabilities and architecture, other key functional aspects are lagging behind, organization being one of the most critical ones.

Note: Organization covers management & support and workplace & culture aspects
Note: Sources from 1 to 10, being 1 "very low" and 10 "very high"
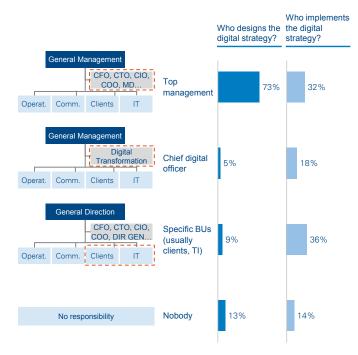Source: Arthur D. Little's Digital Transformation Survey

Adapting the organization for digitalization is critical for several reasons. Some of the most important are:

- A common digital direction is needed. Digital transformation often means an explosion of uncoordinated and often duplicated efforts, with different departments working in different directions; therefore, a strategy and common steering schemes must be laid down. Furthermore, digital must be integrated within the company strategy as a whole.

- The digital environment is quickly evolving, and traditional decision-making is often too slow.

- Most digital projects have heavy IT components. Thus, digital leaders on the "business side" must interact constantly with leaders from the "IT side". The business side must be proficient in IT themes, and vice versa.

Companies define and implement digital with different organization setups

Our experience reveals that most companies do not have clear strategies on how to organize digitalization. Results from an internal European survey reveal that 73% of companies rely on top management to define digital strategy – a correct approach, in our opinion, but then implementation is developed by top management in one-third of all companies, which is wrong by all measures. Only 18% of companies rely on central digital organizations to implement their strategies, 36% having it delegated to specific departments. (The most common are IT and clients). Most surprisingly, 14% of all companies have no clear guidelines about who designs or implements the strategy.

	Who designs the digital strategy?	Who implements the digital strategy?
Top management	73%	32%
Chief digital officer	5%	18%
Specific BUs (usually clients, TI)	9%	36%
Nobody	13%	14%

So, who is right? Setting aside those who rely on top management to implement the strategy and those who do not have strategies at all, distributed implementation responsibilities are more common than a central department, by a 2:1 ratio. Does this mean that distributed is better?

Implementing digitalization – chief digital officer versus decentralized digitalization

Digitalization affects many different aspects of the organization: processes are to be changed, product definition to be

rethought, operative and commercial channels to be affected. Responsibility over those functions is often spread in the organization.

Therefore, any digital transformation plan must coordinate different areas and teams, each one working with its own point of view and agenda. When implementing the plan, two main options arise:

- **Chief digital officer (CDO):** Setting up a central organization under a CDO, who is accountable for all digital projects in the organization, with a digital budget, resources and responsibility over main digital transformation KPIs

- **Decentralized digital functions:** Distributing key digital functions (defining digital processes, fine-tuning digital channels, adapting products to the digital world, new ventures) among the traditional owners of those functions
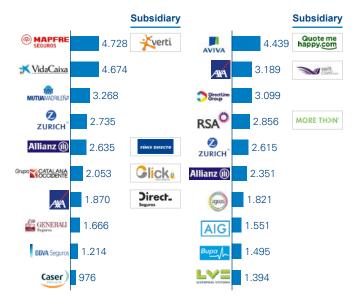
Both options have advantages and disadvantages, and these must be weighed when deciding which one is optimal.

Generally speaking, a CDO and a digital department are better for steering a common strategy. Decision-making is easier, there is more agility and initiatives are better coordinated. Also, responsibilities are clearer, KPIs easier to follow and objectives simpler to set. It also is a better option to ensure adoption of agile methodologies in the organization and change management towards a digital culture in general that facilitates interaction with IT leaders.

On the other hand, distributing functions also has several advantages: the implementation is done closer to the line of business, and the business priorities are therefore easier to harmonize with the digital strategy. Secondly, the particularities of different BUs are better taken into account. Thirdly, authority is easier to build, and the "we-know-best" argument can be better avoided.

In any case, if the company is to go with the CDO, everybody involved should be aware that it is to be, by definition, an interim solution, available only as long as the company is transforming. The aim of the digital department should be to transform the aspects that ought to be changed and then quickly transfer those functions to the line of business. A CDO who wishes to preserve his job rather than transform the company would be a hindrance to digital transformation.

Traditionally, financial institutions have understood the digital market as an independent one, and thus have undertaken digitalization through the development of offshoot digital companies. In developed markets such as the UK and Spain, many of the top-10 insurers have followed this approach, as is shown in the figure below.

	Value	Subsidiary		Value	Subsidiary
MAPFRE SEGUROS	4.728	verti	AVIVA	4.439	Quote me happy.com
VidaCaixa	4.674		AXA	3.189	swift cover
MUTUA MADRILEÑA	3.268		Direct Line Group	3.099	
ZURICH	2.735		RSA	2.856	MORE TH>N
Allianz	2.635	FENIX DIRECTO	ZURICH	2.615	
Grupo CATALANA OCCIDENTE	2.053	Click	Allianz	2.351	
AXA	1.870	Direct Seguros	agaas	1.821	
GENERALI Seguros	1.666		AIG	1.551	
DBVA Seguros	1.214		Bupa	1.495	
Caser	976		LV LIVERPOOL VICTORIA	1.394	

Our opinion on this strategy is that this was good enough in the past, but not advisable anymore. The virtue of this tactic lay in the fact that you could test digital technology and the digital market without having to radically transform the parent company or cannibalize your own clients. This is not an issue any longer (digital technology is well tested and the digital market is not a niche anymore, but the mainstream of clients), and it has considerable drawbacks, such as duplicate investments and lack of digital adaptation within the parent company.

The new roles in a digital organization

As we have stated, in a bank or insurer, the objective of digitalization is to transform the core of operations and processes. The outcome of the transformation should not be the growth of digital functions in parallel to core functions (i.e. digital channels versus traditional channels), but to transform current functions so they are adapted to digitalization (strengthening BI, channels, product areas, etc.). However, it is also a fact that radically new digital functions arise because of digitalization. For these, new capabilities must be developed or acquired. It is important to have a coherent plan for this, as "letting things happen by themselves" will not work. Examples of important new roles are:

- Chief data officer: data becomes critical because of digitalization. Organizations must ensure its quality and availability. Data lakes are another new key item that this role must take care of.

- Customer experience and omnichannel specialist.

- Digital innovator and digital radar.

What is the role of IT? Leader or follower?

It is a common mistake to associate digitalization with IT. IT is undoubtedly a critical enabler of digitalization, but there is much more to digitalization than having the technology. The business point of view is critical when defining digital channels, customer interactions, products and even internal processes. All along the way of digital transformation, IT must play a very active role because most of these aspects to be defined will have impact on the technological architecture or technical components that must be assessed. IT must then play a role as a facilitator and guide the company towards innovative technical solutions that help achieve defined goals.

Implications on IT

Although as stated before, IT should not be the leader of the digital transformation, it is one of the areas in which the impact of the transformation will be heaviest. In order to deal with the changes needed, the traditional way of working has to be changed:

- **A more agile approach is fundamental:** Digitalization means the speed of change of everything increases. Client expectations change faster, products must be adapted more quickly. If an organization wants to remain up to date, it must reduce the time to market for all solutions. This, in turn, has implications on IT. A typical waterfall-like IT project spanning 18 months is not adequate. In the digital world, an 18-month-old idea will probably be obsolete by the time it hits the street. Agile development of projects, micro-segmentation of deliveries, etc., are better suited to digital transformation.

- **A dedicated organization is advisable…:** A very specific skill set is needed for the implementation of digital projects – i.e. big data, omnichannel specialists, etc. Therefore, specializing IT resources on digital projects is a good idea in order to increase efficiency and build a team of IT specialists who then can act as focal points – or internal consultants – for all digital projects. Also, a separate demand management scheme for digital only must be developed.

- **…but with a flexible arrangement:** the amount of IT effort needed for digital projects will vary over time. A common pool of resources between the digital and non-digital projects should be set up as a buffer for these variations in IT demand.

- **Network of specialized providers:** As not all traditional IT providers are suited for digitalization projects, creating a pool of specialized providers is advisable.

Conclusions

Recent cases in which we have participated have shown that the organization of digital efforts is a key and controversial aspect of every digital transformation. Channels, clients, IT and other departments often think that digitalization is their natural field of play, and that they must keep ownership of the process. Traditional channels, product areas and other "business-as-usual" departments sometimes see digitalization as more of a threat than an opportunity, and their lack of involvement and commitment is a real danger to the outcome of the transformation. To have everybody on board and guarantee that the digital transformation takes place, the organization in charge of it has to have the proper tools, authority, interphases and liaisons to compose an adequate governance model. Furthermore, since the role of IT is critical to most digital initiatives, the role of an IT organization must be reviewed thoroughly in order to guarantee that the systems become enablers, not roadblocks, for the transformation progress.

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Arthur D. Little

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