Accelerating the shift to a next-generation operating model

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Digital-native companies have captured value by mastering the use of next-generation operating models. Now established companies must race to catch up.

In the past 30 years, an array of digitally driven companies have captured enormous value at great cost to established businesses. Observers often attribute the success of these challengers to their innovative use and development of technologies, business models, and customer experiences. But this view overlooks an essential feature of many digital-native businesses: their next-generation operating models. The next-generation operating model is defined by a continual effort to improve end-to-end customer journeys and business processes by applying advanced technologies and sophisticated operational methods in an integrated manner. The combination typically results in, or is built around, a business model that is new to the industry and allows the company to move, adapt, and scale quickly.

A next-generation operating model provides traditional companies with the agility and customer focus they need to fend off challenges from digital natives, as companies such as ING have demonstrated.\(^2\) When making the transition to a next-generation operating model, speed is essential. McKinsey research shows that the digital first movers and fast followers in a market seize a decisive share of the available value, usually at the expense of slower-footed incumbents. And incumbents have only a narrow window of opportunity to get ahead of their competitors: once industries near the 40 percent digitization mark, digital attackers have typically secured large market shares.\(^3\)

For an established company, the shift to a next-generation operating model starts with a clear commitment from leadership and other enabling moves, such as the formation of a full-time, cross-functional team to manage the transition and the allocation of funds to pay for the effort.\(^4\) Those elements enable the shift to take place, but they alone won’t speed it up. In our experience, an incumbent company accelerates its implementation of the new operating model by enabling great customer journeys through three actions that need to be carried out at the same time: continually improving end-to-end customer journeys with a clean-sheet approach, integrating technology with operations by testing and learning, and establishing agile ways of working through teams focused on specific journeys.

An enterprise-wide focus on customer journeys is crucial because it allows the company to reorient itself toward customer needs, which can be distinctive sources of value and lie at the core of the operating model. And pursuing the three activities at once is important because companies can realize the full value of great customer journeys only if all three capabilities are firing (exhibit). In this article, we offer a closer look at these three actions and how executing all three together can help incumbents to stay in front of digital natives.

**Continually improving end-to-end customer journeys with a clean-sheet approach**

According to McKinsey research, the quality of the customer journeys that a company provides is much more closely correlated with business outcomes, such as churn, revenue, and repeat purchases, than the quality of individual customer touchpoints. Companies that provide the best journeys—entire sets of interactions that customers have when making purchases or receiving services from a company—also have stronger competitive advantages than those providing the best touchpoints (individual interactions).\(^5\) Since digital-native companies have an inherent focus

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on customer journeys, optimizing end-to-end customer journeys is a core priority for incumbents that wish to speed up the transition to next-generation operating models.

The first step a company takes toward optimizing customer journeys is streamlining its product and service portfolio. It’s not uncommon for this portfolio to expand over time, as a company identifies new opportunities and develops offerings to address them. But adding to lineups of products and services makes customer journeys increasingly complicated, and expensive, to support. It can also be off-putting to customers, who have to make sense of all the products and services that are on the company’s menu. Shortening that menu will make customer journeys simpler, and therefore easier to optimize.
In one case, a large telecom operator made its portfolio simpler for household customers by changing its digital ordering journey. The company’s website originally showed prospective customers several Internet-service packages, which they had to compare and choose from. Now the website asks each prospective customer a short series of questions about his or her needs, then offers just one service package. Streamlining the online-ordering journey doubled the conversion rate for online sales and led to a 50 percent increase in the website’s share of sales.

Next, companies begin evaluating and pursuing opportunities to improve their customer journeys. The conventional approach is to determine which journeys matter most for value creation, identify the worst pain points through surveys and interviews, estimate the costs and effects of fixing those pain points, and activate a new journey only when all the major pain points have been corrected. While this approach is often effective, it is somewhat slower and more deliberate than is appropriate for a rapid transition to a next-generation operating model.

A different approach companies are taking is to “clean sheet” the future experience—to come up with a forward-looking concept that is unbound from all existing processes and systems—and rapidly test it to determine whether it works well. With this approach, companies base their new experience designs on qualitative customer research. In a matter of days, they develop rough prototypes to try out with customers. Then they create digital prototypes, show them to customers, and make several rounds of refinements before launching the prototypes for live use. Many technology companies are comfortable with all the testing and learning that the clean-sheet approach involves, but the approach is different from traditional development methods.

The large telecom operator mentioned above used the clean-sheet approach to overhaul its customer journeys. It started by talking with customers about the most frustrating parts of their experiences dealing with the company. Next, it staged hackathons to create fresh prototypes for its customer journeys, which it showed to customers and adjusted according to their feedback. The company then developed digital prototypes based on its analog models, which it rolled out for testing with customers. Several cycles of revisions and tests brought the company to the point where it was ready to introduce the customer journeys for real-world use. But the testing and fine-tuning didn’t stop there: the company continued refining its customer journeys, putting out new versions on a weekly basis. It also modified its other processes to support the new customer journeys. The company was able to test the new journeys and prove their value in about five weeks—far less time than the normal IT release cycle of three to six months.

The telecom operator’s approach to improving its customer journeys illustrates another important principle of the next-generation operating model, which is to start fixing pain points as soon as they’ve been identified. The next-generation operating model involves devising solutions quickly, introducing them as soon as they are market ready—and
promoting the accomplishments internally, to show that the company has begun to move at a faster pace. The work of optimizing customer journeys then continues as an ongoing endeavor: correcting known problems, reevaluating journeys on a regular basis, and refocusing on new priorities as customer demands change. Other companies set up war rooms to analyze journeys and pursue continual improvements.

**Integrating technology with operations by testing and learning**

In a next-generation model, companies use advanced technologies to improve their behind-the-scenes business operations, for this generates cost savings that fund investments in better customer experiences. As they do when optimizing customer journeys, companies quicken the transition to a next-generation operating model by improving a few segments of their most important processes at a time, rather than tackling each process as a whole. This kind of fast-paced, progressive approach enables a company to achieve performance improvements much sooner than it would by remaking an entire process before putting it into action. In some cases, companies can attain substantial improvements within a matter of weeks.

Brief, rapid change cycles are particularly helpful when considering the use of new technologies. Given the speed at which digital tools are advancing, it is seldom practical for a business to spend weeks evaluating its needs, comparing solutions, and creating a multiyear technology road map. Instead, next-generation companies find it more practical to select and quickly try out tools that could help resolve serious performance problems. Fortunately, the low cost and straightforward integration pathways for new technologies allow companies to stage and learn from technology experiments using small amounts of money and modest commitments of time from an IT function.

At the telecom operator we described earlier, sales agents had to enter some details of new customer orders into two IT systems because the systems had not been integrated. Switching between the systems and reentering order details prolonged the ordering process, which frequently caused prospective customers to abandon their orders before completion. And when sales agents tried to compensate by working faster, they only made more errors. The company attacked these problems by redesigning and automating their order-entry process. Easy-to-use robotics applications allowed the company to automate the work of entering the same information into its two systems, thus enabling sales agents to complete customer orders in just 7 to 15 minutes, far less than the 30 to 45 minutes that the ordering process formerly took.

The performance improvement isn’t the only significant aspect of this change; the manner in which it was attained is just as noteworthy. Installing the robotics applications was a small enough job that the company’s IT department probably would have put it on the back burner. But since the applications were straightforward to set up, the sales department was able to do that on its own, and so complete the installation and capture its benefits much earlier.

Managers use two simple criteria to quickly assess potential changes to business processes. The first criterion is customer benefit: companies favor changes that have clear potential to make
customers’ experiences better. (The link between customer experiences and business processes that support them is a further reason why companies need to work on both at once.) The second criterion is the potential benefit for the business. Managers and frontline workers typically know which activities within processes are especially slow, costly, or error prone and have performance data to prove it. In a next-generation operating model, companies prioritize changes according to the knowledge they already have, rather than inducing delays by preparing new assessments. Fixing the most troublesome activities quickly will produce noteworthy performance gains of the kind that generate savings and help validate a progressive approach to improvement.

A progressive approach to enhancing operations requires boldness and speed. Boldness means accepting that not every new process or technology that is put in place will immediately prove as valuable as expected. Speed means making adjustments quickly to produce greater performance gains. Without boldness and speed, companies won’t be able to validate and refine changes to their operations at the rate required to accelerate their shift to a next-generation model. Few traditional companies, however, are set up to carry out bold, rapid approaches to enhancing operations. Most will need to organize their working groups differently and bring in more technology talent, such as experience designers and engineers, full-stack architects, and product owners.

**Establishing agile ways of working through teams focused on specific journeys**

With its emphasis on continually improving journeys, the next-generation operating model calls for organizing teams and work groups according to different principles from those followed by most established businesses. The typical established company organizes people by function, line of business, or geographic region. Such structures slow the transition to a more digital way of working, which requires collaboration across different working groups. Companies can accelerate their shift to a next-generation operating model by assigning their employees to customer journeys or internal journeys (end-to-end processes, such as those involved in talent management, for which the “customers” are inside the company).

While just a few companies have reorganized themselves in this way, their experiences suggest that the benefits can be significant. ING, the Dutch financial services giant, embarked on an extensive transformation after its leaders recognized the need to focus on customer journeys rather than products. It eliminated its hierarchical structure and installed a more flexible one in which many autonomous working groups, known as squads, are grouped into 13 functional tribes that share missions. Each squad is formed to achieve a client-related goal, with all members located in the same place to facilitate collaboration, and disbanded once the goal is achieved. ING’s new structure has allowed the company to shorten the time-to-market for new products, increase employee engagement, and boost productivity. It now stands out as a leading practitioner of the agile model. Other banks

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and technology-enabled service businesses have followed ING’s lead, adopting some or all of its approaches to become more agile.

To speed their transition to a next-generation operating model, companies start by forming teams responsible for identifying, prioritizing, and making improvements to a few of their most important journeys. Each semiautonomous journey team comprises representatives from the business functions that are directly involved in a journey, so they can highlight pain points and devise ways of addressing them. Teams also include user-experience designers, software developers, and other IT specialists who can help come up with digital features that support new customer or operating requirements. Finally, each journey team is headed by a journey leader who has a diverse skill set: someone who is equally capable of understanding business objectives, overseeing technology-development efforts, and directing the day-to-day activities associated with a customer or internal journey.

One large insurance company initiated its transition to a next-generation operating model with a pilot effort focused on multiple journeys. The engine for its reorganization was a cross-functional “transformation lab” responsible for studying customer journeys, with special attention given to customer needs and pain points, and for locating inefficiencies within its internal journeys. The lab then redesigned customer and internal journeys and conceived digital products to support the new journeys. Cross-functional teams of about 15 employees were formed to launch the journeys and participate in the creation of minimum viable software products that were improved in subsequent rounds of testing and development. Two months into its pilot of the next-generation operating model, the company has seen productivity gains of 30 to 50 percent, higher levels of employee engagement, a 50 percent reduction in the time required to bring new customers on board, and substantial cost savings.

A major factor enabling the success of the insurance company’s operating-model pilot was its move toward agile methods for software development, by which IT specialists use short, high-speed cycles of prototyping and real-world deployment to test and refine software. Agile methods are all but essential, because they are compatible with bold experimentation and rapid, continuous improvement. That said, many companies have IT systems that aren’t suited to agile development. At such companies, a two-speed IT architecture enables agile development while preserving the stability of the legacy systems. A two-speed IT architecture puts software which needs to be updated frequently on different platforms from legacy systems, so that software can be modified without throwing legacy systems into flux.

Next-generation operating models provide traditional companies with big improvements in cost, effectiveness, and customer experience that help them compete with digital-native competitors. Speed is of the essence, for first and second movers capture most of the value. To race ahead of the pack, traditional companies must take action in three areas: continually improving
end-to-end customer journeys with a clean-sheet approach, integrating technology with operations by testing and learning, and establishing agile ways of working through journey-focused teams.

Working on all three areas at once, rather than one or two at a time, is crucial because each area supports the other two. To optimize customer journeys, companies must make their operations more efficient and responsive. And the ability to make improvements quickly requires integrated teams that understand all facets of customer journeys and business operations and are comfortable pursuing incremental gains on a continual basis. By modifying their customer journeys, business operations, and working methods simultaneously, incumbents move quickly toward the next-generation operating model that will enable them to withstand disruption and expand their shares of the value in their markets.

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