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Paved with intention: A path to getting financial value out of digital transformation

If your organization's digital transformation effort is falling short of expectations in terms of delivering value, maybe there's a better approach.

Yes, there may be a better way to successfully implement a digital transformation, at least from a value-creation perspective. In a recent Deloitte Global study, Unleashing value from digital transformation: Paths and pitfalls[1]—detailed in Tim Bottke's book, Digital Transformation Payday (Wiley, 2022)[2]—significant digital transformation factors that correlate with increased market cap were isolated. The good news: the research found that the right combination of digital transformation actions could unlock up to $1.25 trillion in additional market cap for Fortune 500 firms. On the other hand, this analysis found that the opportunity cost for those firms when a transformation goes astray could be as much as $1.5 trillion.

Value creation can represent a growing challenge for CFOs, as outlined in this year's CFO Agenda.[3] A challenging part of any budding digital transformation can be choosing which technologies to invest in. At a time when purse strings may be tightening and some boards may be demanding greater detail about spending, CFOs can benefit by knowing which actions may be correlated with higher returns. Keeping those in mind, they can map out an end-to-end strategy that leverages investments to help de-risk the undertaking, boosting the odds of realizing the full benefits of complex, multidimensional transformations.

This edition of *CFO Insights* will examine what the Deloitte Global analysis of 10 years' worth of financial disclosures—from more than 4,000 global organizations—revealed as to which combinations of technology investments and capabilities yield the most enterprise value. Further, the analysis looked at those actions that can erode value when taken in isolation. The results also shed light on why some companies—despite their stated commitment to implementing leading-edge technology, embracing agility, and fostering a dynamic culture—may still struggle to get financial value out of their digital transformation efforts.

Defining characteristics

Even companies that have declared their commitment to digital transformation may want to hit the pause button and ask: How, exactly, do we define that commitment? The Deloitte Global study also included interviews with 23 chief executives. Some executives described digital transformation as a digitization play, modernizing analog processes to enhance workflows, and adopting platforms to make processes more efficient so there's less manual reconciliation. Others see digital transformation as a way to harness the power of technology to, for example, enter new markets or stand up new products.

Those definitions generally position technology as the catalyst for the transformation. However, digital transformation is not necessarily rooted in technology, per se—but rather should start with clarity regarding the company's ultimate strategic aims, making investments in digital tools that help the business reach its goals.

In other words, the key word in the term is "transformation." Some management teams can get lost in the digital side of the equation. Which technologies should CFOs be paying attention to? All of them—because it's typically not a single technology businesses need to apply to win, but rather a combination. Which digital technologies the business adopts, and how the company leverages them, is at the core of implementing a strategy for winning in the marketplace. Consider digital an umbrella term for all the levers available to adjust strategy.

CFOs and other leaders should consider defining specific outcomes (reaching a certain number of new customers, for example, or using data-based insights to reinvent decision-making) rather than positioning transformation as making a bet on technology to realize more value. The

success of a digital transformation, or any of its distinct milestones, is best measured in terms of its impact on overall strategy—not the more familiar internal metrics as to whether it's on-time or within budget.

Taking initiatives

With strategic goals in place, how can companies map out their transformation-related initiatives to help boost value?

To find out, Deloitte Global applied data science to three million pages of financial disclosures—a decade's worth of business and financial data from 10-K filings, covering US and global companies listed on the NYSE, a total of 4,651 organizations (as of April 2022). The study also removed outliers, as well as those companies that could be identified as digitally native, so as not to skew the results.

Using natural language processing, the Deloitte Global study involved scanning the documents for key words related to setting digital transformation initiatives, enabling technologies, and mobilizing the enterprise for digital change. From there, Deloitte Global used a tool to select three terms to help ascertain how companies describe their digital transformation actions, from implementing a digital strategy to making discrete technology investments to preparing people and processes for digital transformation. Having conducted a frequency analysis of terms commonly used to set strategies, researchers then analyzed the relationships among those terms (see Figure 1).

Figure 1. Hypothetical statements that would demonstrate digital strategy, tech aligned to strategy, and digital change capability in a 10-K filing.

Digital Strategy *Tech aligned to strategy*

We launched a new product as part of our digitization effort. It uses AI to make our customer experience more personalized based on crowdsourced information on how users engage with the app.

Digital change capability

Digital Strategy *Tech aligned to strategy*

As part of our digital transformation initiative, our enterprise has invested in IoT to increase efficiency. We expect it will streamline supply chain operations and allow us to improve our market position.

Digital change capability

Digital Strategy *Tech aligned to strategy*

Digitization is high on our business transformation. We plan to continue investing in cloud technologies to create greater efficiency and agility for our enterprise.

Digital change capability

Source: "Unleashing value from digital transformation: Paths and pitfalls," *Deloitte Insights,* 2023

Since the SEC regulates the companies in Deloitte Global's sample, investor communications were a proxy for the enterprise's digital transformation intentions and actions. Deloitte Global researchers scanned the 10-Ks for the following transformation-related actions:

1. **Digital strategy**: Statements that speak about the overall organizational strategy in proximity to broad digital terms. These refer to strategic possibilities created by digital transformation, including such terms as "new digital capabilities," "new markets," and "new products." Such phrases describe efforts to enable a larger strategy.
2. **Tech aligned to strategy**: Statements about the overall organizational strategy that appear next to more specific individual technologies. These digital transformation technologies seem to be harnessed to achieve a discrete goal and bring the strategy to life.
3. **Digital change**: Statements about broad digital terms that appear next to those indicative of organizational change. These statements seem to relate to an organization's ability to adopt and adapt to new processes, resources, and ways of working—in essence, a multitude of human characteristics necessary for a transformation.

Actions that can drive value

Deloitte Global then correlated each of these actions to market capitalization,[4] examining their impact individually and in various combinations to find which combinations could yield the greatest value—and which resulted in the opposite.

Unsurprisingly, companies in this analysis that articulated a digital strategy in their financial disclosures generally saw a positive impact on their valuations. It may be that the market gives management credit for prioritizing digital goals, no matter how general. But companies in this analysis whose financial disclosures provided evidence of technology aligned to strategy generally saw an impact on valuation that was twice as high as digital strategy. This result is likely due to the specificity of the technologies mentioned, which can provide shareholders with a more tangible sense of the organization's strategy.

That said, companies in this analysis that articulated change programs in general terms or without reference to specific actions generally saw their market cap erode. The analysis revealed that digital change on its own was nearly three times less impactful than digital strategy and put the existing market cap at risk of erosion. The absence of a specific plan can heighten uncertainty among stakeholders. (How else can companies go astray with digital transformation? See the accompanying story, "Lost in transformation.")

Certain combinations of actions, it turns out, can yield up to a 5% increase in market cap, while others can risk value erosion of as much as 9%. The most positive combination is the digital trifecta: the presence of an articulated digital strategy, where specific technology investments are aligned and set, and the organization is mobilized and ready to manage change. The trifecta's value impact is 1.2 times that of just digital strategy and nearly 3.5 times that of having just the capability to bring change to the organization.

As it turns out, change capability can make or break value for the enterprise. On its own, it can erode value; as part of the trifecta, the inclusion of change capability appears to be a catalyst. When the capability is entirely absent—but the other two actions are present—it poses a 9% value erosion risk, making it the worst possible outcome (see Figure 2).

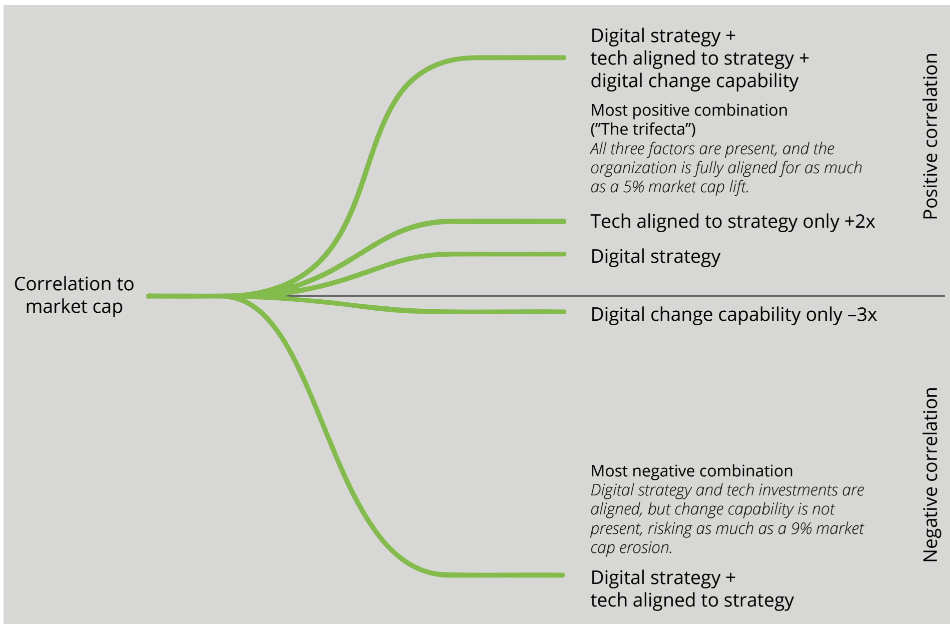
Giving due consideration

For CFOs, capitalizing on these findings can be challenging. It requires a deliberate approach that reflects an understanding of how digital strategy, tech aligned to strategy, and digital change are mutually enabling and reinforcing. Intentionality counts at every stage of the transformation, from developing the strategy to allocating capital to invest in certain technologies and evolving the organization's change capability.

What follows are some considerations for CFOs whose organizations are undertaking a value-enhancing transformation.

- **Think of yourself as the chief value officer**. CFOs have a major role to play in a digital transformation—and not only because they have to report on

Figure 2. The value in finding the right combination of actions



Source: "Unleashing value from digital transformation: Paths and pitfalls," *Deloitte Insights,* 2023 the results. In Deloitte's 2Q 2021 *CFO Signals*™ 42% of surveyed CFOs reported serving as co-leader of a transformation, while 16% identified themselves as the leader.[5] In addition to tracking spending, CFOs may need to find ways to properly measure—and communicate—the value created. In an uncertain economy, finance teams may be called upon to reduce or delay some aspects of the transformation. By using value-based criteria, finance leaders can avoid instituting across-the-board cuts that can potentially destroy the effort.

- **Make sure you're sufficiently tech-savvy**. Given the level of tech investment required, CFOs can't simply delegate those decisions to IT or to the business. It's essential to understand how any individual technology could drive (or deplete) value and how it could affect the pace of transformation.
- **Embed incentives to maintain the transformation's momentum**. Leadership may change, and stakeholders may exit, but continuous transformation should remain a priority. Transformation extends well beyond any single technology, platform, or skill set. Finding ways to entrench that understanding in the organization can help support the enterprise's transformation in the face of ongoing disruption.
- **Strive to communicate with utmost clarity**. Some companies fall short in clearly articulating what kind of digital strategy they plan to bring to the marketplace. While shareholders likely understand the impact of having a digital strategy on the enterprise and may reward the company for even a general description, companies that communicate their strategy more clearly could improve their chances of reaping greater rewards in terms of market value.

Digital transformation 2.0

Confronted with the urgency to invest in a transformation, some CFOs may respond with a well-worn query: How much will it cost us *not* to do it? In the case of a digital transformation, however, the greater risk may be implementing it without a strategy. Absent a clear rationale for making certain technology investments, CFOs may miss out on the opportunity to combine technologies in such a way as to gain a competitive advantage.

After all, digital transformation should support a strategy that is intended to drive the company toward success and value creation. The initial strategy will likely have to adapt and change, with CFOs navigating toward adding value. By tracking market cap, finance leaders can help detect if the business—while growing increasingly agile—is moving in the right direction.

Lost in transformation

Digital transformation is typically a multi-year project and may require some CFOs to have sufficient reserves of patience to help ward off frustration. For others, however, an ongoing lack of clear evidence that their transformation is on track to generate significant value may be a symptom that the company—despite its intention to "disrupt itself"—hasn't gone far enough.

What follows are some questions that CFOs could ask if the transformation doesn't seem to be generating value along the way:

- **Have we changed our operating model?** In some cases, companies may have rolled out digital plans, but have only made superficial changes, such as releasing an app. Or companies' claims of being reshaped by digital transformation, instead of applying to the core business, have mostly taken place outside of it. Shareholders may resist rewarding such activity.
- **Are our actions scalable?** Experimentation in the form of piloting single technologies and creating minimum viable products may feed positive business cases. But they generally can't scale end-to-end, which is what transformation is all about. In some cases, rolling out new technologies, such as cloud, may at first increase revenues, but costs may begin rising, which could impact margins.
- **Do we have an underlying strategy?** With the pace of business accelerating, it can be fashionable to suggest that time-to-market is too short to shape a strategy. But strategic thinking—not to be confused with the strategic planning of yore, when the plan could be static for three years—may be more important than ever. Absent a corporate strategy, a digital transformation can lack direction.
- **Have we appropriately invested in the workforce?** Given the competition for digitally skilled workers, companies may find it more practical to upskill the current workforce. Of course, it's impossible to upskill everyone at once. The key may be to identify those who are likely to be energized by transformation, as they may be more receptive to developing the necessary skills.

End notes

1. "Unleashing value from digital transformation: Paths and pitfalls," Deloitte Global, 2023.
2. Digital Transformation Payday (Wiley, 2022), by Tim Bottke, inspired the study's methods and data sets.
3. "The CFO Agenda 2023," *CFO Insights*, April 20, 2023.
4. The authors understand that correlation—where one action relates statistically to another action—is not the same as causation, where one action causes another to happen. But organizations can still gain significant insight by better understanding correlated data.
5. CFO Signals: 2Q 2021, CFO Program, Deloitte LLP.

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