



The Digital Transformation Playbook for the Middle Market

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Forces of Disruption

Disruption is inescapable. If there were any lingering doubts about the necessity of digital transformation to business longevity, the coronavirus has silenced them. In a contactless world, the vast majority of interactions with customers and employees must take place virtually. With rare exception, operating digitally is the only way to stay in business through mandated shutdowns and restricted activity. It's go digital, or go dark.

True disruption—the kind that marks lasting paradigm shifts in the predominant way things are done—is more than a technology story.

It's a virtuous circle in which technology innovation spawns changes in market and competitive dynamics, and vice versa. To stay on the right side of disruption, businesses need to anticipate the signals and adapt and reinvent themselves before disruption upends them.

Disruption can be turned from threat to opportunity, but only with a combination of foresight and focus. For the middle market, that means establishing a digital strategy that balances the long-term vision with realistic short-term goals.

FORCES OF DISRUPTION



Breaking Down Digitization, Digitalization & Digital Transformation

Digitization and digitalization are often used interchangeably—but they shouldn't be. Digitization is “going digital” in the most basic sense: converting analog information and processes into a digital format. Digitalization goes one step further: using digitized information to identify new value creation opportunities and evolve the way you do business.

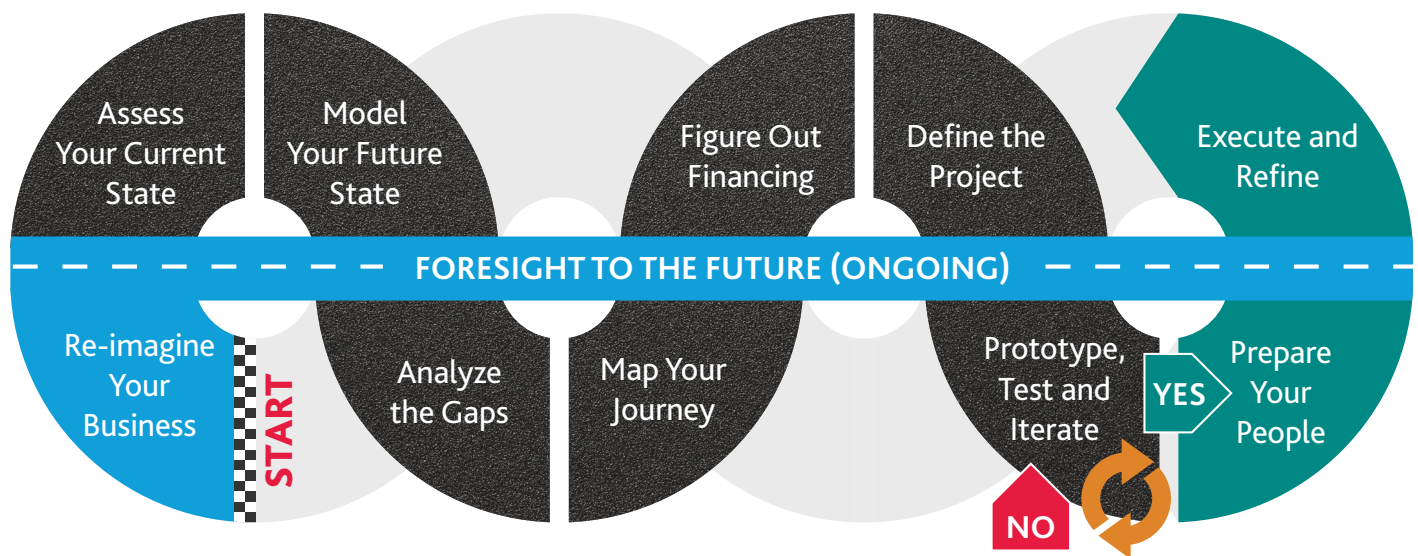
Digital transformation is built on both digitization and digitalization. It's the journey to becoming a digital business, connecting the dots between digital initiatives, strategy and business enablement.

Why do the nuances between the 3 D's matter? Because getting on the right side of disruption isn't as simple as making ad-hoc investments in digital technologies. Digital transformation happens at the intersection of technology and people—what we call the digital interlock. The biggest reason digital initiatives fail is because of failure to adapt to business shifts and adopt meaningful, human-centric change.

As you embark on digital transformation, it's important not to conflate digital implementation with digital strategy. An implementation project—for example, investing in chatbot technology to automate the routing of customer conversations—is a tactic, ideally against the backdrop of a long-term strategy. In isolation, the project should deliver immediate ROI, but it isn't in and of itself transformational. On the flip side, digital strategy without implementation is like a flight route without a plane: You know where you need to go, but you're no closer to your destination.

The Middle Market Digital Transformation Journey

THE 10-STEP GUIDE TO DIGITAL TRANSFORMATION



We've said it before: The middle market needs its own digital transformation playbook. Large enterprises can plumb their deep coffers to make massive digital investments in ambitious, high-risk/high-reward initiatives or fund pet projects that may never see the light of day. On the opposite end of the spectrum, the startup world offers valuable lessons in lean innovation and agile ways of working, but it's worth noting that 90 percent of startups fail in their first three years. Even those that survive can't be compared directly to middle market companies, which simply have different capital structures, operations, and goals than those of their (often) leaner, nimbler counterparts.

We're realists: Most middle market organizations don't have the luxury of making significant upfront investments in a strategy that may or may not pay off until three or four years down the line, or the ability to move as quickly as a younger venture. But in this age of accelerating disruption, myopia is arguably the greater risk. Middle market incumbents stand on a digital precipice where action won't always clinch success, but inaction all but guarantees failure. The challenge is toeing the line between risking too much and not risking enough.

Ultimately, the middle market's road to digital transformation is rooted in balancing smart risk and reality, where short-term priorities are addressed in the context of the long-term vision. The journey is one of incremental improvements to advance digital capabilities and maturity. Every increment along the journey is framed against a clear business case and immediate ROI.

As we walk through a step-by-step approach to digital transformation in the middle market, keep in mind that these are meant to be broad brushstrokes. The middle market spans all industries, each in varying states of disruption and stages of digital maturity. The extent to which a business will need to play catchup is highly industry-dependent, as is the level of urgency with which they need to make moves. And because the underlying value drivers and forces of market disruption are fundamentally different in every industry, so are the digital strategies to remain competitive in the future.

1. RE-IMAGINE YOUR BUSINESS

Digital transformation is predicated on foresight: first, understanding how the forces of change today could reshape the business environment of tomorrow; second, identifying the potential impacts and opportunities; and third, reimagining your business model and operations for the forecasted future.

Foresight, and the ability to act on foresight, is the difference between profiting from disruption and succumbing to it. It is part science, part imagination, and rests on making smart assumptions. At a bare minimum, it requires peripheral vision: continuous monitoring of the external environment to detect indicators of change—before your competitors, or any competitive advantage will be lost.

The breadth and depth of information sources gathered will also determine the quality of the insights analyzed. Are you just looking at what your direct competitors are doing,

or are you also analyzing trends in adjacent businesses and industries? Are there technology or business model disruptions in other industries that could have indirect consequences or signal similar disruption in your industry? Are you continuously scanning the external environment, or is your research focused on a specific hypothesis—or both?

Arguably the most challenging component of foresight—and where creativity and diversity of thinking come into play—is interpreting what future scenarios mean for your specific business. What will be the next frontier of value in your industry? What new customer needs will you need to address? Can you achieve competitive advantage through differentiation, or does your business model need to evolve? The answers to these questions will direct your strategic vision for digital transformation.

GROWTH DRIVERS

Demand Generation

- ▶ Brand Awareness
- ▶ Digital Marketing
- ▶ Market and Customer Segmentation

Reach & Selection

- ▶ Customer Access via Platform/Devices
- ▶ Location-based Services
- ▶ Market Access and Reach

Customer Purchase Process

- ▶ Clean, Seamless, Secure Purchase Experience
- ▶ Mobile Payments
- ▶ Purchase Buying Behavior

Customer Experience

- ▶ Ongoing Customer Engagement
- ▶ Social Listening Across All Channels
- ▶ Customer Experience Improvement

DIGITAL STRATEGY

OPERATIONAL IMPROVEMENTS

Process Efficiency

- ▶ Digital and Automated Processes
- ▶ Automation of Manual/Repetitive Processes
- ▶ Real-Time Insights and Analytics

Asset Utilization

- ▶ Product/Cost Optimization (Plan to Forecast)
- ▶ Inventory Cost Optimization (Plan to Forecast)
- ▶ Task Automation Optimization (Sensors/RPA)

Agility

- ▶ Lean and Agile Adoption
- ▶ Accelerated Decision-Making
- ▶ Predictive Analytics Leverage

New Business & Service Models

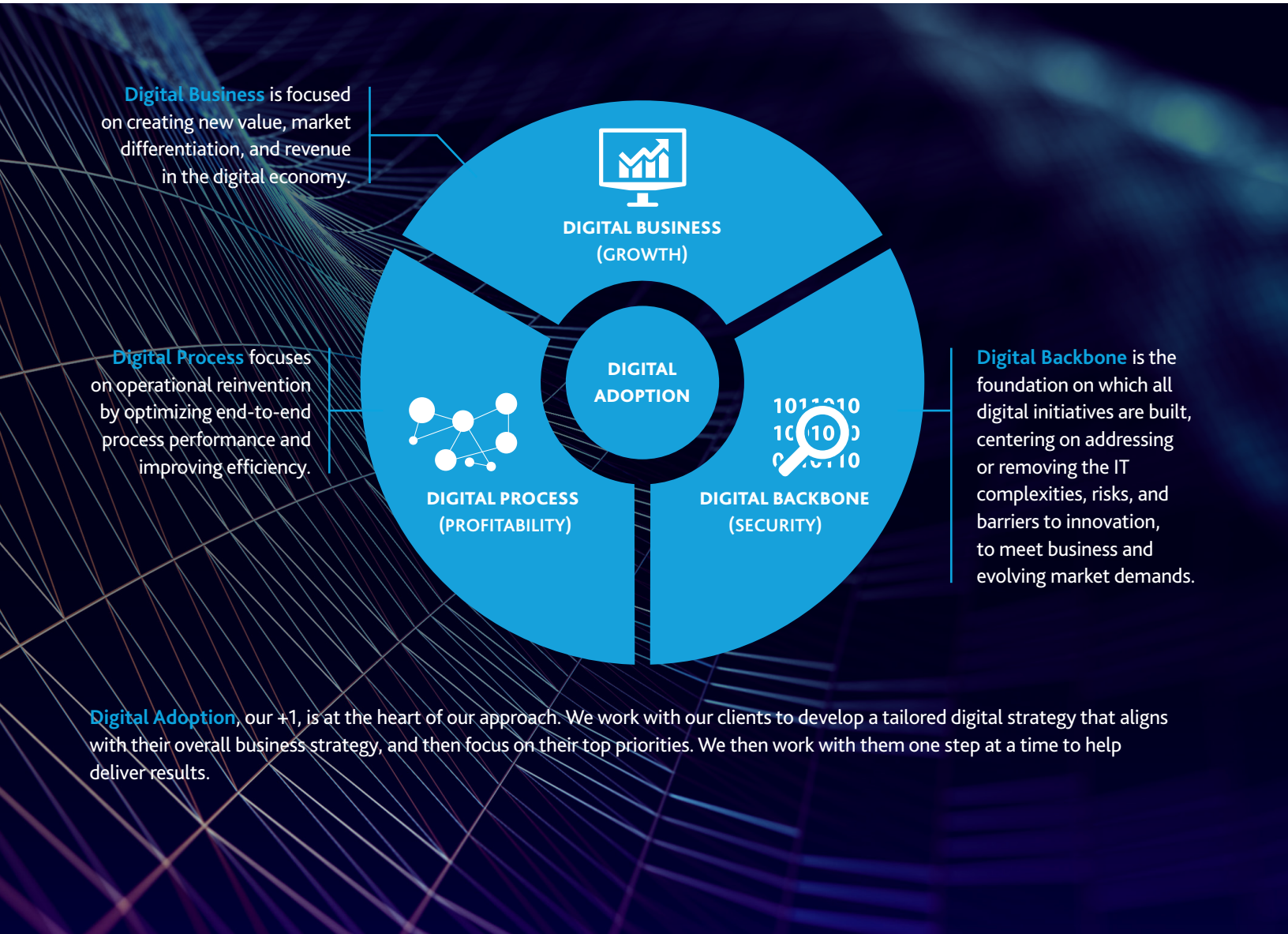
- ▶ Shift to Customer Self-Service
- ▶ ROI Tracking
- ▶ Cloud Computing Platforms

2. ASSESS YOUR CURRENT STATE

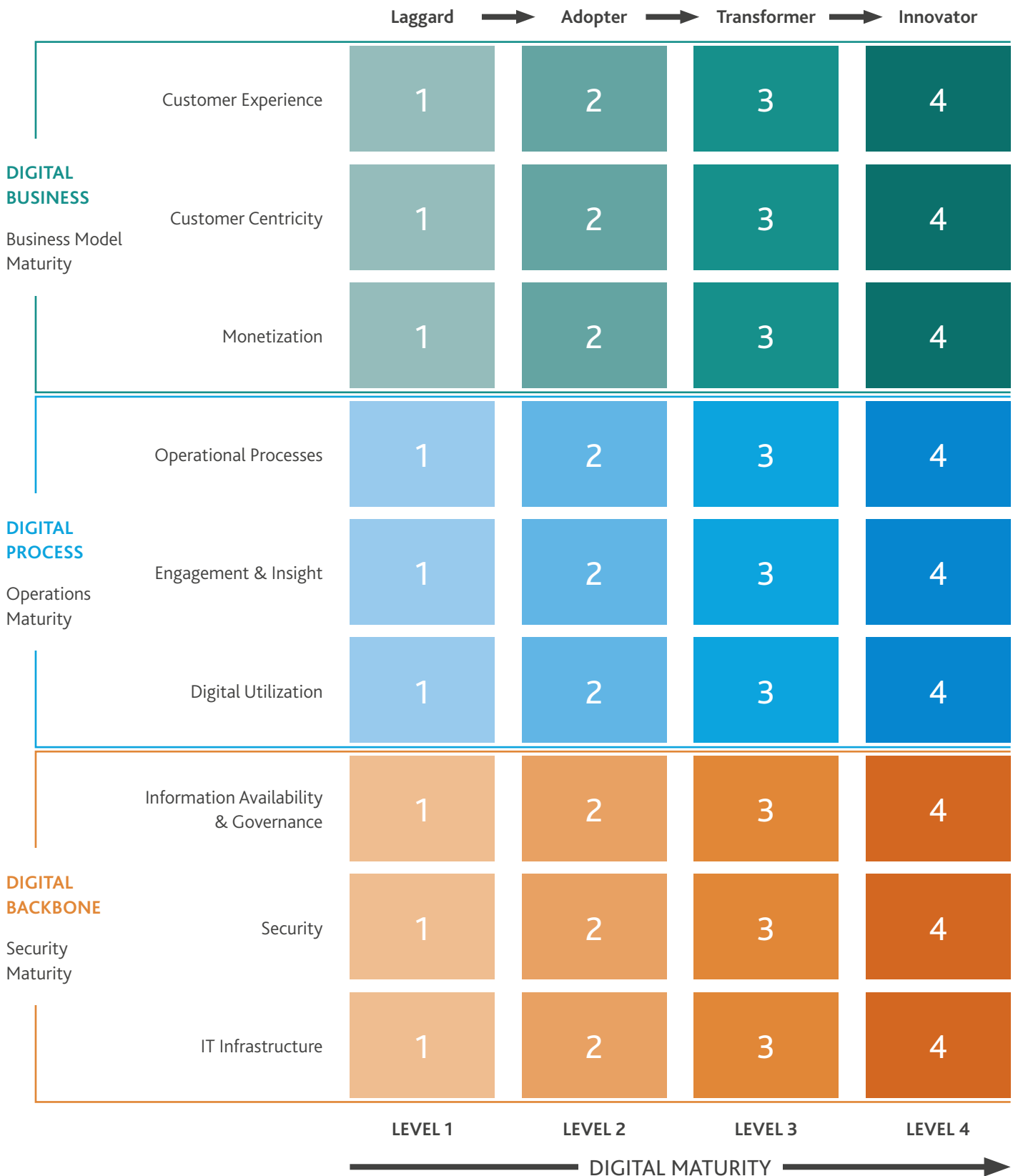
The starting point of your digital transformation journey is based on an assessment of where your organization is today, compared to your peers in the middle market, as well as the major market leaders and challengers competing in your space. As part of your current state assessment, you should also catalogue the ongoing digital initiatives you already have underway. This current state assessment is critical to setting attainable goals, maximizing existing assets, and developing an executable roadmap grounded in reality.

While competitive benchmarking should be performed in the context of industry, in general, we base our digital maturity assessment framework on three key areas of transformation: business model maturity (Digital Business), operations maturity (Digital Process), and IT maturity (Digital Backbone).

These three Transformation Areas overlap and are inextricably connected—and will become even more interlocked as your organization becomes increasingly digital.

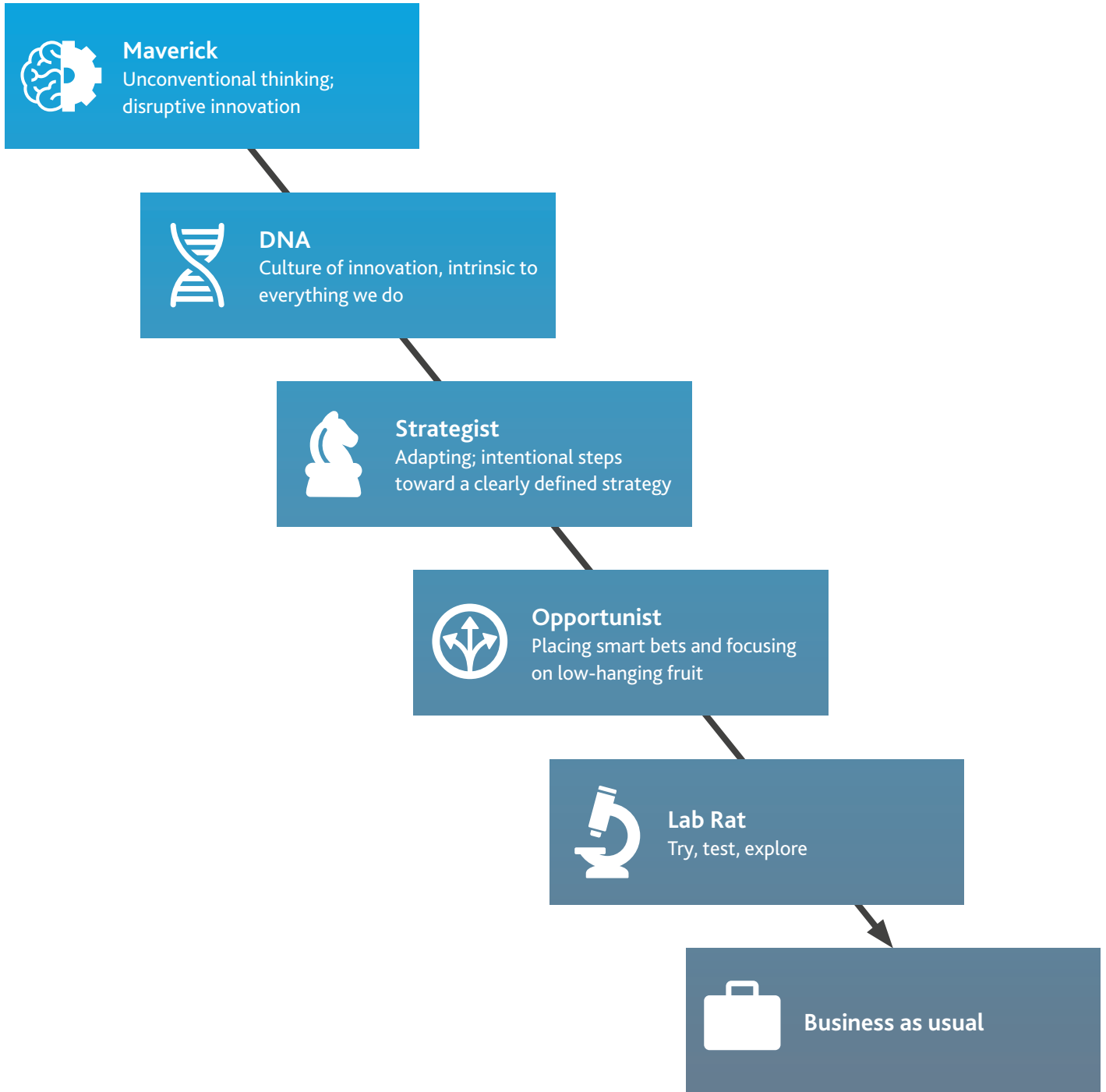


Each Transformation Area is comprised of three sub-categories to evaluate across four levels of maturity. We refer to these nine sub-categories as Digital Performance Indicators, or DPIs.



Equally important—and often overlooked—is assessing innovation maturity, which serves as a benchmark for execution, business enablement, and user adoption. An organization that has historically been more resistant to change isn't built to approach digital transformation the same way as an organization comfortable with experimentation.

INNOVATION MATURITY SCALE



3. MODEL YOUR FUTURE STATE

Crystalizing your vision, a future-state model synthesizes your strategic vision into a visual representation of the critical digital capabilities you will need to drive market acceleration, customer engagement, business innovation, and operational excellence to lead in your marketplace and execute on your strategy. It is your organization reimagined in detail as a digital business operating in the digital future. When your customers or employees ask what your business will look like in two or three years, this is what you point them to.

Because digital transformation is a catalyst for business transformation, your future-state model should reflect all the upstream and downstream changes that will result, looking across all significant business activities, operational processes, and performance drivers. While this might seem like a tall order, model development is a methodical process that can be

broken down into more manageable chunks, as long as you set up a clear decision-making hierarchy. If you understand all the levers that impact performance, you can start by setting your high-level business performance outcomes and then cascading down through each successive layer of decision-making.

Going back to digital maturity, think about all three Transformation Areas and their sub-categories as interlocked components. Your future-state model should account for cross-functional impacts both within your organization and across the boundaries with external entities. A singular, end-to-end view of your digital transformation strategy realized will help you mitigate the risk of unintended consequences, ensure the right people are engaged and involved, and maximize value.

4. ANALYZE THE GAPS

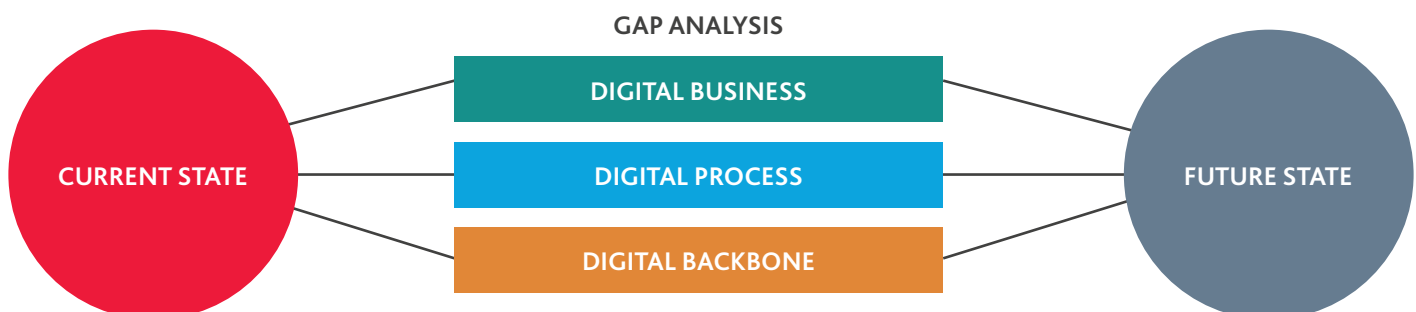
Once you've completed a comprehensive current state assessment and developed your future-state model, you can conduct a gap analysis to identify the data, technologies, talent, and capital you'll need to enable your digital future. In addition to gaps in capability, the analysis should focus on the compatibility and agility of your current IT architecture, systems, and processes—your organization's digital backbone—with the digital enablers you plan to invest in down the line, and identify any other potential constraints that could hinder digital initiatives from working at scale.

As part of this analysis, you will also want to identify the existing assets and capabilities that complement your future vision. Companies chasing disruption that fail to leverage their current strengths will face an uphill battle.

This is also where you will determine the metrics to evaluate progress and outcomes. While conventional corporate metrics will serve as an important measure of financial impact

(revenue, margin, and risk), they won't provide a complete picture of value creation. Other measurements of value—such as employee adoption and mastery of new technology, customer engagement levels or time savings due to increased productivity—are left unaccounted for. Analyzing the DPIs that comprise each Transformational Area of the current state assessment will help you gauge progress holistically as you move up the digital maturity continuum.

In addition, setting customized DPIs based on your organization's unique digital transformation objectives is critical to understanding the value. For example, if your digital strategy is focused on improving customer experience, you will need to set specific CX metrics, such as customer acquisition rate, churn, or retention. If your digital strategy is focused on increasing efficiency, you will need to consider metrics like work in progress, completion time, or exception rates.

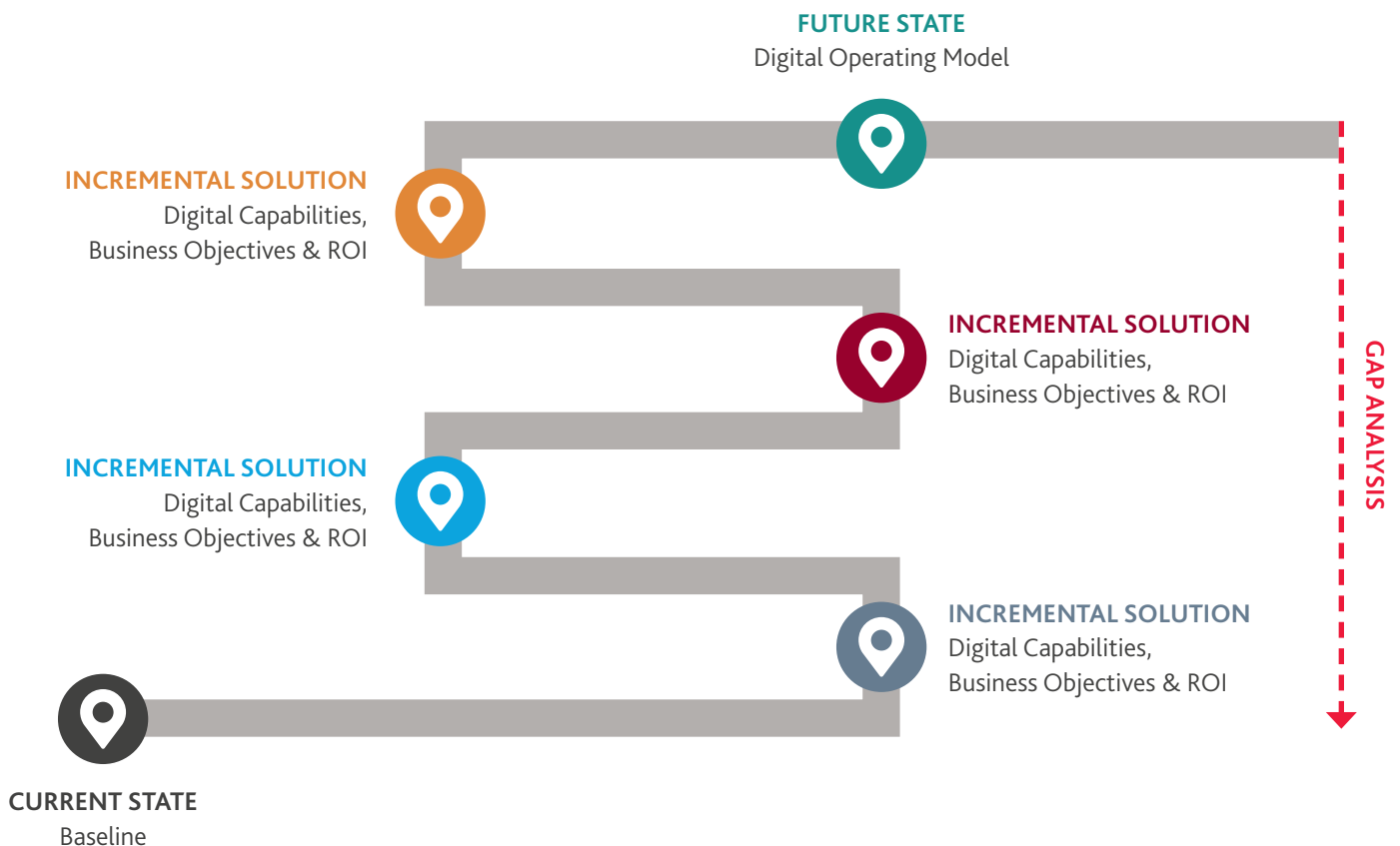


5. MAP YOUR DIGITAL TRANSFORMATION JOURNEY

The process of digital transformation is one of a series of deliberate steps to mature the digital capabilities underpinning the desired future state of the business. Once you understand where you need to go, it's a matter of working backwards.

Your digital transformation roadmap should connect the dots between your future state and current state in small, achievable increments. Critically, ROI should be assessed and realized at every increment; a sound digital transformation roadmap shouldn't make you wait until some ambiguous end to see payoff.

It's important to note an incremental approach does not equate to moving slowly; in today's digital environment, time horizons are shrinking, and the mandate is acceleration. Understanding where you are on the innovation maturity continuum will help you scope incremental milestones at the right cadence and frequency for your organization's current capacity for innovation. Ideally, as you successfully execute against your digital transformation roadmap, your innovation maturity and agility will evolve too, accelerating time to market for new solutions.



At this stage, you should also establish a formal Digital Transformation Office (DTO) to bring together cross-functional teams that have historically worked in silos to align strategy and purpose with execution, as well as to drive momentum and instill accountability. Ensuring that you have representation from all business areas and getting input from each team member early on will help drive success. If the solution architect doesn't fully understand the specific business use case, or if the IT department isn't clear on infrastructure needs, your digital transformation efforts will inevitably stall. Your DTO should also include an overall project manager to organize sub-project teams and work streams and oversee execution.

6. FIGURE OUT FINANCING

Resource constraints can be one of the biggest roadblocks to progress, particularly in the middle market where budgets are tighter, and there is less room for trial and error. To secure resources and funding, you'll need to build an investment case internally, focusing on the market opportunity and specific benefits to your organization. You should be able to make a solid investment case not only for your overarching digital transformation strategy but for each incremental project along the way.

When innovating on a budget, lean principles also come into play. As business conditions change, value streams may evolve, requiring a more dynamic and flexible approach to budgeting where you can reapportion dollars and resources as opportunities arise.

While understandably, most organizations prefer to rely on internal sources of financing, in some cases, it may make sense to seek outside funding. One no-brainer for organizations exploring digital transformation financing options is maximizing federal and state tax incentives for R&D and innovation. Companies that take advantage of available credits and deductions have more cash, increased earnings per share, lower effective tax rates, and the opportunity to increase their digital investments.

For some organizations, it's a make-or-buy-decision between building new capabilities or buying through strategic acquisitions. Others yet may opt to partner with private equity firms to leverage their expertise with capital investments, operational guidance, and strategic bolt-on acquisitions.

But for many, sourcing the technological resources or skillsets they need through out-of-the-box technology solutions or managed services is also a solid option—one that results in less time and lower costs. Another way to free up resources is by identifying opportunities to streamline and consolidate IT assets and processes in your digital backbone, thereby reducing CapEx and OpEx. Applying robotic process automation to routine manual processes, for example, results in both cost savings and increased workforce capacity that can be reinvested in more transformative digital transformation efforts.

Digital transformation—even if you anticipate significant ROI in the long-term—may require reallocating budget or raising additional capital.



Internal Sources

- ▶ Retained Profits
- ▶ Working Capital Management
- ▶ Sale of Assets
- ▶ Cost Savings



Tax Credits & Incentives

- ▶ Federal R&D Credits & Incentives
- ▶ State R&D Credits & Incentives
- ▶ International R&D Credits & Incentives
- ▶ FDII Deduction



External Financing

- ▶ Debt Financing
- ▶ Stock Market Financing
- ▶ Government Grants & Subsidies
- ▶ Crowdfunding



Partnering

- ▶ Joint Ventures
- ▶ M&A
- ▶ Private-Public Partnerships

7. DEFINE THE PROJECT

Project implementation is where the rubber hits the road. Your roadmap should already lay out the desired outcomes; the challenge is figuring out how to achieve those results and which gaps to fill first. Depending on your current level of maturity, you may need to prioritize solving for an urgent need while advancing overall transformation readiness. To leapfrog competitors, however, you should prioritize revenue-generating digital initiatives that address unmet competitor needs or automate routine processes that detract from that focus.

Coming up with the best possible solution starts with accurately defining your problem. We recommend embracing design thinking principles to reframe the problem statement in a human-centric way with empathy and emotion.

Let's take a hypothetical example: An organization that invoices its clients based on billable hours worked is struggling to get its employees to complete time entry by the end of the billing period. Instead of citing the problem as "employees are late in completing their time entry," a design thinking approach starts with the employee point of view. We might uncover, through observation and research, that most employees see time entry as a frustrating burden. Incorporating the employee perspective, the question becomes, "How might we reinvent the time tracking experience so that it adds value to employees' jobs?"

"Design is about how you approach a problem. It's the thinking of how you frame the problem, and then an intention behind the solution, so that it is grounded in empathy for a human being ."

PHIL GILBERT / IBM Design

EMPATHISE

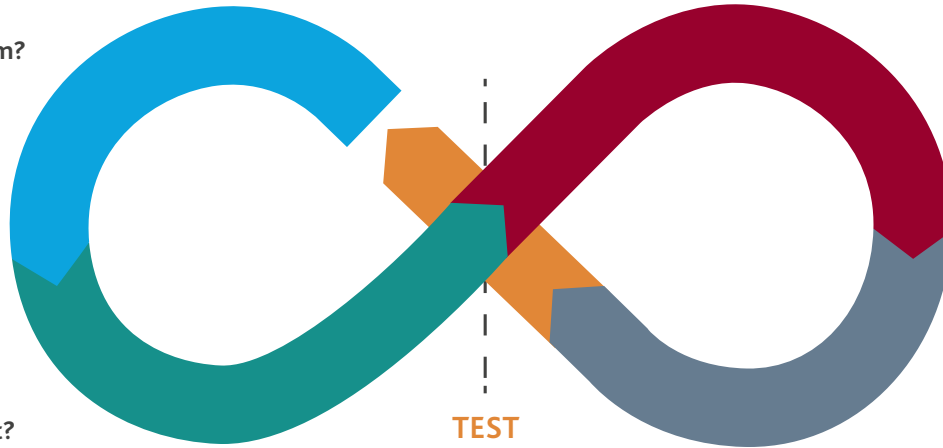
What is the problem?

Define the challenge & explore the human context

DEFINE

Why is it important?

Research, observe, understand & create a point of view



TEST

Does it work?

Implement the product, show & tell, start to refine the product

IDEATE

How do we solve it?

Brainstorm ideas good & bad, don't stop at the obvious

PROTOTYPE

How do we create it?

Start creating, experiment, fail cheap & fast

Don't rush this process; accurately reflecting the user point of view based on real-world observations is essential. This means really getting to know your users, whether they're your customers or employees, through exploratory research, advanced analytics, and direct engagement. What unexpected insights can you uncover about the end user? Are they stressed, bored, or frustrated? What is causing them to feel this way? Synthesize your research insights into a few key needs, and then narrow your focus to the needs that align most closely with your overarching business objectives and digital priorities. And remember: The most innovative solutions are the ones where you're able to predict or pinpoint what your users need before they even know or realize it.

Adam needs a way to...

Increase customer insight

Respond with agility

Increase job efficiency

so that he can...

Understand customer sentiment

Automatically respond to dynamic market conditions

Do the job faster

Better deliver product selections

Maximize money and competitor response

Do more

Provide the right products to the right customers at the right time

Optimize merchandizing activities

Save time and make decisions faster

A POINT-OF-VIEW STATEMENT HELPS YOU UNCOVER USER INSIGHTS AND FRAME THE PROBLEM IN A HUMAN-CENTRIC WAY.

Consider multiple options, soliciting input from diverse perspectives. Possible solutions should concentrate on the what and the why; the how is meant to be a process of discovery after project initiation. During this ideation phase, throw the rules out the window, and let your imagination run wild. The best solutions challenge assumed constraints.

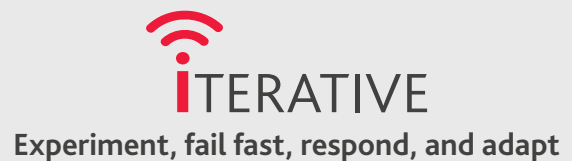
Before advocating for a specific solution, evaluate its novelty compared to what competitors or adjacent businesses are doing. At the same time, however, keep in mind that “novel” doesn’t automatically mean “good”: Make sure you can support the business case for the solution with immediate value creation while also advancing your overarching digital strategy. Also evaluate the solution in the context of your broader digital transformation strategy: To what extent does the solution drive forward momentum on the digital maturity continuum? In some cases, novelty may need to be set aside in favor of playing catchup.

Once you have stakeholder buy-in and budget, scope the project. Define a project-specific vision for business and operational incremental success—as prescribed in your digital transformation roadmap—centered on the customer and user point of view. Identify all the necessary deliverables, and map the different work streams that will need to be actively involved.

8. PROTOTYPE, TEST AND ITERATE



INCREMENTAL
Renovation, not reinvention



ITERATIVE
Experiment, fail fast, respond, and adapt



INTEGRATED
Cross-functional collaboration

Prototyping is the stage at which innovation turns to action: to learn by doing. The goal of prototyping is to conceptualize ideas or hypotheses in a model that can be built and tested quickly and cheaply. Early-stage prototypes are intended to be rough experiments and can take any tangible form—so long as it can be tested and improved upon.

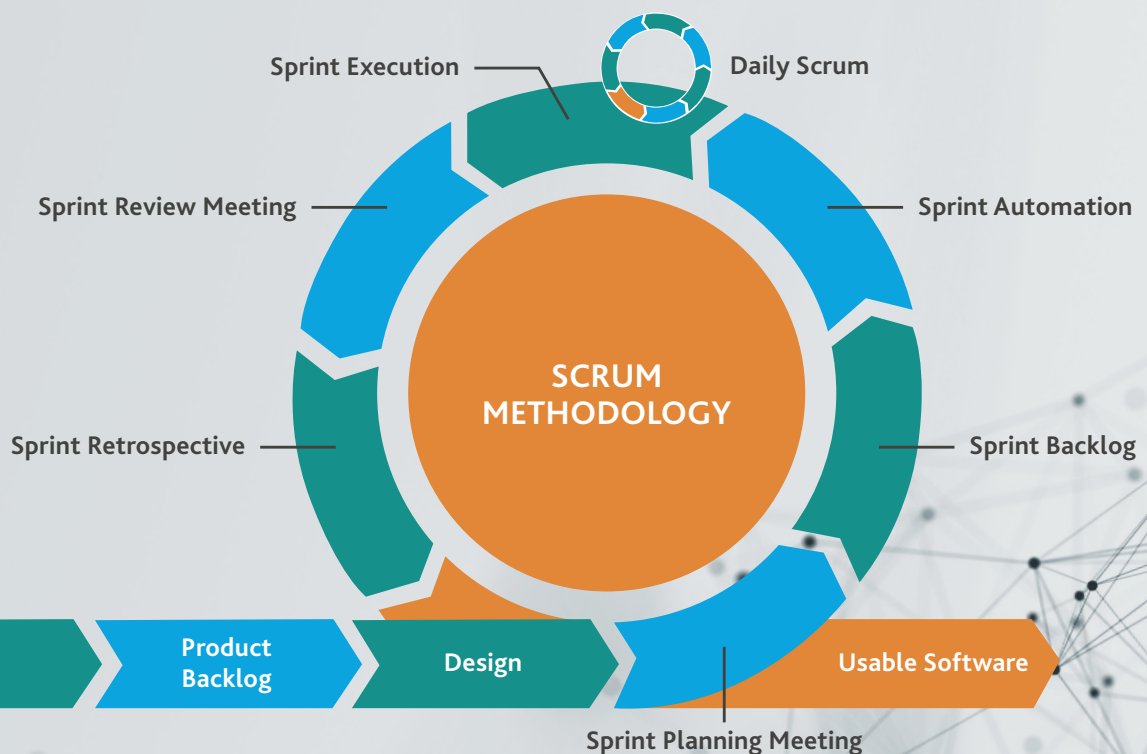
That’s where the three I’s of innovation come in. Iterative, incremental innovation in small pilots enables faster decision-making and implementation, as well as the ability to adapt or change course at any point. Think of each pilot as an experimental sandbox, where the goal is to learn quickly and apply those learnings to the next experiment and/or scale the solution.

Iterative, incremental innovation is at the core of the Agile Manifesto that has become the de facto project management approach in software development, and for good reason. An agile approach enables faster decision-making and implementation, as well as the ability to adapt or change course at any point.

While each pilot iteration can be worked on modularly—broken down into independent tasks to allow for concurrent progress on interdependent areas—testing must always consider cross-functional interactions and feedback. Obtaining quick user feedback is especially vital to ensuring that your experimentation is on the right track. While not every user has to love your product or service, it's important to observe their reaction—not only in what is explicitly being said, but also in subtler, unconscious cues. It's often the latter that unearths deeper meaning, and can help you make the leap between designing an obvious solution to discovering a more novel, intrinsic one.

Once you have discovered something that works well, you must be prepared to absorb, integrate, and expand on these successes without the traditional organizational friction—bureaucracy, politics, and change aversion—that's common in established businesses. Your DTO should ensure these obstacles don't hold you back.

AN AGILE SCRUM METHOD IS EMPLOYED FOR RAPID AND ITERATIVE SOLUTION DEVELOPMENT, DEPLOYMENT, AND REFINEMENT.



9. PREPARE YOUR PEOPLE

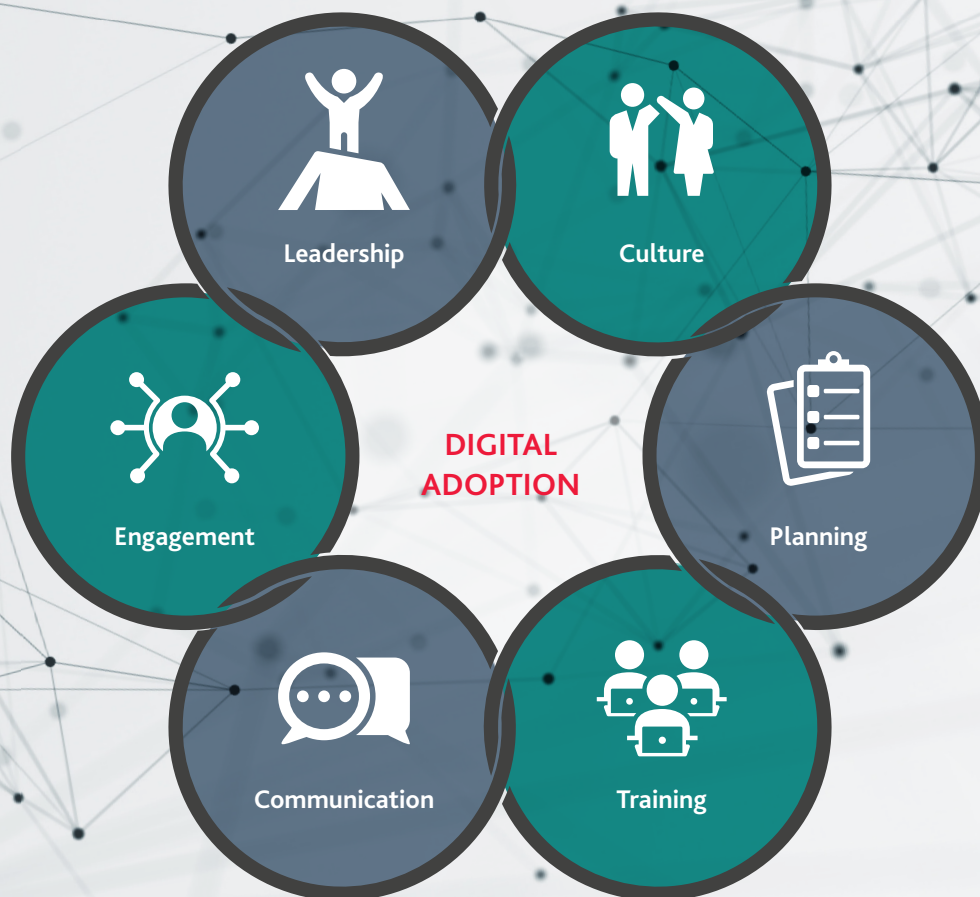
Digital transformation is less about revolutionary technology than it is about changing the way you work. It's a mindset shift that hinges not on digital capabilities but on the adoption of those digital capabilities by the end users—employees and customers—and business enablement.

The hardest piece of this transition may be fostering a corporate culture that embraces constant experimentation and learning—one in which short-term mistakes and failures are expected and accepted in the pursuit of long-term innovation and value creation. Operational change requires behavioral change in order to truly become integrated into the fabric of the business.

Behavioral change starts with tone at the top. The senior-most leaders of the organization not only need to be brought into digital transformation, but also need to convincingly evangelize the vision.

You need your employees to understand why they need to leave the status quo behind, believe in the strategy, and engage in the process. Most importantly, they need to understand what's expected of them. Ambiguity will result in inertia; set clear, behavior-based guidelines, and reinforce desired habits with positive incentives.

While an injection of new talent can help improve your overall digital competency, you will also need to provide current employees with the resources, training, and development they need to be effective as their roles evolve. Consider a formal digital upskilling program—ideally with personalized training modules based on preferred ways of learning—to future proof your workforce. You should also establish a cross-disciplinary “Digital Dream Team” of individuals to be your champions and cheerleaders in the field.



THE 7 C's OF CHAMPIONING CHANGE



CONVINCE

- ▶ Make the case for change
- ▶ Scope the change initiative
- ▶ Win management support



COMMIT

- ▶ Set your strategic vision and desired outcomes
- ▶ Identify internal change champions
- ▶ Establish ownership



CODIFY

- ▶ Conduct a baseline assessment and identify barriers
- ▶ Define operational, process, people, and behavioral changes
- ▶ Create an implementation plan



CONVERT

- ▶ Lay out the strategic vision
- ▶ Communicate individual expectations
- ▶ Empower middle managers



CATALYZE

- ▶ Equip employees with training and tools
- ▶ Systematize reinforcement
- ▶ Recognize and reward the wins



CULTIVATE

- ▶ Clarify new roles and responsibilities
- ▶ Develop and train for new skillsets
- ▶ Invite employee feedback



CHART

- ▶ Monitor and report on progress
- ▶ Measure business and cultural impact
- ▶ Create a cross-functional feedback loop

10. EXECUTE AND REFINE

Digital transformation does not start or stop with a single project, nor is it simply checking off each milestone on your roadmap. Change is unpredictable and rarely linear. While developing a roadmap can point you in the right direction, any milestones you set that are contingent on the success of prior achievements may need to shift or change entirely based on empirical feedback. Failure is a necessary part of the innovation process, while early indicators of success may spur ideas that lead you in new directions. Rigidity has no place in the digital transformation journey.

As the external digital environment evolves, so, too, may your desired outcomes. Don't put foresight on the backburner while you focus on execution. Ongoing strategy refinement is prudent and even necessary. Continue to revisit and evolve your vision of the digital future. Disruption isn't going anywhere.



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