

Gartner Research

# Preserving Your Digital Growth Investments During Economic Uncertainty

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Organizations are betting on digital investments to sustain long-term growth, but shifting economic cycles due to the spread of COVID-19 will force organizations to restrict their investments. Executive leaders must measure and communicate the value of their digital initiatives to sustain funding.

## Overview

Four out of five CEOs in 2019 have a management initiative to make the business more digital. However, shifting economic cycles due to the spread of COVID-19 will change business conditions and force organizations to optimize costs and curtail their digital investments. Organizations making effective investment decisions to build their digital capabilities even during uncertain economic times are poised to increase their competitive advantage and break away from the competition.

Most digital initiatives are different from traditional transformational projects and require different means of measuring value. Hence, to secure stakeholder buy-in, executive leaders must effectively measure the value of digital initiatives to justify the funding requirements. Furthermore, to influence the decision making of stakeholders (such as the CEO, board of directors and investors), executive leaders must communicate the current and future value of their digital initiatives by creating action-oriented narratives.

## Key Findings

- In 2019, 82% of CEOs, up from 62% in the previous year, have a management initiative to make the business more digital.
- Organizations that excelled through the last downturn continued to invest at least 5% to 7% of their IT spend toward innovation or transformation projects.
- Most organizations use conventional value measurement and management approaches for all projects, even though digital initiatives are different from traditional transformation projects.
- Current methods of communicating the progress and value of digital initiatives are often considered not credible, not relatable, too technical and hard to interpret by the stakeholders.

## Recommendations

Executive leaders looking to manage costs and secure funding for their digital growth investments should work with their direct reports to:

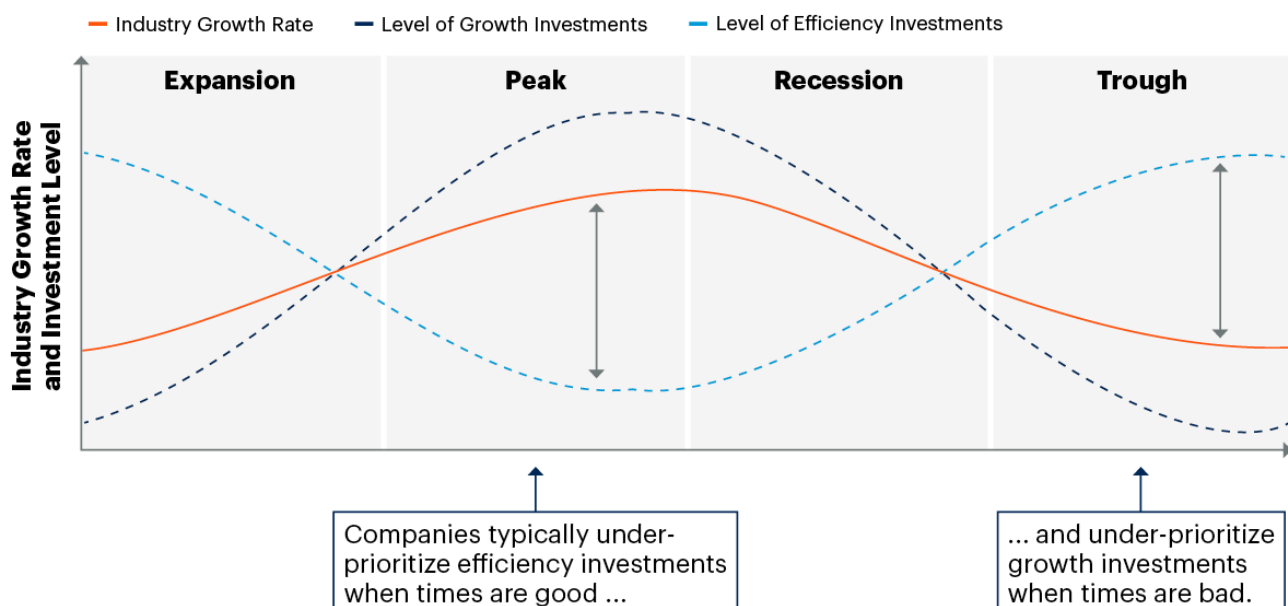
- Customize financial management practices to measure the value of digital initiatives beyond financial returns by using discount rates based on project categorization and recognizing the value of options.
- Measure the impact of digital initiatives on business performance by creating a dashboard of five to seven digital key performance indicators (KPIs), using metrics that are leading and forward-looking.
- Build an action-oriented narrative for each digital initiative to influence stakeholders' decision making by communicating the current state of digital initiatives and their business impact.

### Leading Organizations Continue Investing in Long-Term Growth Bets During a Business Slowdown

As the impact of the COVID-19 coronavirus pandemic spreads, executive leaders face mounting pressure to cut costs due to changing business conditions. The way that organizations manage their cost decisions now will determine how well they sustain performance during this crisis. During times of economic uncertainty, organizations overprioritize efficiency and underprioritize growth investments (see Figure 1). Organizations that smooth out these investments across the economic cycle will be better prepared to weather an impending slowdown and accelerate their expansion as economic cycles shift.

**Figure 1. Industry Growth Rate vs. Level of Investments for a Typical Company**

#### Industry Growth Rate Versus Level of Investments for Typical Company Illustrative



Source: Gartner

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Gartner's research on efficient growth shows that a small number of organizations – just 5% of the 1,200 largest publicly traded organizations in the world – emerged as winners (that is, organizations that took relatively more calculated risks and broke away from the competition) after the 2008 to 2009 recession. These winning companies acted quickly, conserved cash and were ready to invest when others were not. Evidently, organizations that anticipate the future and develop a comprehensive action plan to protect their critical growth projects are rewarded with a sustained advantage over their competitors in the long run.

### **CEOs Value Digital Investments as a Key Growth Driver for Their Organizations**

The 2019 Gartner CEO and Senior Business Executive Survey found that 82% of the CEOs, up from 62% in 2018, have a management initiative to make the business more digital. <sup>1</sup> To achieve long-term sustainable growth, organizations that continue to make digital investments will increase their chances to emerge as winners during an economic uncertainty. Our research shows that organizations that excelled through the last downturn continued to invest at least 5% to 7% of their IT spend toward innovation or transformation projects.

Organizations are building potentially high-growth digital capabilities that are in various stages of the investment cycle (for example, pilot or implementation). Although they have not yet realized their true value, these investments could be pivotal for sustained growth. The 2020 Gartner CIO Survey found that 40% of organizations have reached scale for their digital endeavors, up from 33% in the previous year, and will continue to require additional investments. <sup>2</sup> However, during times of economic uncertainty, organizations will face mounting pressure to optimize costs. To preserve digital investments especially during these times, executive leaders need to deploy a differentiated approach to justify their funding requirements.

### **Digital Initiatives Are Different From Traditional Transformations**

Traditionally, to undertake each potential project, organizations have a process to allocate funds that is typically a mix of making formal detailed business cases, incorporating informal discussions and following leadership's gut feeling. However, building a business case for digital initiatives is difficult because:

- Both the inputs (effort, cost) and the outputs (value created, time taken) aren't actually known, and are typically poor estimates.
- Most digital initiatives run as IT projects and use IT metrics for decision making. Executive leaders often find these metrics too technical to comprehend and face challenges in quantifying the business benefits of digital investments.
- The difficulty intensifies in measuring the value of initiatives that offer indirect benefits. Since such initiatives need nonmonetary ways of expressing value, stakeholders find insufficient justification for providing investments.

Hence, stakeholders often rely on their experience to invest in digital initiatives. This status quo is probably not sustainable in the next few years for three reasons:

1. *There is more pressure to choose well.* The increasingly digital nature of the world means that organizations are likely to face a greater volume, variety and velocity of candidate projects to choose between.
2. *It is harder to value some projects* and, more generally, projects that are transformational in nature. There are also more opportunities where the benefit cases are more complex, such as investments where the benefits are less linear and less predictable.
3. *Some projects are different from the current business.* Increasingly, a subset of potential and actual projects are digital extensions (as opposed to product line extensions or brand extensions), where the new business is fundamentally different from existing lines of business. Hence, a gut feeling developed from existing business experience might lead stakeholders to digress from their target.

*To sustain investments, especially during economic uncertainty, executive leaders must effectively measure and communicate the value of their digital initiatives to stakeholders.*

## 1. Measure the Value of Digital Initiatives to Justify Investments

For decades, the traditional accounting measures have been the broadly adopted and consistently applied measures of business value, such as net profit, earnings per share and return on invested capital. These lagging indicators of value tell an incomplete story. Today's accounting metrics were created during the Industrial Age and cannot accurately capture the value created by digital initiatives. The inability to accurately measure tangible and intangible benefits creates a measurement gap for digital initiatives that traditional accounting measures cannot fulfill. To close this gap, executive leaders must deploy tailored financial management practices and exploit the power of leading indicators to support planning and reporting of digital initiatives.

### 1A. Customize Financial Management Practices to Measure Value

Executive leaders must step up their business-case- and investment-seeking capabilities by working with their direct reports to move away from traditional value measurement techniques:

- *Categorize the current portfolio of projects into fear-, fact- and faith-based projects* to define how projects should be managed, measured, monitored or governed:
- **Fear-based** projects are “survival projects,” primarily about staying in business.
- **Fact-based** projects are primarily about improving business performance in a measurable way.
- **Faith-based** projects are those where the company is making a bet – where the business case would be a fiction if it proposed clear predictions of value creation.

- *Scrutinize the discount rates for cash flows, based on project categorization*, to recognize the time value of money and risk adjustment. Net present value (NPV) based on these adjusted discount rates can be used alongside other measures, such as return on investment (ROI), payback period and internal rate of return (IRR).
- *Recognize the value of options* that digital initiatives can generate in the future if they were scaled across business units, geographies or functions. Real option valuation (ROV) is a methodology that applies calculations similarly to the financial methodologies and estimates the value of future options associated with a particular project investment.

## 1B. Create Digital KPIs to Measure Progress

As the next step, executive leaders must track the progress of digital projects at each stage, which is critical to assess and demonstrate their current value as well as future value. Traditional accounting measures use indicators, such as growth in revenue, net profit margin and inventory turnover, that are lagging and focus only on past successes. To avoid this, executive leaders must deploy digital KPIs that act as leading and forward-looking indicators for digital initiatives.

To define digital KPIs that measure the impact of digital initiatives on business performance, executive leaders must work with their direct reports to:

- Set goals and metrics that can better inform and influence business decision making. For example, clearly quantify a goal against the expected benefits of achieving it.
- Work with cross-functional peers to identify which of their areas would benefit most from a consistent KPI framework across the organization. Define what should be optimized or transformed and what benefits to expect out of it.
- Assess the impact on business performance by creating a dashboard of five to seven KPIs to measure the progress and maturity of digital initiatives.
- Continue to improve the maturity of quantitative metrics against the organization's expected business outcomes.

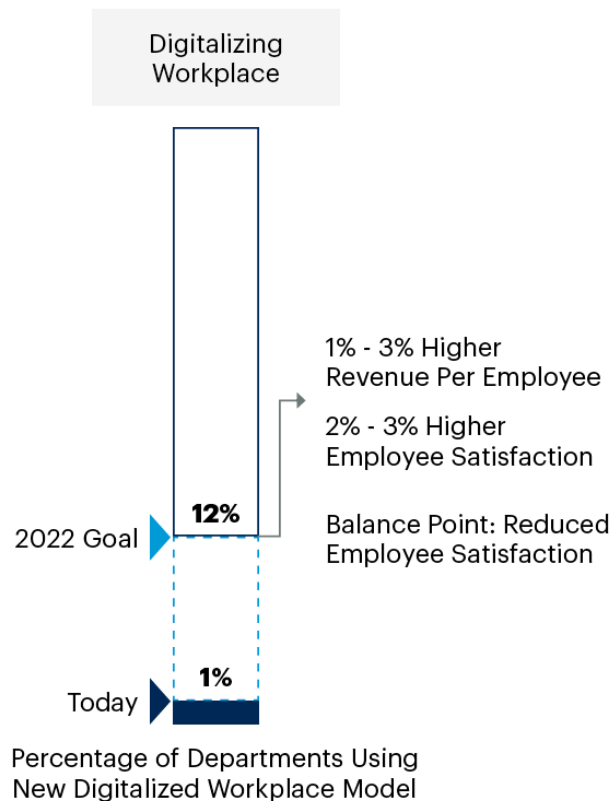
To build digital KPIs, Gartner has created a construct based on the best practices followed by many clients (see Figure 2). The construct is composed of five elements:

1. What is being measured?
2. Where are we today?
3. What is our target goal?
4. What is our desired business outcome or benefit?

5. What is our balance point? This is the point at which diminishing returns will begin.

**Figure 2. Gartner Digital KPI Construct**

### Gartner Digital KPI Construct Illustrative



Source: Gartner

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## 2. Effectively Communicate the Value of Digital Initiatives to Influence Leadership's Decision Making

Executive leaders win only half the battle when they create a dashboard with the right digital KPIs and share it with stakeholders. This is because stakeholders, already operating in a crowded information space, may find these KPIs too technical and difficult to translate the business relevance. While reporting the performance of digital initiatives, executive leaders and their direct reports can apply the “Three Whats” technique (see Figure 3) to clarify:

- *The “What?”* This lays out the evidence-based facts — that is, digital KPIs that all sides involved in digital initiatives can agree on.
- *The “So What?”* This translates the facts into business impacts that the stakeholders care about.
- *The “Now What?”* This expands on the trade-offs and decisions faced by the stakeholders.

**Figure 3. The Three Whats Technique for Reporting Digital Initiatives**

## The 3 Whats Technique for Reporting Digital Initiatives



Source: Gartner

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By infusing these three elements, executive leaders can bridge the gap between merely reporting the numbers and providing actionable insights that are aligned to the organization's priorities for digital optimization or digital transformation. Furthermore, such communication would also be easier for stakeholders to comprehend and implement, thereby helping executive leaders to secure buy-in for their digital investments.

## Conclusion

Investment decisions made today on building digital capabilities will have a lasting impact on an organization's performance. However, securing continued investment for building digital capabilities during times of economic uncertainty could be challenging due to the pressure of cost optimization. Using the traditional metrics to measure the progress and benefits of digital investments fails to demonstrate the extent of business value that they can generate.

Executive leaders must deploy digital KPIs to measure the impact of digital investments on business performance. Subsequently, to influence stakeholders' decision making and sustain funding, executive leaders must communicate the current value and potential future value of digital initiatives by creating action-oriented narratives.

## About This Research



This research is drawn from two major surveys conducted by Gartner: 2019 Gartner CEO and Senior Business Executive Survey and 2020 Gartner CIO Survey.

## Endnotes

<sup>1</sup> 2019 Gartner CEO and Senior Business Executive Survey. Gartner conducted this survey from September through December 2018, to examine CEO and senior business executive views on current business issues, as well as some areas of technology agenda impact. In total, 473 business leaders were qualified and surveyed. The results of this study are representative of the respondent base and not necessarily the market as a whole.

<sup>2</sup> 2020 Gartner CIO Survey. Gartner conducted this survey from 4 June 2019 through 5 August 2019 among Gartner Executive Programs members and other CIOs. The sample includes 1,070 CIO respondents in 64 countries and across major industries (public and private), representing approximately \$3.5 trillion in revenue or public-sector budgets and \$67.5 billion in IT spending. The results of this study are representative of the respondent base and not necessarily the market as a whole.

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