

The Transformation Imperative for Small and Midsize Companies

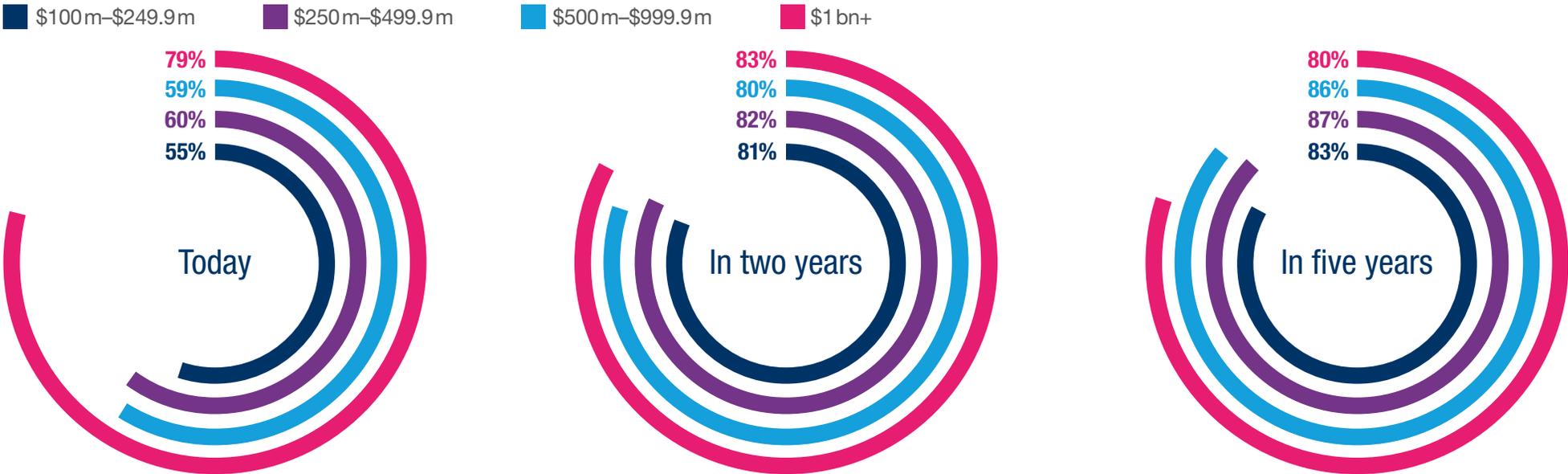
Digital transformation is increasingly understood as a matter of survival for small and midsize companies. Most are planning to make the sweeping, technology-driven organizational changes that define digital transformation, and a growing majority say these adjustments will be essential to their competitiveness in the near future.

Oxford Economics surveyed over 3,000 executives in 17 countries about their readiness for digital transformation, including more than 1,300 companies with revenues below \$500 million. We also analyzed responses from companies with \$500 million to \$1 billion in revenue to better understand how digital transformation efforts change as companies grow.

We found that more than half of small and midsize companies see digital transformation as a core business goal, and this goal is viewed with growing urgency: more than 80% see such initiatives as important or critically important to their company's survival. And while companies are increasingly focusing investments on digital technologies, overall progress towards comprehensive digital transformation remains limited.

Digital transformation is an existential issue

Q: How critical is digital transformation to the survival of your company? "Important" and "Critically important" responses



Our research covered several aspects of the transformation story. How are small and midsize companies going about digital transformation? What challenges do they face? How will their efforts pay off? Among the key findings:

- **Technology is essential.** Executives from small and midsize companies expect technology change and the increasing pace of change to have a major impact on their organization over the next two years. And nearly three-quarters say technology is essential to growth, competitive advantage, and improving the customer experience.
- **Human capital matters.** Effective management is seen as the most important factor in the success of digital transformation for small and midsize companies. Making sure the workforce is equipped with up-to-date skills is a core component in the success of these initiatives.
- **Transformation drives performance.** Small and midsize companies expect digitization to improve business performance for a wide range of functions, and to help their organizations meet critical goals, including more efficient business operations and stronger financial performance.

Well-run small and midsize companies share some defining characteristics with truly digital enterprises—companies that are using technology to radically improve enterprise performance—including engaged workers, a lack of bureaucracy, opportunities for collaboration, strong relationships among leaders and employees, and an ability to adapt quickly to change. But small and midsize companies also face unique challenges. With fewer resources than large companies, they need to be strategic and precise with their decisions and investments to make transformation a reality.

Four traits of digital transformation leaders

We identified an elite group of companies from our survey that say digital transformation is complete across all areas of the business. This set of respondents, who account for 3% of our overall sample, set themselves apart in key areas. These digital transformation leaders:

- **Are focused on true transformation.** They avoid episodic, piecemeal changes and instead embrace a cross-organizational approach designed to enable constant change. They consider transformation an opportunity to reinvent business models, which they prioritize over comparing themselves to their competition.
- **Transform customer-facing functions first.** Leaders view the customer experience as the gateway to a successful digital transformation. They are 58% more likely to cite customer empowerment as a key global trend. The leaders have also successfully connected their customer-facing efforts to business processes across the enterprise and extended them to partners and suppliers.
- **Invest in next-generation technology using a bimodal architecture.** Bimodal IT, or two-speed architecture, separates strategies for technologies used for reliable back-office functionality from advanced technologies that require rapid, iterative development. Using a bimodal architecture is meant to help them run their business efficiently while rapidly integrating new technologies to remain ahead of the competition. Leaders are maintaining the basic functionality, while also reporting a high level of investment in cloud computing and enterprise mobility, double-digit growth in Big Data and analytics and the Internet of Things (IoT), and hypergrowth in machine learning and artificial intelligence.
- **Prioritize talent.** With skills that drive digital transformation in high demand, leaders are investing heavily in recruiting and training. They also are using technology to smooth processes and tear down frustrating process roadblocks. It is all designed to improve employee engagement and ensure they are prepared to meet the demand for new technologies and new ways of working.

To read more about digital transformation leaders—and find out how SMEs can learn from them—[read SAP Digital Transformation Executive Study: 4 Ways Leaders Set Themselves Apart.](#)

The transformation imperative

Technology is redefining the way small and midsize companies do business, and it is happening fast. New tools, new ways of using technology, and the speed at which change is occurring are the top issues facing these companies in the next two years. Increasing speed to market was cited as the top revenue driver for the next two years by the survey respondents (44%), and the response was even higher among smaller companies between \$100 million and \$500 million in revenue.

Most small and midsize companies are just getting started on transformation. Nearly one-quarter are still in the planning stages, and while 58% are piloting initiatives today, just under 20% have completed digital transformation projects in at least some areas of the business. But most already see the latest technology as essential to gaining a competitive edge. Over 80% say it is somewhat or significantly advantageous to their businesses; 69% say it is important or highly important to retaining competitive advantage; and 74% say technology is essential to growth.

Keeping up with technology change is a business imperative

Q: Which global trends do you expect to have the greatest impact on your organization over the next two years (2017/2018)? *Top five responses*



Small and midsize companies around the world

Our global survey included significant numbers of small and midsize companies in Latin America, Asia Pacific, North America, and EMEA. The results show that progress towards digital transformation is relatively even across these regions: they are investing in similar technologies and report similar levels of change across business functions from digitization—and all have a long way to go.

Differences do exist in key areas. North American small and midsize companies, for example, are most likely to say they have completed digital transformation programs in at least some areas of the business; EMEA respondents are not far behind. Meanwhile, respondents from Latin America and Asia Pacific are more likely to say their organization is in the planning stage for digital transformation efforts.

Executives from Asia Pacific, EMEA, and North America tend to report more change from digitization than their Latin American peers, with many expecting to realize value in key areas over the next two years.

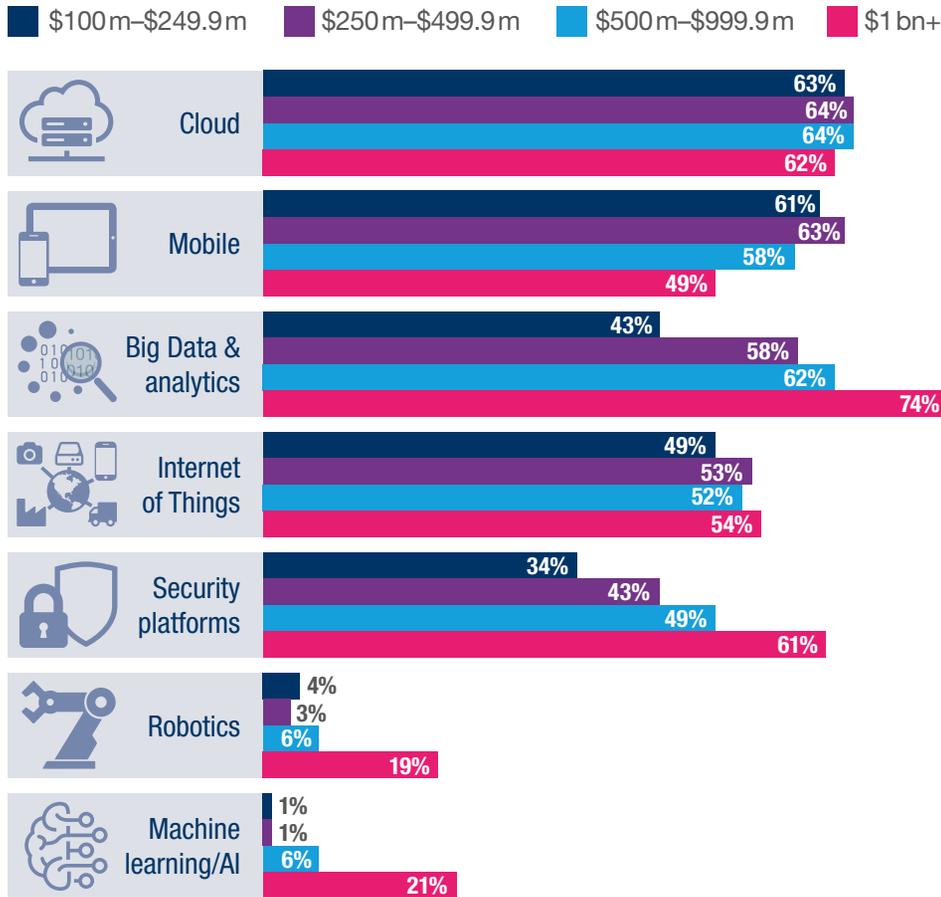
Investing for the future

Small and midsize companies are ramping up investments in a range of digital tools, with a focus on the building blocks (e.g., cloud and mobile) that will support the next wave of emerging technologies. They also are investing in Big Data and analytics (57%) and the Internet of Things (52%). In the next two years, they plan to increase their focus on Big Data (79%) while still investing heavily in cloud and mobile.

Technology investments are focused on the building blocks

Q: Which technologies are you investing in most heavily today?

Respondents could select all that apply.



For now, these companies are focusing less on emerging technologies like machine learning/AI and robotics. But investment levels are expected to pick up over the next two years as technology and organizational capabilities mature. The number of respondents who say they will invest in these toolsets jumps to 18% for machine learning/AI and 9% for robotics in two years' time, up from 5% today. (In general, small and midsize companies with stronger financial performance are more likely to be investing in a range of technologies than other small and midsize companies.)

This growing emphasis on advanced technology can be seen in the percentage of total budget dedicated to digital transformation. Currently, the great majority (84%) of small and midsize respondents are spending less than 9% of their total budget on transformation; this number will grow in the next two years, with nearly one-quarter planning to allocate between 10% and 20% of their total budget to digital transformation in that time.

Still, funding for digital transformation remains an inherent challenge for small and midsize companies. Over one-third say that lack of budget is a top-three challenge for their digital transformation initiatives—a number that rises to 46% for the smallest companies surveyed, while just 13% of companies with over \$1 billion in revenue cite this as a concern. Our [previous research](#) shows that smaller companies are more adept at using technology than is commonly assumed. But as an increasing share of customers and revenue are driven by digital products and services, small and midsize companies must continually reevaluate technology budgets and the types of tools they are investing in.

People-powered transformation

Technology alone does not make a digital enterprise. Hiring and retaining top talent is critical to digital transformation efforts, and small and midsize companies must develop strong skill sets and leadership capabilities to effectively compete with each other, as well as their larger peers. Increasing employee engagement, the quality of talent recruitment, and investment in digital skills are cited as key drivers of revenue growth, ahead of strategies like entering new markets, risk management, and M&A.

Skills shortages present a major obstacle to digital transformation for these companies, ranking as the top impediment to change. How are small and midsize companies addressing these talent challenges? Two-thirds say their technology investments will affect the retraining of existing management resources, and two-thirds say that the retraining of existing general workforce resources will benefit from technology investments. Many will have to change their strategies over the coming years—perhaps by building offices in locations that are attractive to top talent or by allowing for more flexible work arrangements—to stay competitive.

Leadership is a critical element in creating a digital enterprise. Small and midsize companies cite effective management as the most important factor in the success of their transformation initiatives, with 57% ranking it a top-three response.

Management also needs to work collaboratively with employees; about three-quarters of the respondents say that strong relationships between employees and leadership provide them with a competitive advantage.

These leaders cannot succeed by doing the same old things. Small and midsize companies must remodel their organizational structures and executive roles to meet shifting demands. Today, 60% of small and midsize companies report that the IT function has primary responsibility for each stage of the digital transformation project, while barely 10% say that they have a purpose-built group for these initiatives—which is considered a state-of-the-art approach.

Leadership for transformation also involves foresight. One measure of organizational shortfalls can be seen in the lack of planning—or the presence of ineffective planning—that is a common challenge for small and midsize companies. Over 40% cite planning issues as an obstacle, ranking behind only demands for workforce skills and lack of mature technologies.

Leadership must develop human-capital strategies for the digital era

Q: Thinking about the technologies you are investing in, to what extent do you expect them to affect your human capital and HR strategy? “Minimal increase” and “Substantial increase” responses combined



The path forward

Digital transformation promises to change the competitive landscape for small and midsize companies, allowing them to enter new markets and challenge larger companies more effectively.

Some are already seeing value from their investments and efforts, including the development of new products and services, the effectiveness of various parts of the business, and overall business performance. They report measurable success in terms of their ability to attract and retain talent (53% say this is true), compete with large companies (57%), and increase their profitability (53%).

But these are still early days. In general, smaller companies report less change from digitization across a range of areas than do larger companies, although even

most large enterprises have yet to see significant value. Sales and marketing is the function that has been most affected by digitization so far, with 57% of small and midsize companies reporting substantial or transformative change.

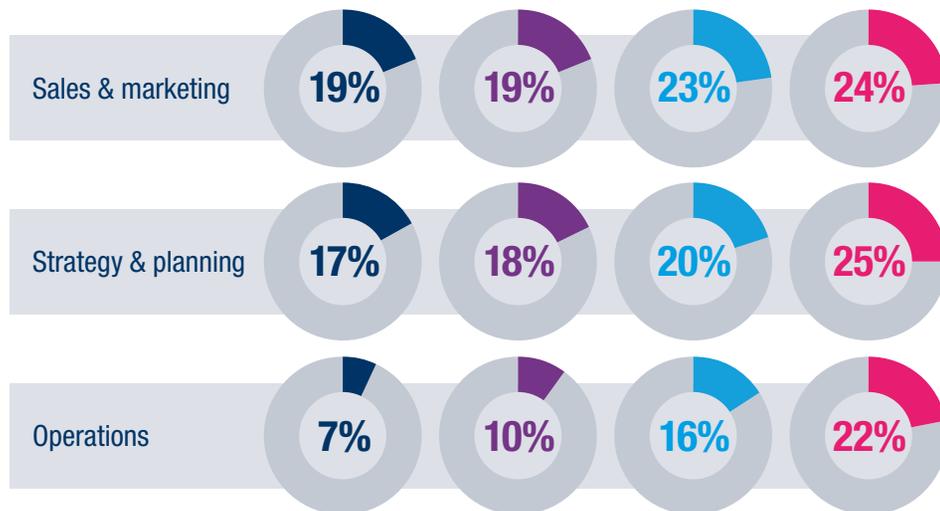
The next two years should see rapid growth. Digital transformation will drive customer acquisition and the development of new products and services. While just 6% say that over one-fifth of their new customers come directly from their digital transformation efforts today, 20% say they expect this amount of customers from digital efforts by 2019. And the number of small and midsize companies expecting one-fifth of their products and services to come from digital transformation jumps from 10% today to more than 30% in 2019.

Big changes are ahead across the organization

■ \$100m–\$249.9m ■ \$250m–\$499.9m ■ \$500m–\$999.9m ■ \$1 bn+

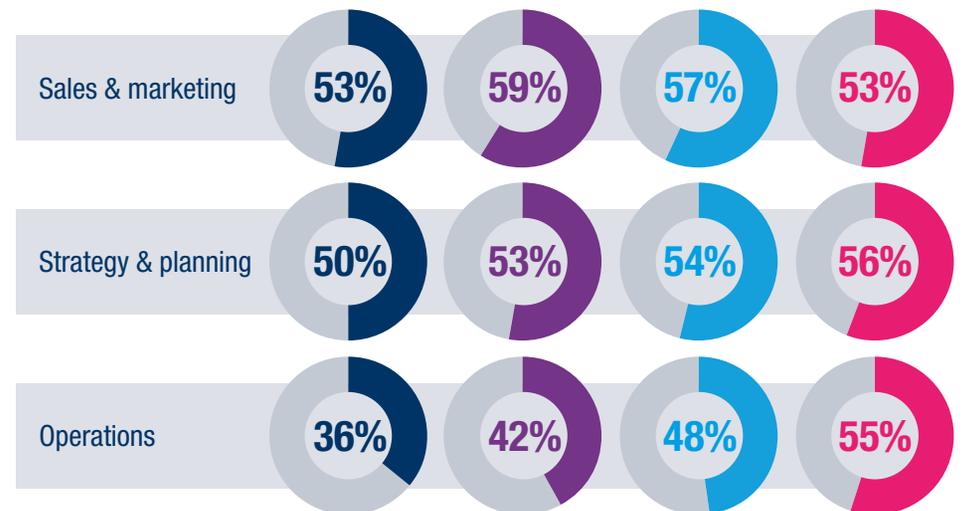
Today

Q: To what extent has digitization changed the following areas of your organization? *“Substantially” and “It has been transformative” responses combined*



In the next two years

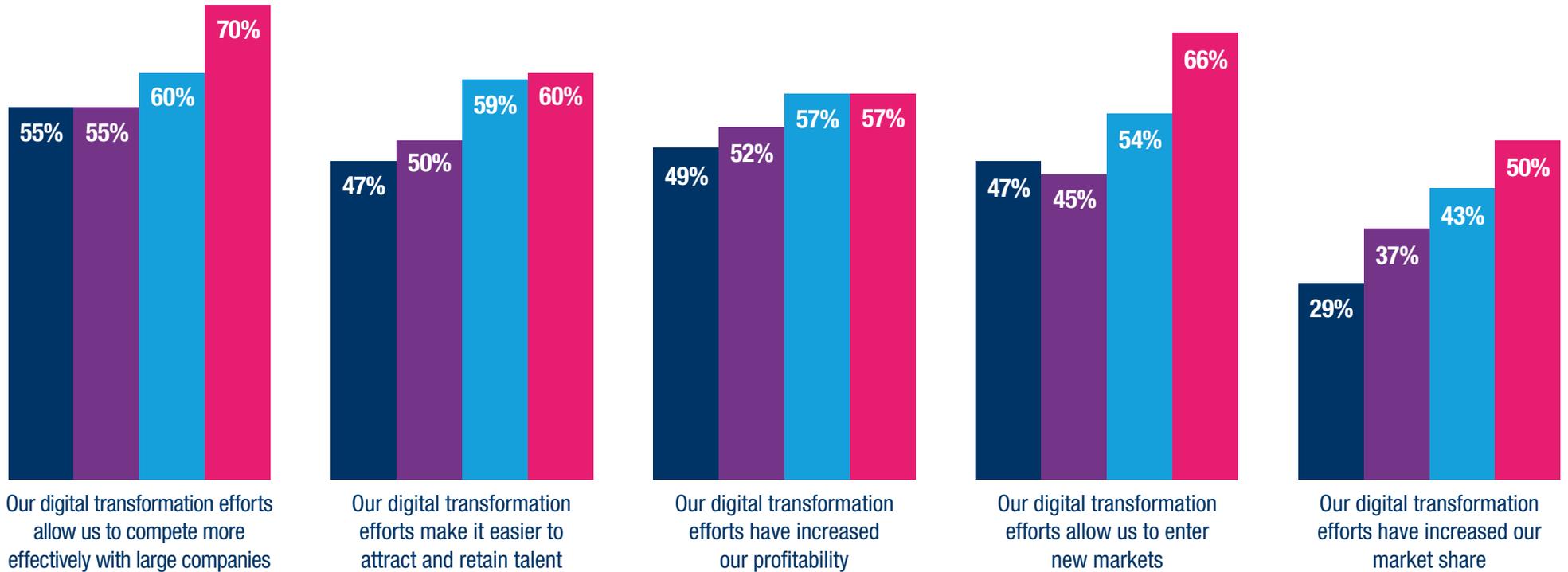
Q: To what extent do you expect digitization to change the following areas of your organization in the next two years? *“Substantially” and “It has been transformative” responses combined*



Digitization has already given some small and midsize companies a competitive edge

Q: To what extent do you agree with the following statements about the impact of your digital transformation efforts?
 “Agree” and “Strongly agree” responses combined

■ \$100m–\$249.9m ■ \$250m–\$499.9m ■ \$500m–\$999.9m ■ \$1bn+



In many ways, top financial performers—those small and midsize companies with revenue growth and profit margin over 10% for the past two years—are currently on the same level as others. For example, they are roughly as likely as others to say digitization has already affected their business. But these top performers have a sunnier outlook on the future, expecting digitization to change various functions over the next two years, especially in areas like sales and marketing (75% of top-performing small and midsize companies report substantial or transformative change, vs. 56% of other SMEs), strategy and planning (70% vs. 52%), and operations (60% vs. 43%).

Conclusion

Small and midsize companies face many of the same challenges that larger enterprises do, including rethinking operations, products and services, and business models to compete in the digital economy.

And while many lack the monetary and talent resources of larger enterprises, they also have inherent advantages—such as the ability to make decisions quickly, take risks, and pivot the organization—that allow them to compete effectively in this environment. How can small and midsize companies leverage technology and digitization to capitalize on their strengths?

- Build a strong technology foundation that allows for continual improvement to operations, processes, and product and service development.
- Develop a strategic plan for workforce development, including recruitment, reskilling, and retention. Businesses may need to rethink their location or allow for more flexible work to ensure access to top talent.
- Think beyond IT. Successful transformation around digital technologies requires business units to work closely with IT on implementation and innovation. Specialized task forces within the company dedicated to transformation may help facilitate change.

About the research

Oxford Economics was commissioned by the SAP Center for Business Insight to conduct and analyze a survey of over 3,100 executives around the world about the opportunities and challenges facing companies as they attempt digital transformation. Fieldwork took place in 2017 by computer-assisted telephone interviewing.

Respondents come from 17 countries or regional groupings, with a significant sample of small, midsize, and large enterprises within each area. Geographies covered were Brazil, Mexico, Australia/New Zealand, Japan, Southeast Asia, India, Greater China, Canada, the US, Germany, Switzerland, Russia/Ukraine, France, the Nordics, the Netherlands, the UK, and the Middle East/North Africa. Companies surveyed represent a range of industries: manufacturing, retail, banking/insurance, healthcare, professional services, technology, consumer goods, the public sector, and wholesale distribution.

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