

# The new growth game: Beating the market with digital and analytics

A guide to how market beaters have  
embraced the Growth PASS: Precision,  
Agility, Speed, Scale

2019



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# Introduction

If you wanted to boil down the mindset of top growth leaders to its essence, it would be: “Grow or die.”

Revenue growth dominates how these leaders think and the decisions they make. They manage growth as a top priority and execute with discipline. This is as true when markets are good as when they’re bad.

So how do they do it? We’ve undertaken a multiyear program to answer that question. The findings have been intriguing. Growth winners use digital and analytics to build their Growth SPA (Speed, Precision, and Agility) in order to supercharge their growth engines and open new revenue paths. They use advanced analytics and digital tools to find pockets of growth at hypergranular levels and personalize go-to-market programs at scale. They’re agile in how they allocate resources, adjust prices, and shift spend to feed growth at scale. They embrace speed to test and learn in the market and automate processes to cut costs and improve customer experience at scale.

We also find that growth winners are master multipliers. While there are various pathways to growth, growth leaders combine Invest, Perform, and Create approaches to deliver multiples of impact.

With the economic picture in 2019 showing signs of slowdown, we believe that now is the time for companies to take a hard look at their growth agenda. That requires being systematic in developing an objective view of what kind of growth they need, focusing on building capabilities that get them to the next level, and putting in place an infrastructure to manage it with rigor.

This collection of recent articles is intended to help you make concrete choices about where to put your growth energies. We hope it spurs useful conversations and decisions in 2019.



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A person with short brown hair is seen from the back, looking out at a sunset over water. The sun is low on the horizon, creating a warm orange glow. The water reflects the light, and there are dark silhouettes of trees or buildings in the background.

# 1. Rethink growth

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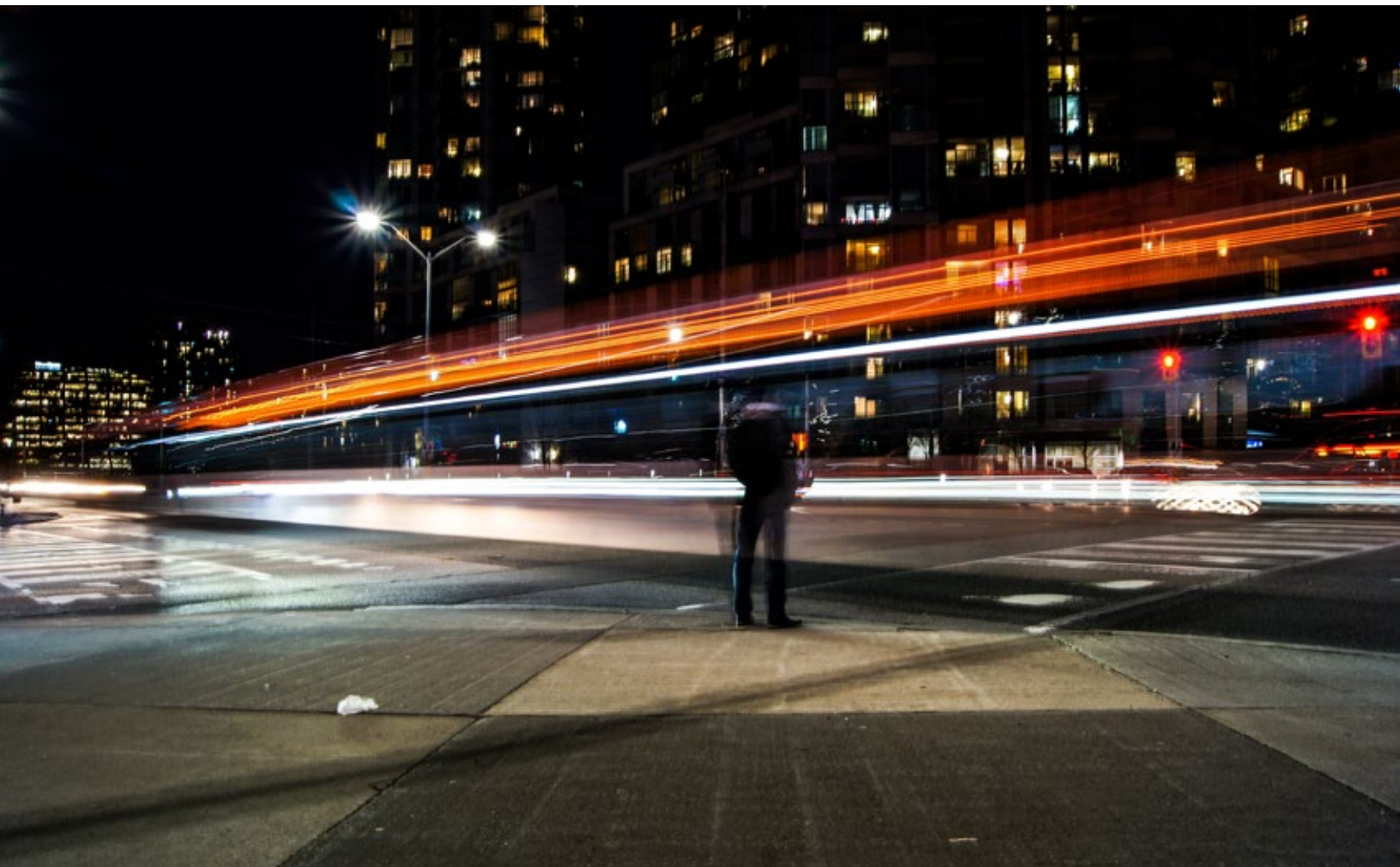


# Growing faster than the market:

## Three questions the C-suite should ask

Leaders who are most successful at driving growth in their organizations are deliberate, persistent, and disciplined in the way they go about it.

Biljana Cvetanovski, Eric Hazan, Jesko Perrey, and Dennis Spillecke



Growing a business is a matter of do or die. Consider the fate of the 100 largest companies on the New York Stock Exchange of 30 years ago. Among those that enjoyed strong shareholder returns but didn't post top-line growth, almost 50 percent had been acquired or delisted 20 years later.<sup>1</sup> Companies with high organic growth also return a better stock price.<sup>2</sup>

But growth is getting tougher in the face of new market dynamics: rising consumer expectations, increasing competition, and digital disruption. That has turned growth into more of a contact sport, rewarding businesses that can spot opportunities at hypergranular levels and then capture them quickly.

Most business leaders understand the need to change, but making it happen is easier said than done. In our experience, those leaders who are most successful at driving growth in their organizations are deliberate and disciplined in the way they do it. To help instill that approach, top growth leaders are methodical in asking and answering three crucial questions:

1. Where is my growth going to come from?
2. How do I grow now and tomorrow?
3. How do I set up my growth engine?

Let's take a closer look at these questions:

#### 1. Where is my growth going to come from?

There's no point optimizing your growth engine until you're clear about the opportunity you're going after. That means investing in sound analysis to identify where the growth is today and where it will be tomorrow, whether that's in your current sector or an adjacent one. Top growth leaders, once armed with a realistic picture of their company's growth situation, take care to set their priorities in the corporate mission, knowing growth initiatives can easily misfire if they aren't anchored in strategic

business priorities. In some cases, companies will articulate or refine their corporate mission and vision in line with what they learn about growth in their industry.

Leaders map a view of their growth initiatives across two dimensions:

- *Scanning for growth opportunities.* This involves understanding how your industry and category is structured, how customers navigate it, where the profit pools are, and what trends are emerging. Then you figure out how your portfolio stacks up against it all. When one leading global consumer-goods company analyzed a set of critical factors—projected market size, proportion of nonloyal shoppers, and ability to convert consumers—it identified untapped value pools worth almost \$100 million. Based on this analysis, it created a pipeline to tackle white spaces and new segments.<sup>3</sup>
- *Getting granular with customer segmentation.* Our research on revenue growth at large companies suggests that executives should “de-average” their view of markets and develop a granular perspective on trends, future growth rates, and market structures. Insights into subindustries, segments, categories, micromarkets, and even pockets of growth within existing large accounts are the building blocks of portfolio choice and a critical factor in making sound decisions about where to compete.<sup>4</sup> In the past few years, the use of advanced analytics to track behavior and preferences has made it possible to segment markets down to the level of individual customers. By pursuing mass personalization at scale, companies can lift revenues 5 to 15 percent while also improving the efficiency of their marketing spend and reducing acquisition costs.<sup>5</sup>



One car-rental company used advanced data-mining techniques to analyze its database of driver profiles and trips. Having identified ten distinct customer archetypes, it pulled in data from external sources to build a scoring model that it used to identify drivers in a given city or neighborhood who fit one of these archetypes. By tailoring offers and communications to individual archetypes, it managed to grow its customer base by more than 10 percent in a year, increasing revenues by almost 20 percent.

## 2. How do I grow now and tomorrow?

Every growth journey is different, but there are three broad fronts: Invest, Perform, and Create.<sup>6</sup> *Investing* in growth is something companies can start doing immediately by diverting funds from activities that are not performing efficiently or effectively into the right opportunities. *Performing* optimally in commercial functions allows companies to generate new revenues from growth in the medium term. And *creating* new offerings and business models custom-designed to satisfy unmet needs more completely, quickly, and flexibly than before enables companies to build a pipeline that fuels growth far into the future. The best companies use a combination of these three approaches to drive growth quickly, and reinvest released funds into future opportunities to support longer-term growth.

## Invest: Put your money where the growth is

Large companies can capture significant incremental revenue through a relentless search for efficiencies and then reallocating those resources to promising new initiatives or proven winners. McKinsey research shows that “dynamic reallocators”—companies that reallocate at least 49 percent of the previous year’s budget—achieve a compound annual growth rate of 10 percent in total return to shareholders (TRS). By contrast, “static allocators” that simply adjust last year’s spending achieve TRS growth of just 6.1 percent.<sup>7</sup> Within 20 years, the dynamic reallocator will be worth twice as much as its less agile counterpart—a lead that is likely only to increase as digital disruption and geopolitical uncertainty make nimble reallocation even more important.<sup>8</sup>

Central to this Invest approach is a thorough and rigorous approach to rooting out savings and a disciplined method of funneling funds to short- and long-term growth opportunities. Successful growth leaders have robust metrics and processes for identifying areas where they can squeeze out cost and a clear idea of where to invest every incremental dollar they find to drive growth.

Companies with the right mind-set can release tens or even hundreds of millions of dollars for

## CEO takeaways

- Start with a realistic picture of your company’s growth situation, and make sure you have a clear vision and mission to guide your decision making.
- Work out where to play by understanding customer trends and value pools in your current and adjacent categories, segments, and markets.

reinvestment in a matter of months by optimizing their commercial functions. Savings can be captured from many sources, such as general and administrative expenses, but marketing is a prime candidate. Many companies can save 10 to 20 percent of their marketing budgets by making processes leaner and more efficient, paying the right price for a given service (and paying only for what they really need), and figuring out who does the work. By breaking open the black box around agency fees, for example, companies can save money and improve agility and quality. By optimizing consumer promotions and engagement (CPE) through better targeting, simpler programs, and better measurement, they can save 10 to 30 percent of their marketing spend.<sup>9</sup>

Tracking marketing return on investment (MROI) helps companies identify underperforming marketing spend that can be reallocated to activities that deliver a better return on investment. Advanced analytics allows companies to measure the impact on customer behavior of offers and messages across multiple channels by combining media-mix modeling with digital-attribution modeling.

One European online retailer attracted 12 percent more active customers after reallocating internal and external resources, expanding its ecosystem of partners, and applying agile marketing approaches. It also implemented a customer-reactivation and -acquisition program and applied more rigor to MROI. Taken together, these initiatives enabled the retailer to raise its original growth target by a factor of six.

#### Perform: Optimize your commercial capabilities

Great growth companies constantly optimize their commercial capabilities in marketing, sales, pricing, and promotions. This approach helps to get much more growth from existing capabilities while also generating more revenue that can then be invested in growth opportunities.

Customer experience (CX) is one potent driver of growth. Successful CX enhancements can increase sales, facilitate cross-selling, and boost revenues by as much as 15 to 20 percent. One large European bank digitized its credit processes to slash its approval times for small and medium-sized enterprises (SMEs) lending from 20 days to less than ten minutes, far outpacing competitors. It increased win rates by a third and improved average margins by more than 50 percent.<sup>10</sup> Similarly, reducing the complexity of CX—for instance, by optimizing online self-help features such as FAQ pages so that customers don't have to make unnecessary calls to call centers—can free up savings in cost to serve on the order of 15 to 50 percent.

Introducing automated algorithm-driven dynamic pricing is another important source of growth. Companies can achieve sustainable price increases without damaging customer satisfaction by focusing resources on specific groups, such as more-profitable customers. Some global retail and consumer companies have achieved sales growth of 2 to 5 percent by this route, while also adding 5 to 10 percent to margins.<sup>11</sup> B2B businesses are adopting dynamic pricing too. After introducing a mix of new pricing approaches, redesigning its supporting organization and incentives, and training more than 300 frontline-sales staff, one global chemicals company achieved \$150 million per year in incremental revenue over three years.

Similar growth opportunities exist in sales. Adopting omnichannel sales and analytics can be a crucial enabler of growth for B2B companies that understand when and when not to use digital. These companies achieve five times more revenue than their peers, eight times more operating profit, and twice the return to shareholders.<sup>12</sup> Adopting new digital channels can reduce the cost to acquire a new customer and the cost to serve an existing one, changing the commercial efficiency of the future channels that can be reinvested into current or new



opportunities. From our research and experience, three traits have emerged that should be core ingredients of every company's optimal human-digital blend: speed, transparency, and expertise.

### Create: Innovate by design with the customer at the center

To build things that customers want, a business needs to out-innovate its competitors—not just uncovering unmet customer needs to find profitable white spaces but also using technology to enter new markets or go to market in new ways. Yet a recent McKinsey survey found that just 27 percent of companies systematically scan for opportunities to expand beyond their core business.<sup>13</sup>

New sources of growth come from redesigning business models, creating something new, and exploring disruptive services. New business models don't have to be complex; they could involve tapping into new sales channels to reach different customers, for instance, or introducing new services to support an existing product.

When exploring new opportunities, winners go beyond standard focus groups and surveys and pull in data on macro trends, marketplace analyses, ground-level performance metrics, and a host of other sources. Thanks to digitally enabled techniques such as social listening, sentiment analysis, digital ethnography, and online-consumer cocreation, research into unmet needs is more effective, more flexible, and faster than ever before. Companies can assemble an online focus group of B2B buyers in as little as ten minutes. Mobile ethnographies can be completed in a weekend; quantitative surveys can be fielded and analyzed in days.

Having equipped themselves with a deep understanding of customer purchase journeys, leading companies employ design thinking to create

new products and services that will address unmet needs, reach unserved segments, or support entry into adjacent markets. At a time when consumers can choose from the best products that global marketplaces have to offer, design has become a key source of differentiation and a C-suite topic. Companies with scores in the top quartile of the McKinsey Design Index outperformed industry-benchmarked growth by as much as two to one.<sup>14</sup>

To help get ideas to market quickly, winning innovators increasingly rely on “speedboats”: small launches where a product is tested and refined in a real market setting. One global consumer-goods company has been testing products in nontraditional locations such as office buildings, juice shops, and yoga studios to gain insight into why consumers buy or don't buy them. Through multiple iterations, it uses the feedback to refine products until it sees indicators of success and then rapidly scales them. Today's companies can capitalize on this kind of approach because they have multiple distribution channels, digital channels, and social-media outlets at their disposal to reach consumers at low cost. They can also take advantage of external networks that support efficient and productive discovery and development.

The ability to scale up rapidly is critical to getting new products to market before competitors can. Leading consumer-goods innovators have reaped substantial rewards by scanning the market for promising ideas, watching for emerging consumer acceptance and new behaviors, and then jumping in before the market landscape has fully evolved. When we evaluated 25 high-growth categories in four countries in North and South America, Asia, and Europe, we found that companies that took this approach were growing faster than the market 60 to 80 percent of the time; in the US, they won the highest market share 80 percent of the time.<sup>15</sup>

## CEO takeaways

- Develop a clear view of exactly where you can squeeze out cost and where to invest each dollar you save for the greatest impact.
- Set aggressive targets for productivity and growth, and use analytics and capability building to optimize commercial levers.
- Adopt novel methods to probe unmet customer needs, employ design thinking to create innovative offerings, and scale up fast.

Merger & acquisition (M&A) functions can play an important role as well, though they need to become much more dynamic on reading the evolution of market trends, competitor moves, and the entry of new attackers. This requires greater focus on the return on capital in the current business areas and on future growth opportunities, and oftentimes an ecosystem of partners to deliver.

### 3. How do I set up my growth engine?

Markets shift, so businesses must keep finding and pursuing new sources of growth. To do that, they need a growth engine: an operating model underpinned by analytics and top talent, and built around the core blocks of organization-wide alignment, focused capability building, an agile culture, and a leadership mind-set.

To launch a growth transformation, the most important element will be dedicating sufficient resources and being rigorous in driving the process. That means putting in place a well-supported growth-transformation office that has the authority and resources to rigorously track and manage the transformation. It establishes a baseline and manages output to that baseline. This kind of central resource is crucial because it can drive and

coordinate change across the entire business. It also provides a stable backbone with well-oiled processes for tracking implementation, driving initiatives, removing barriers, and managing trade-offs for short-term earnings targets. Without a dedicated team in place, change tends to be piecemeal or incremental, which inevitably leads to impact far below expectations.

The transformation office has an important role in focusing on developing the right capabilities. McKinsey research has found that top growers beat their peers by differentiating themselves in key capabilities such as data and analytics, and by developing products, services, and processes such as agile working and cross-functional collaboration.<sup>16</sup> In developing those growth capabilities, our research has shown that it's crucial to sequence their development thoughtfully. If you are moving from the bottom to the third quartile, for example, you might focus on aligning priority markets, building a product strategy and portfolio, and systematically measuring the voice of your consumer. If you move from the second to the top quartile, some examples of capabilities to develop include improving core offerings, introducing innovation awards, or

## CEO takeaways

- Build alignment on your growth effort across the organization by telling a compelling growth story and role modeling the change you want to see.
- Pay close attention to evolving capability needs, sequence them based on where your company is on the growth curve, and be ready to reinvent the way your organization works.
- Constantly ask yourself and your people: How will this conversation/decision/action help us grow?

improving processes to shorten commercialization cycles.

Developing these capabilities clearly has implications for talent and skills. Recent research by the McKinsey Global Institute found that digitization and automation are beginning to make new demands on workforce skills, with marketing and sales likely to be among the functions most affected. Up to 40 percent of sales activities can be automated with today's technology, and that number can go up to 50 percent as technology advances. Overall, the greatest need will be for advanced technological capabilities and basic digital skills, followed by social and emotional skills.<sup>17</sup>

For new capabilities to take full effect, businesses need to reinvent how work gets done. That means making offices more like workshops, with employees working together to build something great. A McKinsey survey reported that 71 percent of high-growth companies have adopted agile processes such as scrum, sprints, cross-functional collaboration, and colocated teams.<sup>18</sup>

Agile ways of working need to become a fact of life, embedded in every aspect of a company's operating

model from innovation and product development through to marketing. Indeed, agile approaches are critical in enabling companies to target micro-markets, test ideas at speed, run hundreds of campaigns simultaneously, personalize offers on a truly granular scale, use data to drive decisions, and maximize MROI. This applies to embedding design thinking into how companies work. One major European furniture manufacturer employed both a central design department and small independent design teams working within product groups. It found the distributed teams had a clearer focus on customers and better cross-functional partnerships. They were 30 percent more successful in getting concepts to market and 10 percent faster in time to launch.<sup>19</sup>

The final piece of the growth puzzle is a leadership mind-set. Top growth leaders are obsessed with growth and committed to keeping their business on a growth trajectory. They have a key role in developing a well-crafted story to help people at all levels understand what changes are in store, what the company is striving to create, and how new ways of working will affect what they do every day. Then they must communicate that clearly and continuously to the organization. They are also disciplined in the



way they go about orienting the business to growth, constantly asking themselves and their peers questions such as:

- Do I use language that emphasizes growth rather than productivity?
- Do I and my top team role model the behavior we want to see from our employees?
- Should I carve out a lighthouse organization that focuses purely on growth?



**Growth today drives not just performance, but survival itself. The companies with the brightest prospects are those that know where to find pockets of growth, how to capture that growth now and in the future, and how to build a growth engine for sustainable success. ■**

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<sup>1</sup> McKinsey analysis.

<sup>2</sup> Marc Goedhart and Tim Koller, "The value premium of organic growth," McKinsey & Company, January 2017.

<sup>3</sup> The Growth Opportunity Scanner is a proprietary McKinsey solution that maps market, category, and competitors and identifies opportunities for growth.

<sup>4</sup> Patrick Viguerie, Sven Smit, and Mehrdad Baghai, *The Granularity of Growth*, Marshall Cavendish/Cyan, 2007.

<sup>5</sup> Brian Gregg, Hussein Kalaoui, Joel Maynes, and Gustavo Schuler, "Marketing's Holy Grail: Digital personalization at scale," McKinsey & Company, November 2016.

<sup>6</sup> Kabir Ahuja, Jesko Perrey, and Liz Hilton Segel, "Invest, Create, Perform: Mastering the three dimensions of growth in the digital age," McKinsey & Company, March 2017.

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<sup>13</sup> "Growing beyond the core business," McKinsey & Company, July 2015.

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<sup>16</sup> Kabir Ahuja, Jesko Perrey, and Liz Hilton Segel, "Invest, create, perform: Mastering the three dimensions of growth in the digital age," McKinsey & Company, March 2017.

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# The roots of organic growth

There are many paths to growth, and high performers take more than one—supported by reinforcing capabilities such as advanced analytics and digital customer-experience management.

Kabir Ahuja, Liz Hilton Segel, and Jesko Perrey





Growth is a tonic for most companies. It attracts talent and creates strategic options while generating financial resources to fund new moves—provided the growth is profitable. It's also been harder to come by over the past decade, as a sluggish macroeconomic environment and accelerating, technology-driven disruption have ratcheted up pressure on businesses.

Digital technologies and the pace of competition, however, also open new avenues to organic growth for those companies that have the capabilities and dexterity to take advantage of them. Today's fastest growers, for example, price products in real time; they create meaningful and positive customer experiences with digital interactions; and they refine products continually with customer feedback. To understand the relationship between organic growth approaches, capabilities, and performance in this environment, we recently surveyed approximately 600 executives at leading companies in the European Union and North America.<sup>1</sup> We found that companies exhibit three basic growth tendencies; that an approach combining two or more of these holds particular power in driving growth; that advanced analytics is an ingredient of standout growth; and that success depends on nurturing a set of reinforcing capabilities that fit the growth approach.

### Three growth profiles

The corporate growth goals and the behavior tracked by our survey show that companies can be described as having three broad growth profiles.

**Investors** have a clear understanding of sources of growth from existing products and services and squeeze funds from a variety of areas, such as low-growth initiatives or unproductive costs, to reallocate capital and double down on winners.

**Creators** build value by developing new products, services, or business models. And **performers**

grow by constantly optimizing core commercial capabilities in sales, pricing, and marketing.

Understanding each profile is helpful because leaders tend to fall back on what has worked for them in the past, and this can often blind them to new growth opportunities. In our experience, companies that carefully evaluate each growth profile, and make choices based on the strategic fit, will increase their chances of achieving above-market growth rates.

### The power of the diversified approach

While approximately 60 percent of those surveyed identified one of the approaches as their primary source of growth, the largest group in our sample—representing about 40 percent of companies surveyed—were those that diversified their organic growth portfolio. A disproportionate number of the companies that grew significantly—at 4 percent greater than the rate of their sector's over the past three years—were in this group.

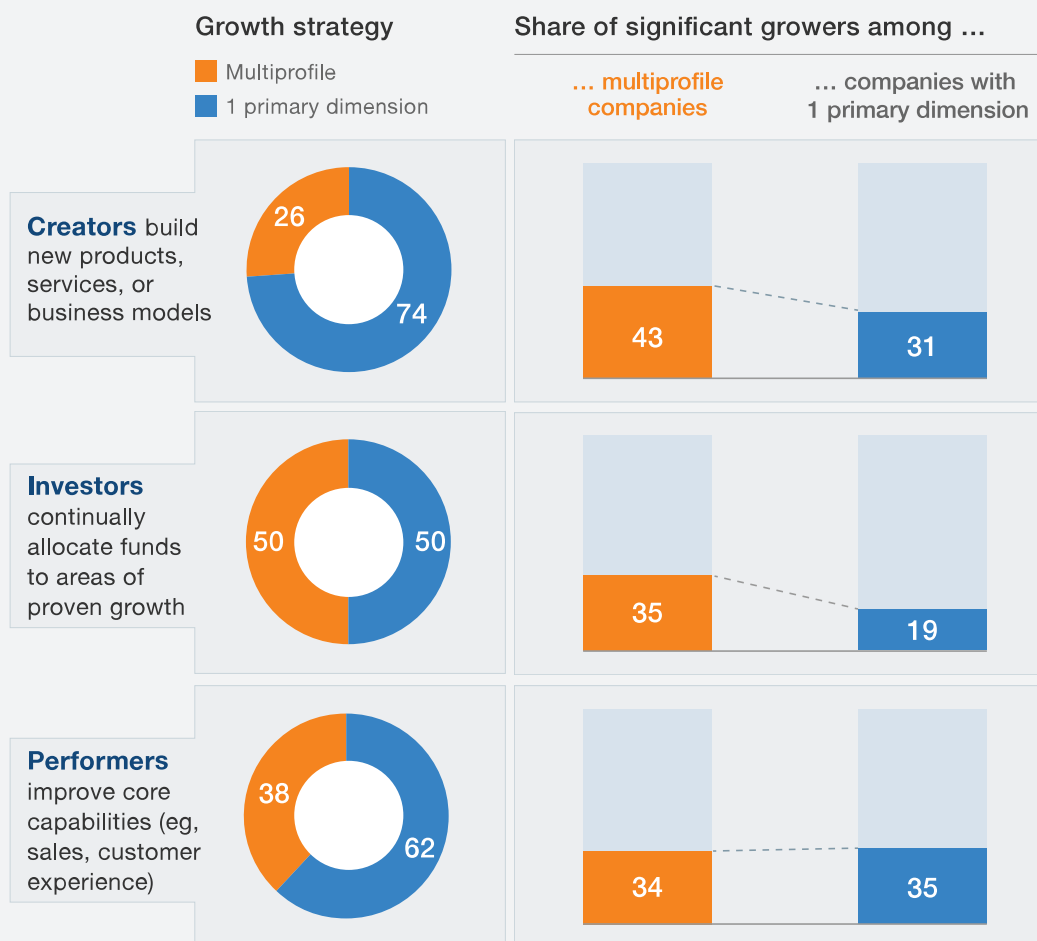
These results make intuitive sense: companies creating new products or services frequently need to reallocate capital so they can place their bets, while an exceptional sales force or top-flight marketing team can accelerate a variety of new product or service initiatives. Our analysis further showed that companies exhibiting strong investor and creator tendencies particularly benefited from a diversified approach to changing their growth trajectory (Exhibit 1).

### The potential of advanced analytics

Across all the growth lenses, we found significant potential for an upside in advanced analytics. As Exhibit 2 shows, even at today's low levels of penetration, advanced-analytics capabilities were strongly associated with the highest levels of growth, suggesting they will be a critical platform for the next generation of performance.



**Exhibit 1 When creators and investors embrace one or more additional growth profiles, they boost their odds of becoming top-tier growers.**



Source: 2017 McKinsey survey of 573 executives in European Union and North America

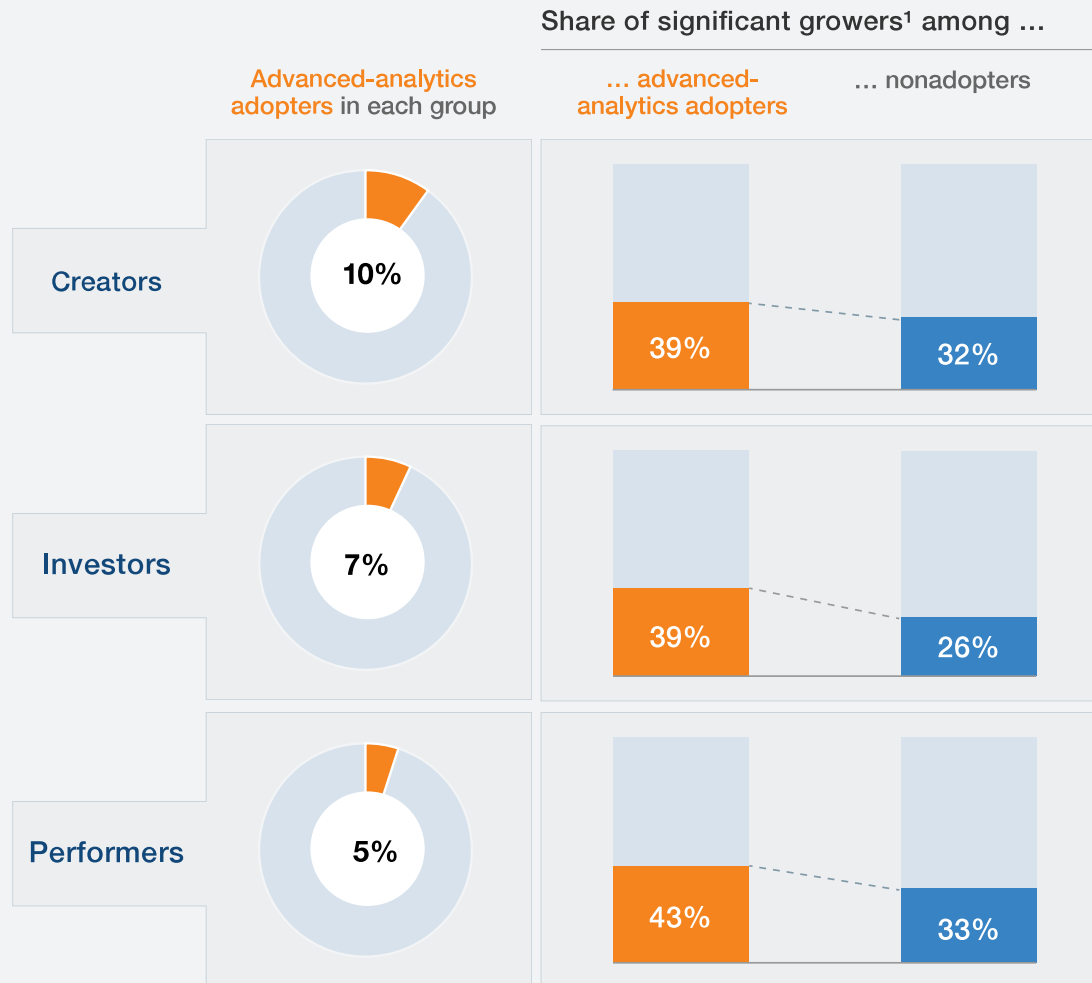
**The importance of reinforcing capabilities**

Like a triathlete who needs to develop different sets of muscles to effectively compete, delivering on a diversified growth strategy requires building the right reinforcing capabilities. Our research indicated that there are table stakes for growers across all dimensions: nimble resource reallocation, effective branding, and growth-oriented organizational culture. There were other

areas that, predictably, seemed more tightly linked with individual strategies. Sales and pricing were key to faster-growing performers while the ability to develop products and services differentiated investors and creators.

These capabilities, combined with an understanding of the options for activating growth, are fundamental to building up a company's growth

**Exhibit 2 Few companies have strong advanced-analytics capabilities, but those that do exhibit higher levels of growth.**



<sup>1</sup>Companies with 4% greater growth rate than their sector's over past 3 years.

Source: 2017 McKinsey survey of 573 executives in European Union and North America

DNA. And, as our research shows, a purposeful approach across a diverse portfolio of growth strategies increases the odds of success. ■

**Kabir Ahuja** is a partner in McKinsey's Stamford office, **Liz Hilton Segel** is a senior partner in the New York office, and **Jesko Perrey** is a senior partner in the Düsseldorf office.

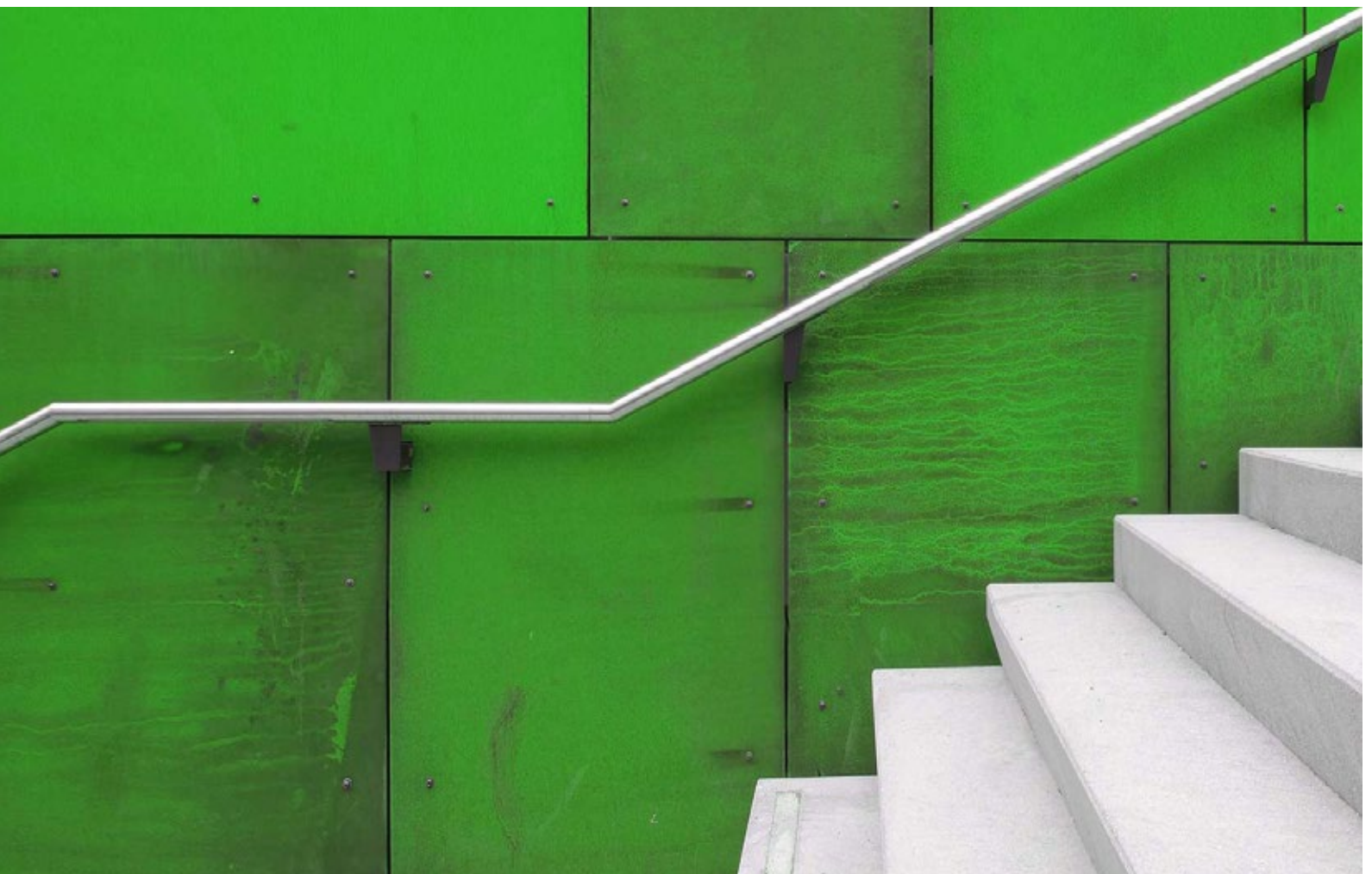
<sup>1</sup> We asked companies to determine their growth strategy, providing the option of choosing more than one. We then asked respondents to indicate how much each strategy contributed to their growth in percentage terms.

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# Choosing the right path to growth

To boost organic growth, most companies need a diverse set of initiatives—and how you sequence them matters.

Abhinav Goel, Duncan Miller, and Ryan Paulowsky





Innovation and growth are often lumped together as management concepts, for good reason: it's self-evident that innovation drives growth, and conspicuous fast growers often benefit from high-profile innovations. Our research, however, suggests growth-minded companies stand to benefit by disaggregating the two concepts. There are, in fact, multiple paths to growth, and the most common growth characteristics among above-average growers often aren't related to innovation. Significant as well, companies aspiring to the highest levels of growth need to sequence their initiatives carefully. Put differently: you probably can't do everything at once.

### How many levers?

In earlier research, we explored three broad profiles that describe how companies achieve organic growth.<sup>1</sup> “Investors” tap new sources of funding or reallocate existing funds to capture new growth for their goods and services. “Creators” build business value with new products or through business-

model innovation. “Performers” grow by steadily optimizing commercial functions and operations. Our latest findings suggest that focusing on two of these growth levers simultaneously will spur growth more effectively than emphasizing one.<sup>2</sup>

In fact, we found that more than three-quarters of companies that mastered two or more levers grew faster than their industry (Exhibit 1). This makes intuitive sense; combining two approaches allows for synergies that can multiply impact. Companies with strong reallocation practices (investors), for example, can provide managers with the needed additional resources to optimize higher-potential assets (performers). Too often, this sort of helpful one-two punch is the exception: companies instead tend to emphasize what worked in the past, and thus to rely too heavily on a single lens—which leaves potential growth on the table.

What about three levers? In some sense, it's the gold standard; a healthy proportion of top-growth-

Exhibit 1

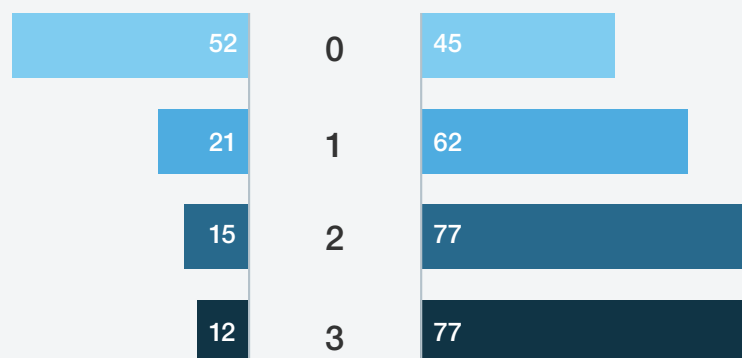
**Few organizations follow more than one approach ...**

**... yet those that do are more likely to beat their industry's average.**

% of respondents citing mastery of approach (n = 1,306)

Number of approaches

% of companies placing in top 2 quartiles for growth



quartile companies were investors, performers, and creators.<sup>3</sup> That said, executing on every front simultaneously is more than many companies can handle. That's particularly the case for large organizations, where complexity tends to multiply as growth initiatives proliferate.<sup>4</sup>

### The power and limitations of innovation-led growth

Creative companies are more heavily represented among the fastest growers. And the ability to innovate consistently appears to separate the good growers in the second quartile from exceptional ones in the top quartile. We found that exceptional growers were 56 percent more likely to have mastered creative practices (that is, reached the 70 percent successful adoption level) than the second-quartile firms (Exhibit 2).

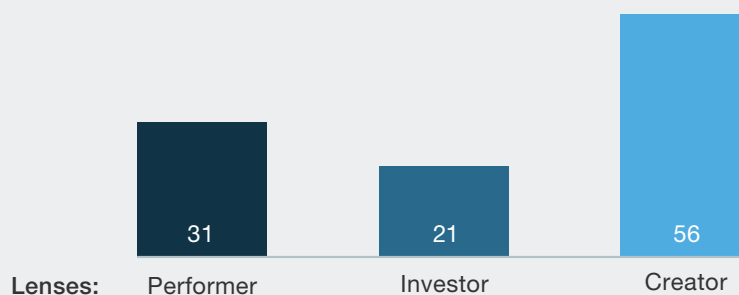
What's also true, however, is that it's hard to get innovation right: nearly half of all the companies

surveyed were weakest in creative practices, while fewer than one in five said innovation was an area of greatest strength. In addition, our research suggests that the pursuit of innovation is not the surest way to move into the top-growth tiers. Rather, the most prevalent practices among above-average growers reflected mastery of core investor and performer levers (Exhibit 3). Three of the top five practices characterizing upper-tier growers were related to investing: aligning on priority markets, engaging in portfolio management informed by prospective returns, and overseeing resources top down. Two more were tied to performing: developing high-value customer development across business units and measuring the voice of customers. The prevalence among high performers of strengths related to smart resource allocation and strong commercial performance suggests that they are more than mere table stakes for growth and that executives should not take them for granted, even if they seem rudimentary.

## Exhibit 2 Innovative companies that have mastered creative capabilities are more heavily represented among the fastest growers.

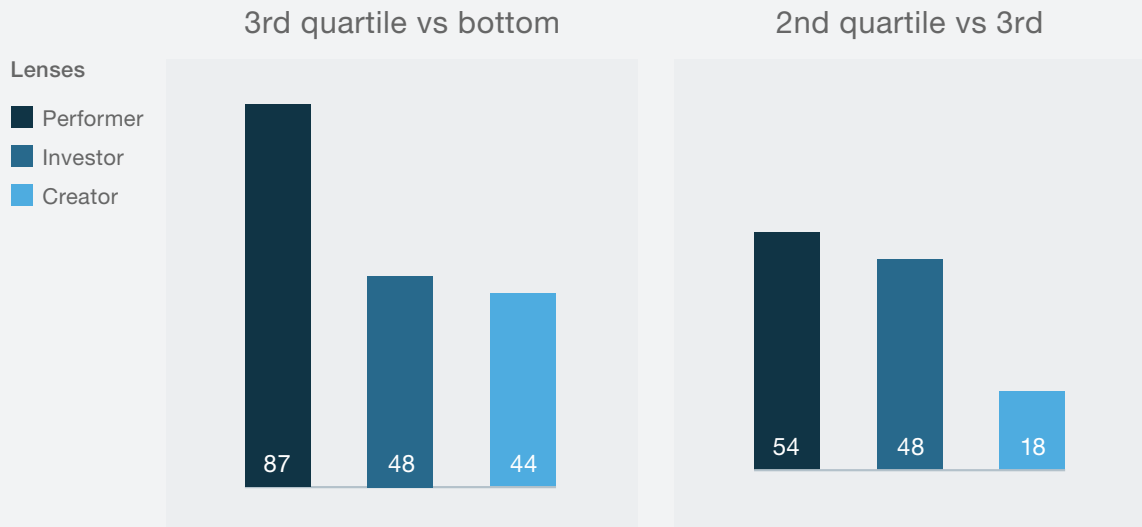
Companies' likelihood to have mastered a lens compared with those in a lower quartile, %

Top quartile vs 2nd



**Exhibit 3 Third-quartile companies emphasized performance, while those in the second quartile worked equally on performance and investment.**

Companies' likelihood to have mastered a lens compared with those in a lower quartile, %



**Sequencing the growth journey.**

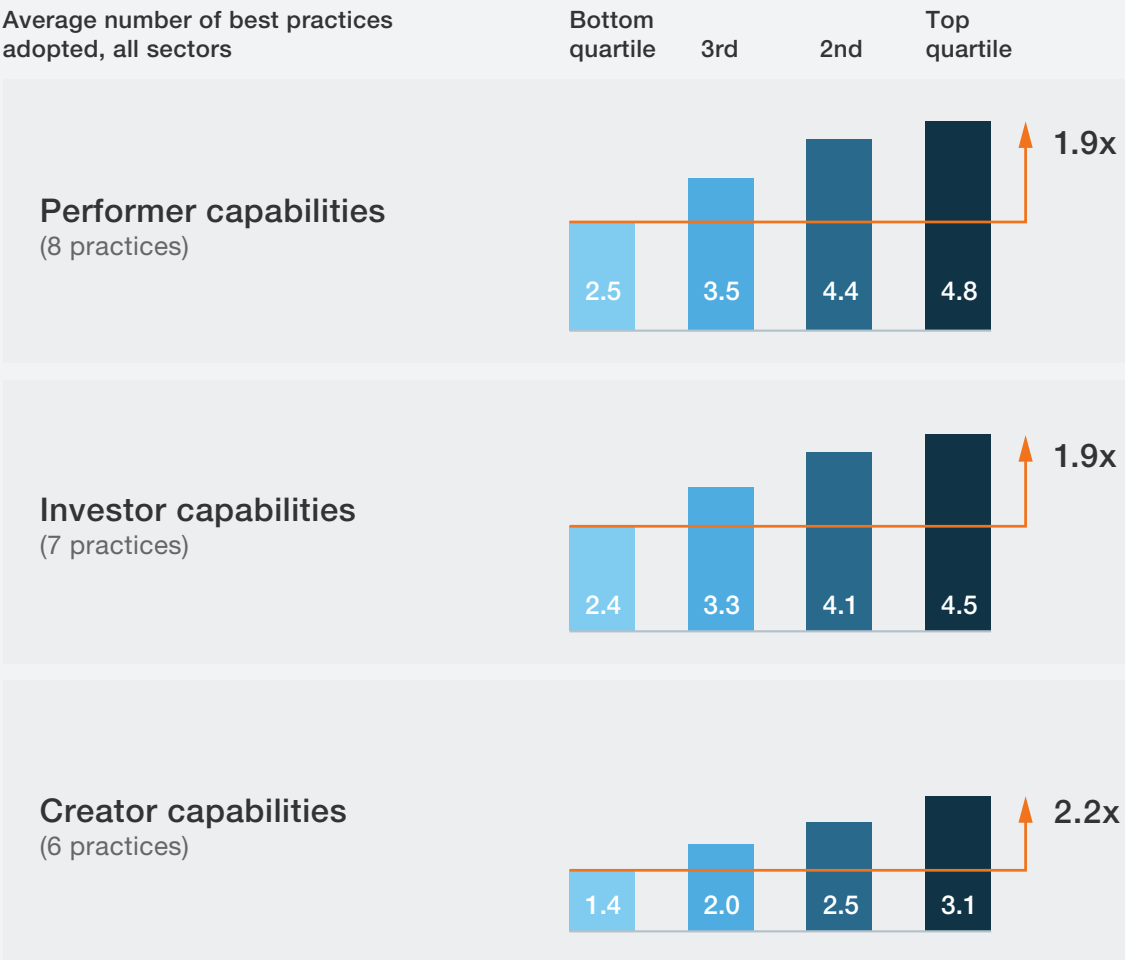
Moving your growth journey forward in a structured way will sidestep a common trap that we have observed: pushing growth and product initiatives almost haphazardly in hopes of jump-starting a strategy. Instead, companies need a more deliberate, stepwise approach to building growth initiatives and capabilities. While there is no iron law of sequencing, the data are clear that a steady pace of change is vital: we found a positive correlation between the number of growth best practices adopted by a company and the company's growth-performance quartile (Exhibit 4). Across all companies surveyed, we found that employing two additional practices, on average, correlated with an organic-growth edge ranging from one to three percentage points. Companies that regularly fine-tune and add to their capabilities appear to improve their odds of generating steady performance gains, providing additional resources

that leaders can reallocate, as needed, to further their growth agenda.

Getting this right, in our experience, goes hand in hand with rigorous initiative and performance management, which includes rallying organizational support for growth priorities; supporting them with capability building, incentives, and cultural change; and looking for opportunities to exploit synergies among new business initiatives. That's the path a global manufacturer is following as it strives to shift its growth performance in critical markets from lagging to leading. The company has started by upgrading the effectiveness of its transactional pricing, marketing tactics, and core sales force—priorities that, leaders believe, will help it hold its own against rivals. Looking forward, the senior team is studying more ambitious initiatives to accelerate growth, surpass competitors, and increase market



Exhibit 4 **Higher rates of best-practice adoption are correlated with higher growth-performance quartiles.**



share. One avenue, for example, would boost the use of advanced data analytics, to gather deeper insights on customer-procurement practices and emerging product preferences. Those data and greater mobilization across functions would help managers uncover and share insights about untapped growth opportunities. Margin improvements from the initial steps would provide the means, confidence,

and capabilities for more innovative efforts. Sales teams, R&D, and product-development functions, for example, would be able use the data-driven knowledge about customers and markets to collaborate more closely on new, higher-margin offerings aimed at nascent customer preferences.



Growth is difficult, but our research shows that it's possible to bring a disciplined approach to improving your growth trajectory. Build momentum through well-sequenced initiatives. Support them with the right capabilities. And get your organization on board with a multifaceted approach that often will rest on a strong foundation of resource allocation and execution before taking on the tougher discipline of innovation. While this may challenge some traditional growth tenets, it also offers a reason to start moving—with confidence. What you do well today prepares the way for the next leg of the climb. ■

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The authors wish to acknowledge Kabir Ahuja, Darin Bellisario, Kate Siegel, and Lisa Yu for their contributions to this article.

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<sup>1</sup> See Kabir Ahuja, Liz Hilton Segel, and Jesko Perrey, "The roots of organic growth," *McKinsey Quarterly*, August 2017, McKinsey.com. In related research, McKinsey looked at the share-price performance of 500 US and European companies over 15 years, which showed that for all levels of revenue growth, those with more organic growth generated higher shareholder returns than those whose growth relied more heavily on acquisitions. For more, see Marc Goedhart and Tim Koller, "The value premium of organic growth," January 2017, McKinsey.com.

<sup>2</sup> We studied dozens of corporate-growth programs and paired those findings with insights from a panel of approximately 1,500 managers and executives globally, across 17 industries. We surveyed executives on 36 practices and capabilities that supported their growth strategies. About half were foundational capabilities such as contract management and transactional pricing. The rest were advanced capabilities that supported the three key levers or approaches: creativity (6), investment (7), and performance (8). We defined mastery of an individual lever as successful adoption of 70 percent of the supporting practices.<sup>3</sup> Top-quartile (exceptional) growth beats industry growth rates by more than four percentage points.

<sup>3</sup> Top-quartile (exceptional) growth beats industry growth rates by more than four percentage points.

<sup>3</sup> Fewer than 15 percent of executives in our survey said they were in the top quartile for mastery of all three levers.

# The value premium of organic growth

Beware of letting acquisitions take priority over organic growth.

Marc Goedhart and Tim Koller





It's not surprising that many executives think about growth primarily in terms of acquisitions. For some, opportunities to grow organically are limited, especially in maturing or contracting product markets. Others are drawn to the allure of high-profile deal making, with its virtually instant boost to revenues and often earnings per share as well.

But executives shouldn't underestimate the power of organic growth. It may take more time and effort to affect a company's size, but organic growth typically generates more value. A look at the share-price performance of 550 US and European companies over 15 years reveals that for all levels of revenue growth, those with more organic growth generated

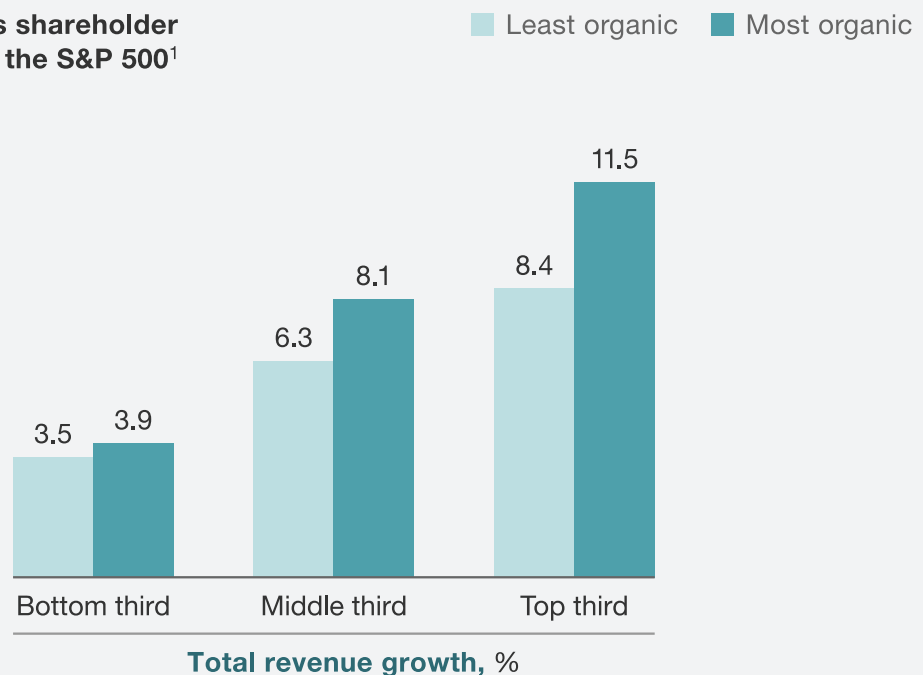
higher shareholder returns than those whose growth relied more heavily on acquisitions<sup>1</sup> (exhibit). The main reason is that companies don't have to invest as much up front for organic growth.<sup>2</sup> In growing through acquisition, companies typically have to pay for the stand-alone value of an acquired business plus a takeover premium. This results in a lower return on invested capital compared with growing organically.

We often see companies pass up organic-growth opportunities because they take longer to boost earnings than acquisitions do. But, given an option, they should probably tip the balance toward what they can achieve organically. ■

Exhibit

**At comparable total growth levels, companies with more organic growth outperform those with more growth from acquisitions.**

**Annualized excess shareholder returns relative to the S&P 500<sup>1</sup>**  
1999–2013, %



<sup>1</sup>Excludes banks, insurance companies, extraction companies, and cyclical commodities.

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<sup>1</sup> We grouped 550 large US and European companies into thirds based on total revenue growth. We then ranked the companies in each tercile by their increase in goodwill and intangibles as a proxy for acquired growth, and again broke them into thirds based on their level of acquired growth. We then compared the median TRS for each of the nine groups. Since our proxy is imprecise, the chart shows the TRS only for those companies with the most and least organic and acquired growth. The sample excludes the banking and insurance sectors, which severely underperformed in this period because of the 2008 financial crisis. It also excludes the extraction and commodity sectors because their

<sup>2</sup> There is a selection bias in our sample: not all companies that invest in organic growth actually realize that growth.

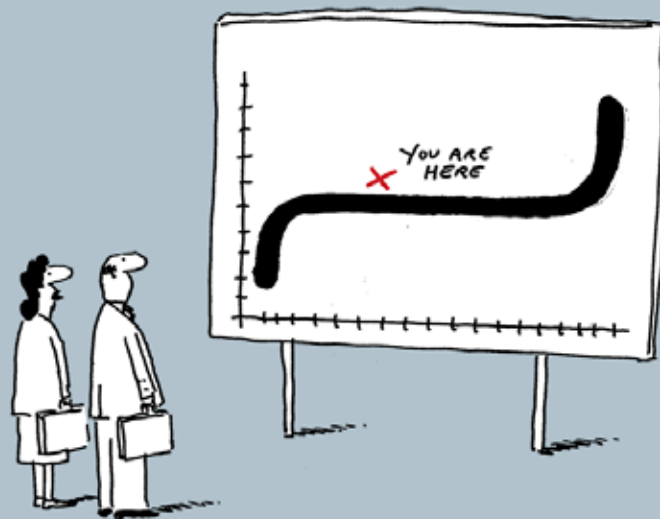
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# Strategy to beat the odds

If you internalize the real odds of strategy, you can tame its social side and make big moves.

Chris Bradley, Martin Hirt, and Sven Smit





Several times a year, top management teams enter the strategy room with lofty goals and the best of intentions: they hope to assess their situation and prospects honestly, and mount a decisive, coordinated response toward a common ambition.

Then reality intrudes. By the time they get to the strategy room, they find it is already crowded with egos and competing agendas. Jobs—even careers—are on the line, so caution reigns. The budget process intervenes, too. You may be discussing a five-year strategy, but everyone knows that what really matters is the first-year budget. So, many managers try to secure resources for the coming year while deferring other tough choices as far as possible into the future. One outcome of these dynamics is the hockey-stick projection, confidently showing future success after the all-too-familiar dip in next year's budget. If we had to choose an emblem for strategic planning, this would be it.

In our book, *Strategy Beyond the Hockey Stick* (Wiley, February 2018), we set out to help companies unlock the big moves needed to beat the odds. Another strategy framework? No, we already have plenty of those. Rather, we need to address the real problem: the “social side of strategy,” arising from corporate politics, individual incentives, and human biases. How? With evidence. We examined publicly available information on dozens of variables for thousands of companies and found a manageable number of levers that explain more than 80 percent of the up-drift and down-drift in corporate February 2018 2 performance. That data can help you assess your strategy's odds of success before you leave the strategy room, much less start to execute the plan.

Such an assessment stands in stark contrast to the norms prevailing in most strategy rooms, where discussion focuses on comparisons with last year, on immediate competitors, and on expectations for

the year ahead. There is also precious little room for uncertainty, for exploration of the world beyond the experience of the people in the room, or for bold strategies embracing big moves that can deliver a strong performance jolt. The result? Incremental improvements that leave companies merely playing along with the rest of their industries.

Common as that outcome is, it isn't a necessary one. If you understand the social side of strategy, the odds of strategy revealed by our research, and the power of making big moves, you will dramatically increase your chances of success.

### The social side of strategy

Nobel laureate Daniel Kahneman described in his book *Thinking, Fast and Slow* the “inside view” that often emerges when we focus only on the case at hand. This view leads people to extrapolate from their own experiences and data, even when they are attempting some-thing they've never done before. The inside view also is vulnerable to contamination by overconfidence and other cognitive biases, as well as by internal politics.

It's well known by now that people are prone to a wide range of biases such as anchoring, loss aversion, confirmation bias, and attribution error. While these unintentional mental shortcuts help us filter information in our daily lives, they distort the outcomes when we are forced to make big, consequential decisions infrequently and under high uncertainty—exactly the types of decisions we confront in the strategy room. When you bring together people with shared experiences and goals, they wind up telling themselves stories, generally favorable ones. A study found, for instance, that 80 percent of executives believe their product stands out against the competition— but only 8 percent of customers agree.<sup>1</sup>

Then, add agency problems, and the strategy process creates a veritable petri dish for all sorts of dysfunctions to grow.<sup>2</sup> Presenters seeking to get that allimportant “yes” to their plans may define market share so it excludes geographies or segments where their business units are weak, or attribute weak performance to one-off events such as weather, restructuring efforts, or a regulatory change. Executives argue for a large resource allotment in the full knowledge that they will get negotiated down to half of that. Egos, careers, bonuses, and status in the organization all depend to a large extent on how convincingly people present their strategies and the prospects of their business.

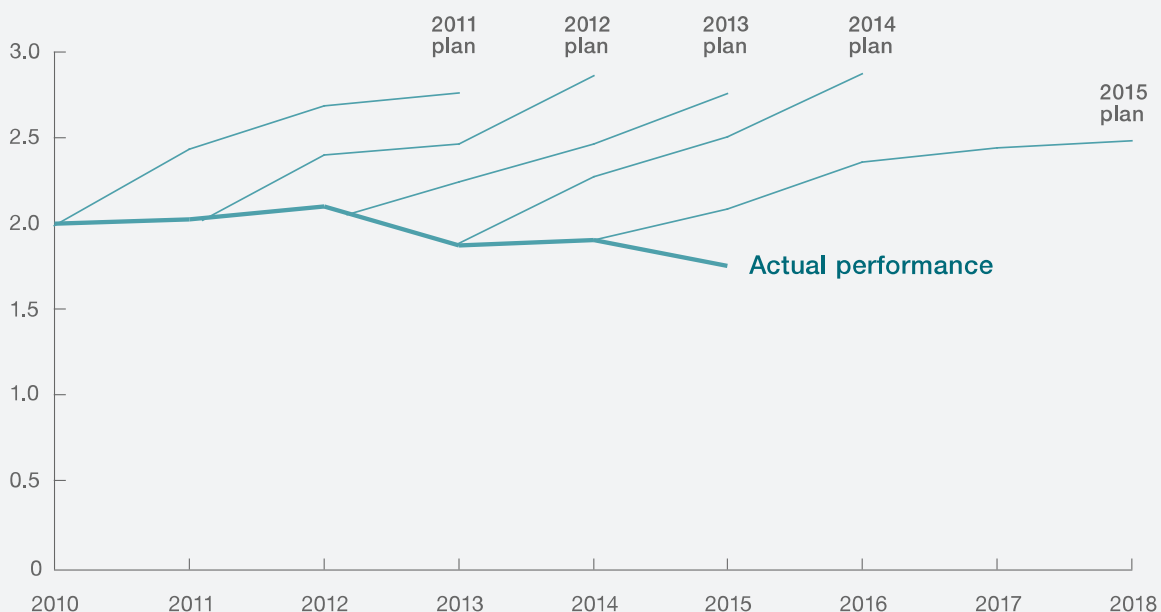
That’s why people often “sandbag” to avoid risky moves and make triple sure they can hit their

targets. Or they play the short game, focusing on performance in the next couple of years in the knowledge that they likely won’t be running their division afterward. Emblematic of these strategy-room dynamics is the hockey-stick presentation. Hockey sticks recur with alarming frequency, as the experience of a multinational company, whose disguised results appear in Exhibit 1, demonstrates. The company planned for a breakout in 2011, only to achieve flat results. Undeterred, the team drew another hockey stick for 2012, then 2013, then 2014, then 2015, even as actual results stayed roughly flat, then trailed off.

To move beyond hockey sticks and the social forces that cause them, the CEO and the board need an objective, external benchmark.

**Exhibit 1 One thing leads to another: Social dynamics and cognitive biases can lead to successive hockey sticks.**

EBITDA,<sup>1</sup> disguised example, \$ billion



<sup>1</sup>Earnings before interest, taxes, depreciation, and amortization.

### The odds of strategy

The starting point for developing such a benchmark is embracing the fact that business strategy, at its heart, is about beating the market; that is, defying the power of “perfect” markets to push economic surplus to zero. Economic profit—the total profit after the cost of capital is subtracted—measures the success of that defiance by showing what is left after the forces of competition have played out. From 2010 to 2014, the average company in our database of the world’s 2,393 largest corporations reported \$920 million in annual operating profit. To make this profit, they used \$9,300 million of invested capital,<sup>3</sup> which earned a return of 9.9 percent. After investors

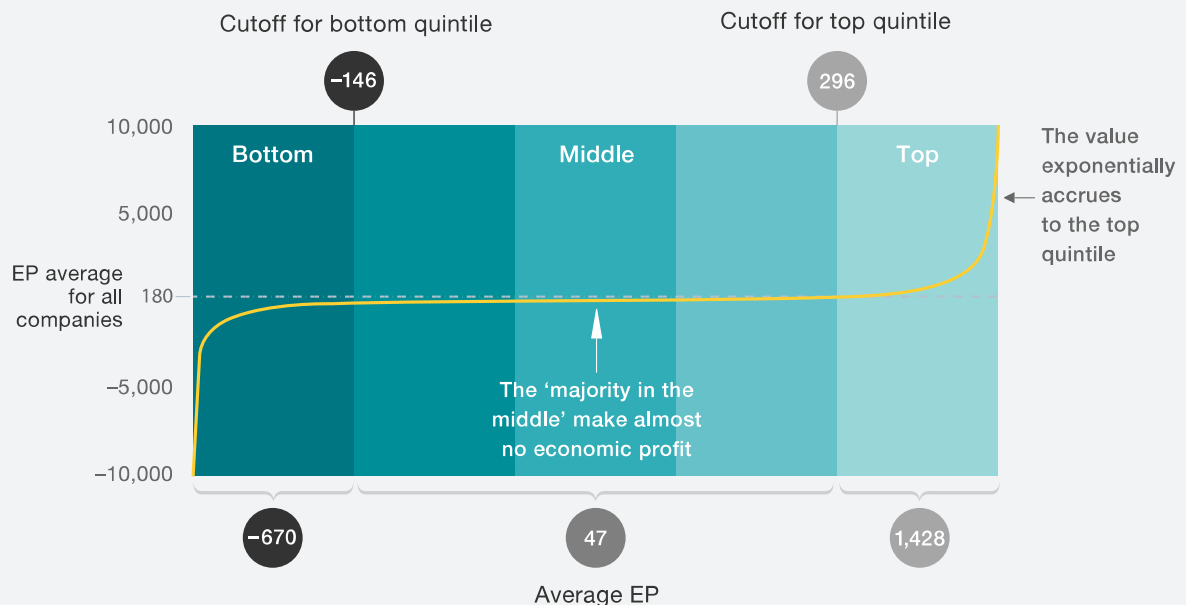
and lenders took 8 percent to compensate for use of their funds, that left \$180 million in economic profit.

Plotting each company’s average economic profit demonstrates a power law—the tails of the curve rise and fall at exponential rates, with long flatlands in the middle (Exhibit 2). The power curve reveals a number of important insights:

- **Market forces are pretty efficient.** The average company in our sample generates returns that exceed the cost of capital by almost two percentage points, but the market is chipping away at those profits. That brutal competition

## Exhibit 2 The power curve of economic profit: The global distribution of economic profit is radically uneven.

Average annual economic profit (EP) generated per company, 2010–14, \$ million, n = 2,393<sup>1</sup>



<sup>1</sup>Excluding 7 outliers (companies with economic profit above \$10 billion or below -\$10 billion).

is why you struggle just to stay in place. For companies in the middle of the power curve, the market takes a heavy toll. Companies in those three quintiles delivered economic profits averaging just \$47 million a year.

- *The curve is extremely steep at the bookends.*

Companies in the top quintile capture nearly 90 percent of the economic profit created, averaging \$1.4 billion annually. In fact, those in the top quintile average some 30 times as much economic profit as those in the middle three quintiles, while the bottom 20 percent suffer deep economic losses. That unevenness exists within the top quintile, too. The top 2 percent together earn about as much as the next 8 percent combined. At the other end of the curve, the undersea canyon of negative economic profit is deep—though not quite as deep as the mountain is high.

- *The curve is getting steeper.*

Back in 2000–04, companies in the top quintile captured a collective \$186 billion in economic profit. Fast forward a decade and the top quintile earned \$684 billion. A similar pattern emerges in the bottom quintile. Since investors seek out companies that offer market-beating returns, capital tends to flow to the top, no matter the geographic or industry boundaries. Companies that started in the top quintile ten years earlier soaked up 50 cents of every dollar of new capital in the decade up to 2014.

- *Size isn't everything, but it isn't nothing, either.*

Economic profit reflects the strength of a strategy based not only on the power of its economic formula (measured by the spread of its returns over its cost of capital) but also on how scalable that formula is (measured by how much invested capital it could deploy). Compare Walmart, with a moderate 12 percent return on capital but a whopping \$136 billion of invested

capital, with Starbucks, which has a huge 50 percent return on capital but is limited by being in a much less scalable category, deploying only \$2.6 billion of invested capital. They both generated enormous value, but the difference in economic profit is substantial: \$5.3 billion for Walmart versus \$1.1 billion for Starbucks.

- *Industry matters, a lot.*

Our analysis shows that about 50 percent of your position on the curve is driven by your industry—highlighting just how critical the “where to play” choice is in strategy. Industry performance also follows a power curve, with the same hanging tail and high leading peak. There are 12 tobacco companies in our research, and 9 are in the top quintile. Yet there are 20 paper companies, and none is in the top quintile. The role of industry in a company's position on the power curve is so substantial that it's better to be an average company in a great industry than a great company in an average industry.

- *Mobility is possible—but rare.*

Here is a number that's worth mulling: the odds of a company moving from the middle quintiles of the power curve to the top quintile over a ten-year period are 8 percent (Exhibit 3). That means just 1 in 12 companies makes such a leap. These odds are sobering, but they also encourage you to set a high bar: Is your strategy better than the 92 percent of other strategies?

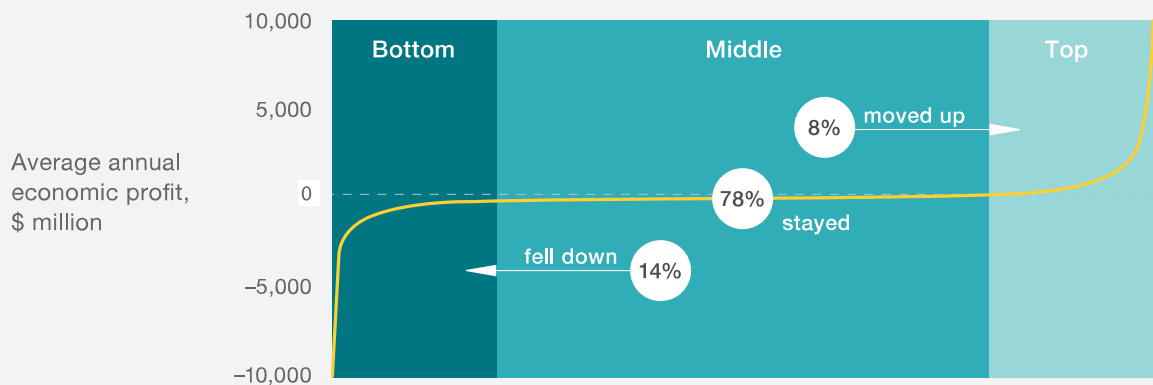
### **The power of big moves**

So what can you do to improve the odds that your company will move up the power curve? The answer is lurking in our data. Consider this analogy: To estimate a person's income, we can start with the global average, or about \$15,000 per year. If we know that the person is American, our estimate jumps to the average US per capita income, or \$56,000. If we know that the individual is a 55-year-old male, the estimate jumps to \$64,500. If that guy works in the



**Exhibit 3 What are the odds? Companies have an 8 percent chance of jumping from the middle to the top.**

% of companies staying in or moving out of middle 3 quintiles, n = 1,435



McKinsey & Company | Source: Corporate Performance Analytics by McKinsey

IT industry, it jumps to \$86,000. And if we know the person is Bill Gates, well, it's a lot more than that.

Adding ever more information similarly helps to zero in on the probabilities of corporate success. Even if you know your overall odds, you need to understand which of your attributes and actions can best help you raise them. We identified ten performance levers and, importantly, how strongly you have to pull them to make a real difference in your strategy's success. We divided these levers into three categories: endowment, trends, and moves. Your endowment is what you start with, and the variables that matter most are your revenue (size), debt level (leverage), and past investment in R&D (innovation). Trends are the winds that are pushing you along, hitting you in the face, or buffeting you from the side. The key variables there are your industry trend and your exposure to growth geographies. In analyzing the odds of moving on the power curve, we found

that endowment determines about 30 percent and trends another 25 percent.

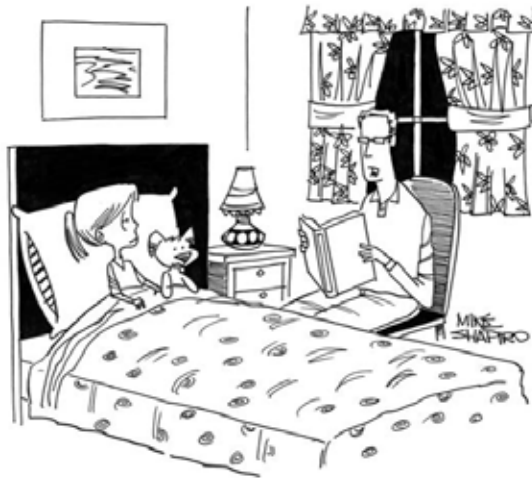
#### The moves that matter

However, it is your moves—what you do with your endowment and how you respond to trends—that make the biggest difference. Our research found that the following five moves, pursued persistently, can get you to where you want to go:

- **Programmatic M&A.** You need a steady stream of deals every year, each amounting to no more than 30 percent of your market cap but adding over ten years to at least 30 percent of your market cap. Corning, which over the course of a decade moved from the bottom to the top quintile of the power curve, shows the value of disciplined M&A. Corning understands that doing three deals a year means it must maintain a steady pipeline of potential targets,

conduct due diligence on 20 companies, and submit about five bids.

- **Dynamic reallocation of resources.** Winning companies reallocate capital expenditures at a healthy clip, feeding the units that could produce a major move up the power curve while starving those unlikely to surge. The threshold here is reallocating at least 50 percent of capital expenditure among business units over a decade. When Frans van Houten became Philips' CEO in 2011, the company began divesting itself of legacy assets, including its TV and audio businesses. After this portfolio restructuring, Philips succeeded at reinvigorating its growth engine by reallocating resources to more promising businesses (oral care and healthcare were two priorities) and geographies. Philips started, for example, managing performance and resource allocations at the level of more than 340 businessmarket combinations, such as power toothbrushes in China and respiratory care in Germany. That led to an acceleration of growth, with the consumer business moving from the company's worst-performing segment to its best-performing one within five years.
- **Strong capital expenditure.** You meet the bar on this lever if you are among the top 20 percent in your industry in your ratio of capital spending to sales. That typically means spending 1.7 times the industry median. Taiwanese semiconductor manufacturer Taiwan Semiconductor Manufacturing Company (TSMC) pulled this lever when the Internet bubble burst and demand for semiconductors dropped sharply. The company bought missioncritical equipment at the trough and was ready to meet the demand as soon as it came back. TSMC had been in a head-to-head race before the downturn but pulled clear of the competition after it ended because of its investment strategy. That laid the foundation for TSMC to become one of the largest and most successful semiconductor manufacturing pure plays in the world.
- **Strength of productivity program.** This means improving productivity at a rate sufficient to put you at least in the top 30 percent of your industry. Global toy and entertainment company Hasbro successfully achieved the top quintile of the power curve with a big move in productivity. Following a series of performance shortfalls, Hasbro consolidated business units and locations, invested in automated processing and customer self-service, reduced head count, and exited loss-making business units. The company's selling, general, and administrative expenses as a proportion of sales fell from an average of 42 percent to 29 percent within ten years. Sales productivity lifted, too—by a lot. Over the decade, Hasbro shed more than a quarter of its workforce yet still grew revenue by 33 percent.
- **Improvements in differentiation.** For business-model innovation and pricing advantages to raise your chances of moving up the power curve, your gross margin needs to reach the top 30 percent in your industry. German broadcaster ProSieben moved to the top quintile of the power curve by shifting its model for a new era of media. For example, it expanded its addressable client base by using a “media for equity” offering for customers whose business would significantly benefit from mass media but who couldn't afford to pay with cash. Some of ProSieben's innovations were costly, sometimes even cannibalizing existing businesses. But, believing the industry would move anyway, the company decided that experimenting with change was a matter of survival first and profitability second. ProSieben's gross margin expanded from 16 percent to 53 percent during our research period.



*"... The third little pig wanted to build a wolf-proof brick house. But the other two pigs thought that would take away resources from their budgets, so they talked him out of it right before the wolf killed all three of them."*

### Greater than the sum of the parts

Big moves are most effective when done in combination—and the worse your endowment or trends, the more moves you need to make. For companies in the middle quintiles, pulling one or two of the five levers more than doubles their odds of rising into the top quintile, from 8 percent to 17 percent. Three big moves boost these odds to 47 percent.

To understand the cumulative power of big moves, consider the experience of Precision Castparts Corp. (PCC). In 2004, the manufacturer of complex metal components and products for the aerospace, power, and industrial markets was lumbering along. Its endowment was unimpressive, with revenues and debt levels in the middle of the pack, and the company had not invested heavily in R&D. PCC's geographic exposure was also limited, though the aerospace industry experienced enormous tailwinds over the following ten years, which helped a lot.

Most important, however, PCC made big moves that collectively shifted its odds of reaching the top quintile significantly. The company did so by surpassing the high-performance thresholds on four of the five levers. For mergers, acquisitions, and divestments, it combined a high value and large volume of deals between 2004 and 2014 through a deliberate and regular program of transactions in the aerospace and power markets.

PCC also reallocated 61 percent of its capital spending among its three major divisions, while managing the rare double feat of both productivity and margin improvements—the only aerospace and defense company in our sample to do so. While nearly doubling its labor productivity, PCC managed to reduce its overhead ratio by three percentage points. It lifted its gross profit- to-sales ratio from 27 to 35 percent.

The combination of a positive industry trend and successful execution of multiple moves makes PCC a showcase of a "high odds" strategy and perhaps explains why Berkshire Hathaway agreed in 2015 to buy PCC for \$37.2 billion. Could our model have predicted this outcome? Based on the moves PCC made, its odds of rising to the top were 76 percent.

### Patterns of movement

You should be mindful of several dynamics when undertaking major strategic moves. First, our research shows that really big moves can "cancel out" the impact of a poor inheritance. Making strong moves with a poor inheritance is about as valuable as making poor moves with a strong inheritance. And even small improvements in odds have a dramatic impact on the expected payoff, owing to the extremely steep rise of the power curve. For example, the probability-weighted expected value of a middle-tier company increasing its odds to 27 percent from the average of 8 percent is \$123 million—nearly three

times the total average economic profit for midtier companies.

Big moves are also nonlinear, meaning that just pulling a lever does not help; you need to pull it hard enough to make a difference. For instance, productivity improvements that are roughly in line with the improvement rates of your industry won't provide an upward boost. Even if you are improving on all five measures, what matters is how you stack up against your competitors.

And four of the five big moves are asymmetric. In other words, the upside opportunity far outweighs the downside risk. While M&A is often touted as high risk, for example, in reality programmatic M&A not only increases your odds of moving up the curve but simultaneously decreases your odds of sliding down. Capital expenditures is the one exception. By increasing capital expenditures, your chances of going up on the power curve increase, but so do the chances of dropping.

In general, making no bold moves is probably the most dangerous strategy of all. You not only risk stagnation on the power curve but also miss out on the additional reward of growth capital, which mostly flows to the winners.



So how do you set up a strategy process that embraces a data-based outside view in order to tame the social side of strategy and generate winning, big moves? As we show in our book, there are several practical shifts you can make to transform what happens in your strategy room, such as changing the annual strategy-planning exercise into a continual strategy journey, replacing base-case scenarios with momentum cases that extend the past trajectory into the future, and making strong bets on a few breakout opportunities rather than spreading resources across your divisions.

Adjustments such as these, combined with an empirical, objective benchmark for the quality of a strategy that is independent from subjective judgments in the strategy room, will change the conversation at the top of your company. When you know, ahead of time, the chances of your strategy succeeding, and you can see the levers that matter most to your own business, you can make better choices and mitigate the impact of fear, ambition, rivalry, and bias. A good strategy is still hard to shape, but you can at least navigate toward one based on an accurate map. ■

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<sup>1</sup> See Dominic Dodd and Ken Favaro, *The Three Tensions: Winning the Struggle to Perform Without Compromise*, first edition, San Francisco, CA: Jossey-Bass, 2007.

<sup>2</sup> Agency problems emerge when an agent is required to make decisions for another person or group, whose information, preferences, and interests may not be aligned with the agent's.

<sup>3</sup> We measure profit as NOPLAT—net operating profit less adjusted taxes. Invested capital comprises operating invested capital of \$6,660 million and goodwill and intangibles of \$2,602 million. In other words, 28 percent of the capital of a typical company represents additional value over book value paid in acquisitions.

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## 2. Go where the growth is

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39 The granularity of growth

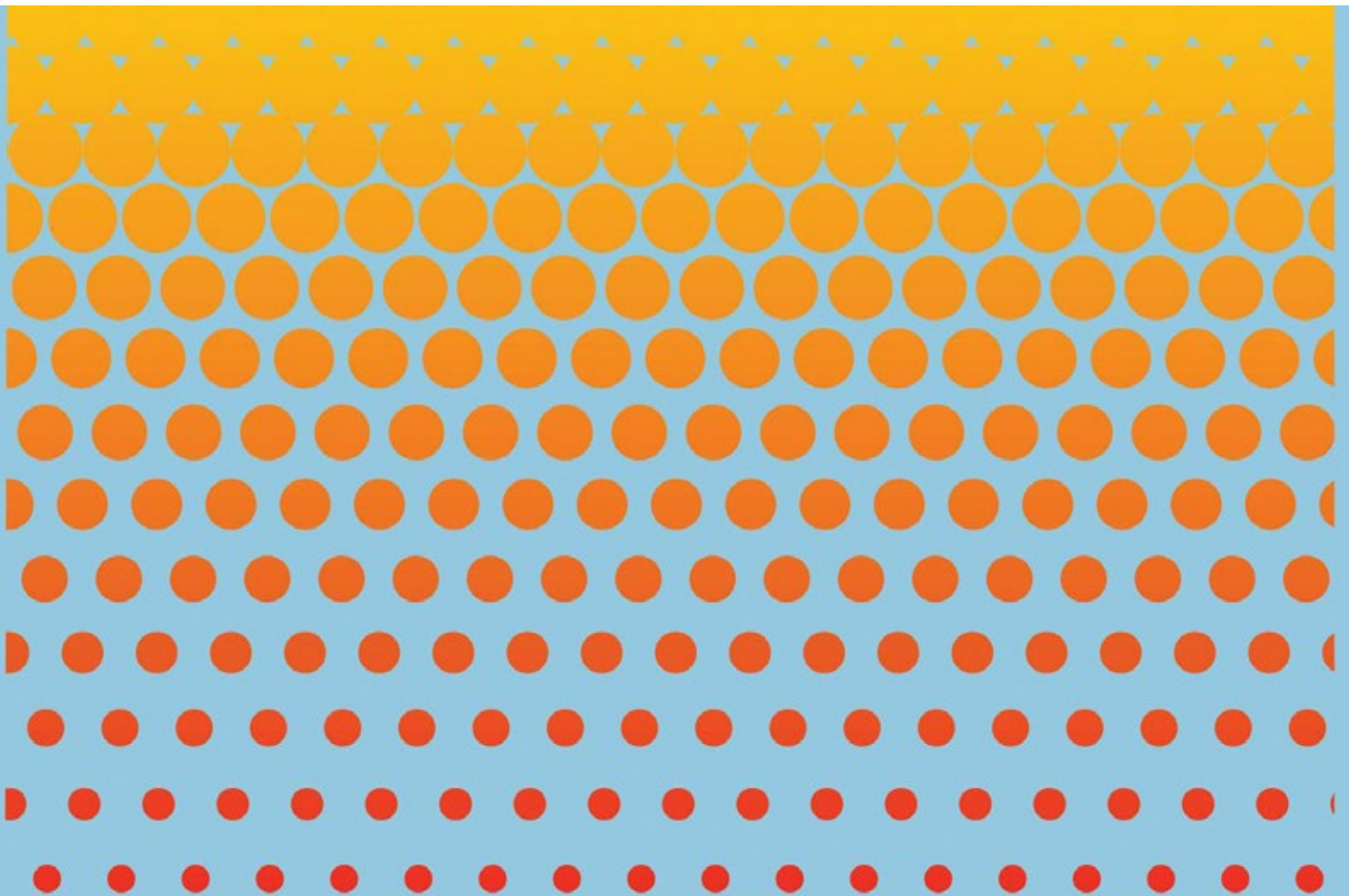




# The granularity of growth

A fine-grained approach to growth is essential for making the right choices about where to compete.

Mehrdad Baghai, Sven Smit, and Patrick Viguerie



What are the sources of corporate growth?

If, like many executives, you take an average view of markets, the answers may surprise you: averaging out the different growth rates in an industry's segments and subsegments can produce a misleading view of its growth prospects. Most so-called growth industries, such as high tech, include subindustries or segments that are not growing at all, while relatively mature industries, such as European telecommunications, often have segments that are growing rapidly. Broad terms such as "growth industry" and "mature industry," while time honored and convenient, can prove imprecise or even downright wrong upon closer analysis.

Our research on the revenue growth of large companies suggests that executives should "de-average" their view of markets and develop a granular perspective on trends, future growth rates, and market structures. Insights into subindustries, segments, categories, and micromarkets are the building blocks of portfolio choice. Companies will find this approach to growth indispensable in making the right decisions about where to compete.

These decisions may be a matter of corporate life and death. When we studied the performance of 100 of the largest US corporations in 17 sectors during the two most recent business cycles, a pair of unexpected findings emerged.

The first was that top-line growth is vital for survival. A company whose revenue increased more slowly than GDP was five times more likely to succumb in the next cycle, usually through acquisition, than a company that expanded more rapidly. The second, suggesting the importance of competing in the right places at the right times, was that many companies with strong revenue growth and high shareholder returns appeared to compete in favorable growth environments. In addition, many of these companies were active acquirers.<sup>1</sup>

To probe deeper into the mysteries of what really drives revenue growth, we have since disaggregated, into three main components, the recent growth history of more than 200 large companies around the world. The results indicate that a company's growth is driven largely by market growth in the industry segments where it competes and by the revenues it gains through mergers and acquisitions. These two elements explain nearly 80 percent of the growth differences among the companies we studied. Whether a company gains or loses market share—the third element of corporate growth—explains only some 20 percent of the differences.

At first blush, our findings seem counterintuitive. They demonstrate that although good execution is essential for defending market share in fiercely contested markets, and thus for capitalizing on the corporate portfolio's full-market-growth potential, it is usually not the key differentiator between companies that are growing quickly and those that are growing slowly. These findings suggest that executives ought to complement the traditional focus on execution and market share with more attention to where a company is—and should be—competing.

Going beyond averages to adopt a granular perspective on the markets is essential for any company as it shifts its portfolio in search of strong growth, as this article will explain. It will also argue that a fine-grained knowledge of the drivers of the company's past and present growth, and of how these drivers perform relative to competitors, is a useful basis for developing growth strategies. To that end we will present the findings of two diagnostic tools: one that enables companies to benchmark their growth performance on an apples-to-apples basis with that of their peers, and one that disaggregates growth at a segment level.

### Growth in a granular world

Telecommunications in Europe is often described as a mature industry. But though revenues at ten large European telcos rose by an average of 9.5 percent a year from 1999 to 2005, we found that individual companies expanded by 1 to 25 percent annually. How could this be?

The most important reason is that European telcos make different portfolio choices so that they have varying degrees of exposure to different segments with different rates of growth. Wireless grows faster than fixed line, for example, and the growth rates of each vary widely by country. In addition, these companies have different levels of exposure to fast-growing markets outside Europe.

In industries with higher overall growth, the same kind of variation is apparent. The annual growth rates of a representative set of large high-tech companies, for instance, ranged from –6 to 34 percent from 1999 to 2005.

In fact, the companies in our 200-strong database that outperformed their peers on top-line growth and shareholder value from 1999 to 2005 compete in industries—construction, consumer goods, energy, financial services, high tech, retailing, and utilities—with different rates of overall growth. No matter which industry they competed in, however, the average market growth of their portfolios outperformed that of their peers. This fact suggests that they tend to outposition their

## A fine-grained view

Which market levels must executives explore when they develop a company's portfolio strategy? To find out, we tested the extent to which industry growth rates correlate with the growth rates of companies at five levels of market granularity, which we call G0 to G4.

**G0: the world market.** Over the past 20 years, the world economy has grown by roughly 7 percent a year. By 2005, its total output had reached \$81.5 trillion. This is the global pie. Global GDP growth is the yardstick used to measure the growth performance of companies.

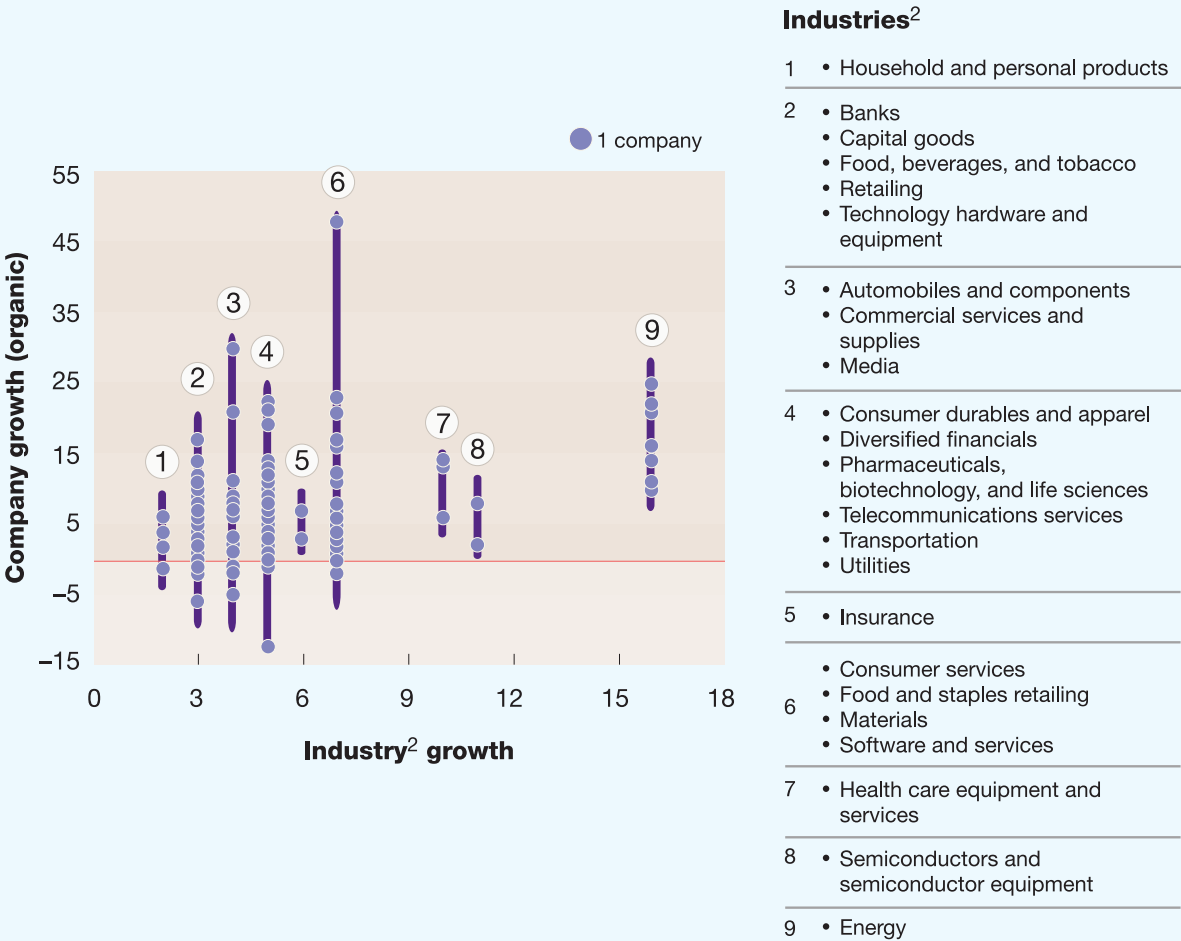
**G1: sectors.** The Global Industry Classification Standard (GICS) carves up the global economy into sectors, such as energy and capital goods. On average, these groups have a market size of \$3.5 trillion. When we plotted the growth of industries and companies, we saw no obvious correlations. This supports our point that talk of “growth industries” is meaningless. The growth rates of different industries vary from approximately 2 to 16 percent—far less than the spread at the company level, which ranges from –13 percent to 48 percent (exhibit).

**G2: industries.** The GICS breaks down the sectors into 151 industries; the food, beverages, and tobacco sector, for instance, becomes three separate industries. These 151 industries—more granular than the sectors but still huge—have an average size of around \$500 billion. At the G2 level, differences in the portfolio exposure of companies explain little more of the variation in organic top-line growth than they did at the G1 level.



Exhibit A greater spread at the company level

Compound annual growth rate (CAGR) for selected companies by industry,<sup>1</sup> 1999–2005, %



<sup>1</sup>207 representative companies selected from total for readability.  
<sup>2</sup>Industry group classifications by Global Industry Classification Standard (GICS), developed by Morgan Stanley Capital International (MSCI) and Standard & Poor's.

Source: Global Insight; Global Vantage; Thomson; McKinsey analysis

**G3: subindustries.** Now it gets interesting. Our growth database builds on the finest level of data that companies report to the markets, so we can look at subindustries, and sometimes at broad product categories, divided by continents, regions, or, in certain cases, countries. Examples of subindustries within the food industry include frozen foods, savorys, edible oils, and dressings. At the G3 level, the world market has thousands of segments ranging in size from \$1 billion to \$20 billion. The growth rates of these segments explain nearly 65 percent of a typical company's organic top-line growth; in other words, at this level market selection becomes more important than a company's ability to beat the market. That point supports our finding that the composition of a portfolio is the chief factor in determining why some companies grow faster than others.

**G4: categories.** In a few cases we have been able to use internal company data to dig deeper and explore categories within subindustries (such as ice cream within frozen packaged foods) or customer segments in a broad product or service category (such as low-calorie snacks). At this level of granularity the world economy has millions of growth pockets that range in value from \$50 million to \$200 million. Our analysis found that a company's selection of G4 segments often explained its organic growth even better than the G3 segments did. This is the level of granularity on which companies must act when they set their growth priorities—and the level on which they must make the real decisions about resource allocation.

industry competitors in high-growth segments. The portfolios of outperforming utilities, for example, enjoyed growth momentum that was two percentage points higher than the overall industry did. Indeed, when we compared the growth rates of industries with the growth rates of the companies in our database, we could explain why some grew faster than others only by zooming in and taking a granular view of subindustries and product categories by continent, region, and country (see sidebar, “A fine-grained view”).

These findings should encourage companies in industries with slow overall growth. Seeking growth is rarely about changing industries—a risky proposition at best for most companies. It is more about focusing time and resources on faster-growing segments where companies have the capabilities, assets, and market insights needed for profitable growth.<sup>2</sup>

To make granular choices when selecting markets, management teams must have a deep and similarly granular understanding of what drives the growth of large companies and, in particular, of their own company and its peers. They can use the resulting growth benchmarks when they plan their portfolio moves. One thing they are likely to learn from the benchmarks is to avoid making unrealistic assumptions about a company's chances of consistently gaining market share.

### Disaggregating growth

The growth profiles of companies began to emerge when we broke down their growth into three main organic and inorganic elements that measure positive and negative growth.

- Portfolio momentum is the organic revenue growth that a company achieves through the market growth of the segments represented

in its portfolio. The company can influence the momentum of its portfolio in several ways. One is to select acquisitions and divestments, which affect the company's exposure to underlying market growth. Another is to create market growth—for instance, by introducing a new product category. Portfolio momentum (including currency effects) is in a sense a measure of strategic performance.

- M&A is the inorganic growth a company achieves when it buys or sells revenues through acquisition or divestment.
- Market share performance is the organic growth a company records by gaining or losing a share of the market. We define market share by the company's weighted-average share of the segments in which it competes.

### Beyond the averages

Our growth analysis of ten large European telcos revealed the relative importance of these growth elements for the companies as a group. It also showed how individual companies differed widely in their performance on each element.

Portfolio momentum was by far the biggest growth driver for the group as a whole, followed by M&A. Market share performance made a negative contribution. When we looked beyond the averages, a more nuanced picture emerged. Individually, these companies' range of performance on the three growth drivers was startling: from 2 to 18 percent annual growth for portfolio momentum, from -2 to 13 percent for M&A, and from -6 to 5 percent for market share performance. Clearly, companies in the same sector grow not only at different speeds but also in different ways (Exhibit 1).

### What about market share?

To probe the sources of growth for the average company in any sector, we took the data on all of the companies in our database and broke down

their average performance into the three growth elements. We found that of the overall 8.6 percent top-line annual growth that the average large company achieved from 1999 to 2005, 5.5 percentage points came from the market growth of the segments in its portfolio, 3.0 from M&A activity, and a marginal 0.1 from market share performance.

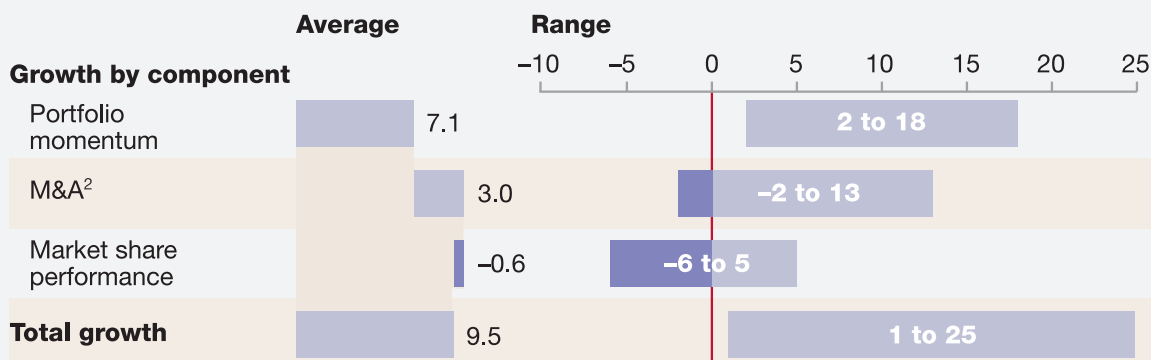
The negligible role of average market share performance—both gains and losses—wouldn't be surprising if markets included only these 200 large companies. But what about the smaller companies that are commonly seen as growing more quickly and gaining share from incumbents?

Perhaps new entrants and other small and midsize companies redefine categories, markets, and businesses rather than capture significant market share from incumbents. There are differences among countries, however. Our analysis suggests that over time the average large company loses a bit of market share in the United States but gains a bit in Europe. Although we haven't analyzed this phenomenon in detail, we believe that the dynamism of the US market allows young companies to challenge incumbents to a greater extent than they can on the other side of the Atlantic.

We found it more interesting to go beyond the averages and explore the differences in the growth performance of large companies. The results show that portfolio momentum, at 43 percent, and M&A, at 35 percent, explain nearly four-fifths of them; market share is just 22 percent. To put the facts another way, a company's choice of markets and M&A is four times more important than outperforming in its markets. This finding comes as something of a surprise, since many management teams focus on gaining share organically through superior execution and often factor that goal into their business plans.

## Exhibit 1 The range of performance in the three growth drivers was startling.

Compound annual growth rate (CAGR) of revenues for 10 large European telcos,<sup>1</sup> 1999–2005, %



<sup>1</sup>Based on local currency; companies with headquarters in European Union.

<sup>2</sup>Includes impact of changes in revenue base caused by inorganic activity and share gain/loss.

Source: Analyst reports; company reports; Dealogic; Global Insight; Hoover's; McKinsey analysis

Not that managers can afford to neglect execution. On the contrary, catching the tailwind of portfolio momentum requires a company to maintain its position in the segment, and this in turn hinges on good or even great execution—particularly in fast-growing segments that tend to attract innovative or low-cost entrants.

The key point is that averages can be deceptive, so we dug deep into our database to see if a more granular story on market share performance would emerge. We did find a number of share gainers and losers, at the corporate (and particularly the segment) level. But we also discovered that few companies achieve significant and sustained share gains and that those few tend to have compelling business model advantages.

A valid question is whether sectors (with their different rates of growth) differ in ways that

might affect the importance of market share. We found that market share performance explained 14 to 23 percent of the difference in the growth performance of companies in seven of the eight industries we analyzed. It was significantly more important, at 37 percent, only in the high-tech industry, where short product life cycles and generally higher growth headroom make market share shifts more common.

### Linking growth and shareholder value

The detailed growth and value creation histories in our database let us analyze the growth drivers—portfolio momentum, M&A, and market share performance—and identify correlations between their roles for revenue growth and value creation.<sup>3</sup> Not surprisingly, companies that outperform on the growth drivers increase their revenues faster than the underperformers do,<sup>4</sup> and the more drivers they outperform on, the faster they grow.



It's more intriguing that outperformance on revenue growth is correlated with the superior creation of shareholder value. We defined four levels of performance for benchmarking purposes: exceptional, great, good, and poor. The threshold for differentiated performance appears to be outperforming on one growth driver while not underperforming on more than one. Slightly more than half of the companies in our sample did both and achieved average annual total returns to shareholders (TRS) of 8 percent and revenue growth of 11 percent, which we define as good performance. Companies that outperformed on two dimensions or that outperformed on one at top-decile levels without underperforming on more than one—nearly 15 percent of the sample—did even better, achieving great performance. Only four companies, which chalked up exceptional revenue growth and shareholder returns, outperformed on all three growth drivers. Companies that did not outperform on any driver or underperformed on more than one performed poorly, with TRS of only 0.3 percent.

Management would do well to step back and assess a company's performance, at the corporate level, on each of these drivers, for they are actionable, and the evidence shows that the more of them companies outperform on, the more those companies have been rewarded. It might also be wise to scrutinize a company's peers to find out which growth drivers, if any, they outperform on, and in which parts of their businesses. Such knowledge can be the starting point of a useful benchmarking discussion about the company's growth performance and potential.

### Scanning for growth opportunities

Getting a detailed sense of the growth performance of a company involves judging how well it is performing on each of the three growth drivers at the segment level. By analyzing this information in the context of the company's market position and capabilities, its management team can develop a

perspective on future opportunities for profitable growth.

Consider the disguised case of GoodsCo, a multinational consumer goods corporation. Our disaggregation of its growth at the corporate level revealed that it delivered stable, albeit slow, growth from 1999 to 2005. M&A drove almost all of the company's growth in the United States, however; in Europe positive exchange rates propelled modest growth. Organic revenues rose strongly only in emerging markets, such as Africa, Latin America, and the Middle East. In fact, the North American and European markets that made the largest contribution to the company's revenues were in the bottom quartile for our full sample of companies.

The story gets more precise as we disaggregate the company's performance on the three growth drivers in 12 product categories for five geographic regions. No fewer than 27 of the 47 segments the company competes in register as poor in terms of their performance on our three growth drivers. Unfortunately, these segments represent 87 percent of GoodsCo's sales. On the positive side, 20 segments are good or great, but they make up only the remaining 13 percent of sales. And although a promising growth story is developing in Latin America in most segments, the business is performing poorly in its core ones in Europe and North America. It cannot claim exceptional performance in any segment. GoodsCo has a portfolio problem (Exhibit 2).

Once all the cards are on the table, GoodsCo's managers will be in a better position to make well-informed portfolio choices. The pros and cons of acquiring businesses—or expanding organically by exploiting positive market share performance—in segments where GoodsCo enjoys strong portfolio momentum will probably be high on the top team's agenda. Another issue might be whether to seize divestment opportunities in segments where the

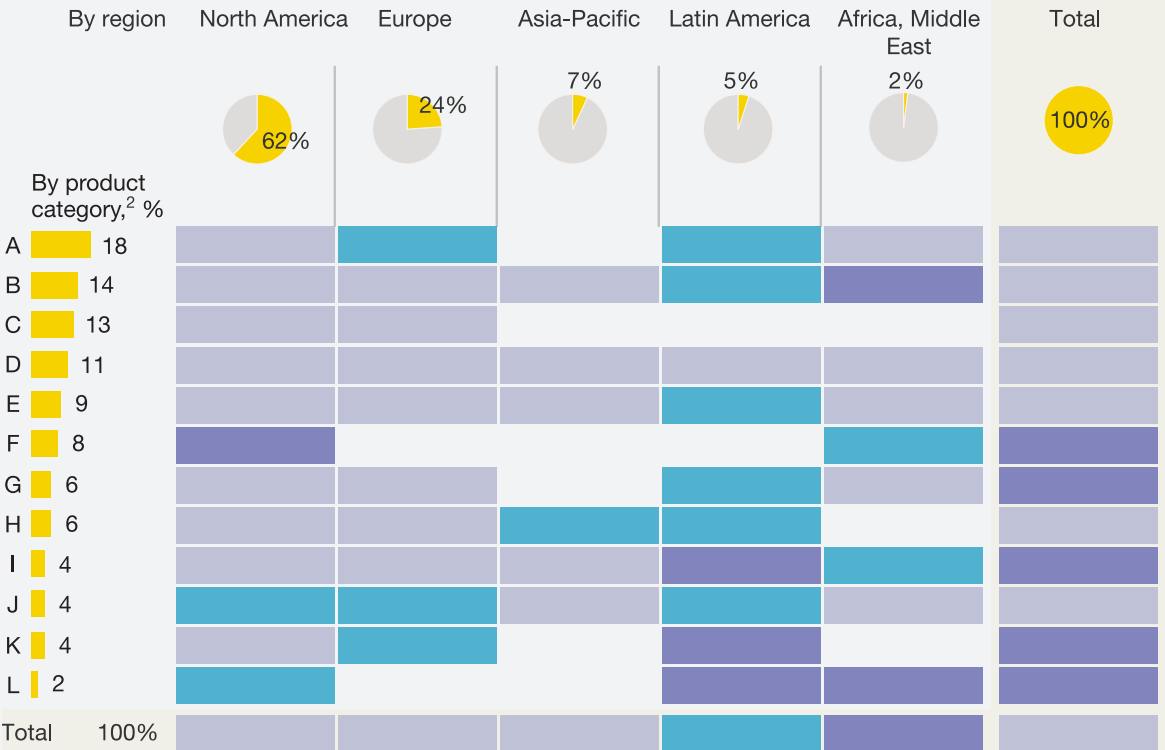
Exhibit 2 **Analysis of growth by segment or region can reveal strengths and weaknesses in a company's portfolio.**

Disguised example of growth for GoodsCo, a multinational consumer goods company, 1999–2005

Growth<sup>1</sup>

■ Exceptional (not achieved by any segment)   ■ Great   ■ Good   ■ Poor

**Revenue share**



<sup>1</sup>Exceptional = outperforming on all 3 growth drivers; great = outperforming on 2 growth drivers or outperforming on 1 growth driver at top-decile level without underperforming on more than 1; good = outperforming on 1 growth driver without underperforming on more than 1; poor = underperforming on 2 or more growth drivers or not outperforming on any.

<sup>2</sup>Figures do not sum to 100%, because of rounding.

company's portfolio momentum is good, though the company is losing market share. A third could be whether to acquire a company (and so build portfolio momentum) in lackluster segments where

GoodsCo's management expects market growth to improve significantly.



The growth of segments within industries correlates closely with the differing profiles that emerge when we disaggregate the growth of large companies. This suggests that executives should make granular choices when they approach portfolio decisions and allocate resources toward businesses, countries, customers, and products that have plenty of headroom for growth. ■

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<sup>1</sup> Sven Smit, Caroline M. Thompson, and S. Patrick Viguerie, "The do-or-die struggle for growth," *The McKinsey Quarterly*, 2005 Number 3, pp. 34–45.

<sup>2</sup> Our analysis suggests that chasing revenue growth for growth's sake alone, at the expense of profitability, generally destroys shareholder value.

<sup>3</sup> Our analysis covers a six-year period that we used to compare detailed segment performance year over year, so we couldn't look at the very long term. However, we can compare revenue growth with at least short- to medium-term trajectories of total returns to shareholders.

<sup>4</sup> We define outperformance as the attainment of a growth rate in the top quartile of the sample for a particular growth driver. We define underperformance as the opposite: performance in the sample's bottom quartile. Quartiles two and three (the middle ones) are neutral—neither outperforming nor underperforming.



# 3. Make growth happen

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# Building an engine for growth that funds itself

You don't have to look far to finance your growth ambitions.

Kabir Ahuja, Biljana Cvetanovski, Jesko Perrey, and Liz Hilton Segel





To drive growth, you first have to find the fuel—and for many companies, that’s not so straightforward. Internal and external obstacles, including onerous approval processes, and short-term stock-market impact, can make it hard to fund promising ventures. But it doesn’t have to be that way.

Our research shows that many companies that consistently post top-line growth operate with what we call an investor mind-set. They continually squeeze funds from underperforming areas and allocate the savings to new ventures or existing programs that have the potential to scale. In other words, they fund their own growth.

As simple as that might sound, this investor approach is a significant departure for many executives, who tend to be consumed with cutting costs and playing it safe by banking marginal gains. They fall victim to a common behavior that drives only short-term profit: taking the savings from often highly disciplined cost-cutting programs and dropping the cash to the bottom line.

Growth leaders are different. They constantly scour for savings across the business. They know exactly where each incremental dollar of savings should be reinvested to drive new growth, and they know the ROI of every dollar invested. In our experience, it often takes a significant event, such as a new CEO or business-unit leader, an acquisition, or a transformation to turn around a declining business, to jolt the business into action. While these catalysts are effective motivators, business leaders intent on driving growth (and in some industries or sectors facing stiff headwinds, investing only in growth might not be the best option) don’t have to wait for them to occur to build the Investor DNA into their organization.

This Investor approach is most effective as part of a purposeful and diversified approach to driving growth (Exhibit 1).

The Performer approach, where businesses continually optimize commercial functions (marketing, sales, and pricing) can yield a massive source of investment funding. The Creator approach pours those investments into new products, services, or business models to drive future growth. The true power of the Investor profile is reflected in a recent McKinsey survey, which revealed that 51 percent of top-growth companies use Invest as their primary growth approach (vs. 20 percent for Create and 28 percent for Perform), though there is significant variance by sector (the Investor premium is significant in pharma, for example, but much less so in automotive and assembly).

### How to think and act like an Investor

For companies looking to jump-start their growth ambitions, the Investor approach can be a fast way to achieve results. Investing in proven winners—initiatives that are already driving growth but may be underfunded—can put points on the board quickly. Sustaining that, however, requires leaders to be intentional in making the necessary commitments to change the business’s growth trajectory. That includes making a number of “big moves” (as our colleagues who authored *Breaking the Hockey Stick* call them) to improve productivity and dynamically reallocate funds. It also requires putting in place new processes and using data to make better decisions. In fact, data and analytics are the top differentiating capabilities between high-growth Investor companies and their peers, according to McKinsey research (Exhibit 2).

#### 1. Find the money and squeeze

Investor companies can uncover hundreds of millions of dollars in savings. This isn’t some

## Exhibit 1 Three strategies for organic growth



theoretical pot of money that will materialize in the distant future; often, companies can begin banking the new funds in a matter of weeks or months. Here are three steps high-performing companies take to find the biggest savings opportunities:

### *Get real about transparency.*

For growth leaders, there's no such thing as black-box spending, in which you invest money in a service or program and wait to see how it works out. Instead, these companies insist on radical transparency, demanding to know the exact purpose of each dollar

spent as well as the anticipated return. They put in place processes, metrics, and simple dashboards that allow them to get a clearer view of how their spend is performing. Increasingly, we're seeing the maturation of IoT technologies) that can now provide near real-time insights into process and performance, particularly in logistics, supply-chain management, and manufacturing.

On the commercial front, Western Union provides an example of a systematic approach to bringing transparency to media activities. The company

embarked on a program to break down the efficiency and effectiveness of its media spend. It consolidated its agency roster and improved the way it negotiated commercial terms with its agencies. That work included developing a better understanding of costs, which allowed it to be more precise about bidding out the work. The company also put in place different effectiveness measures.

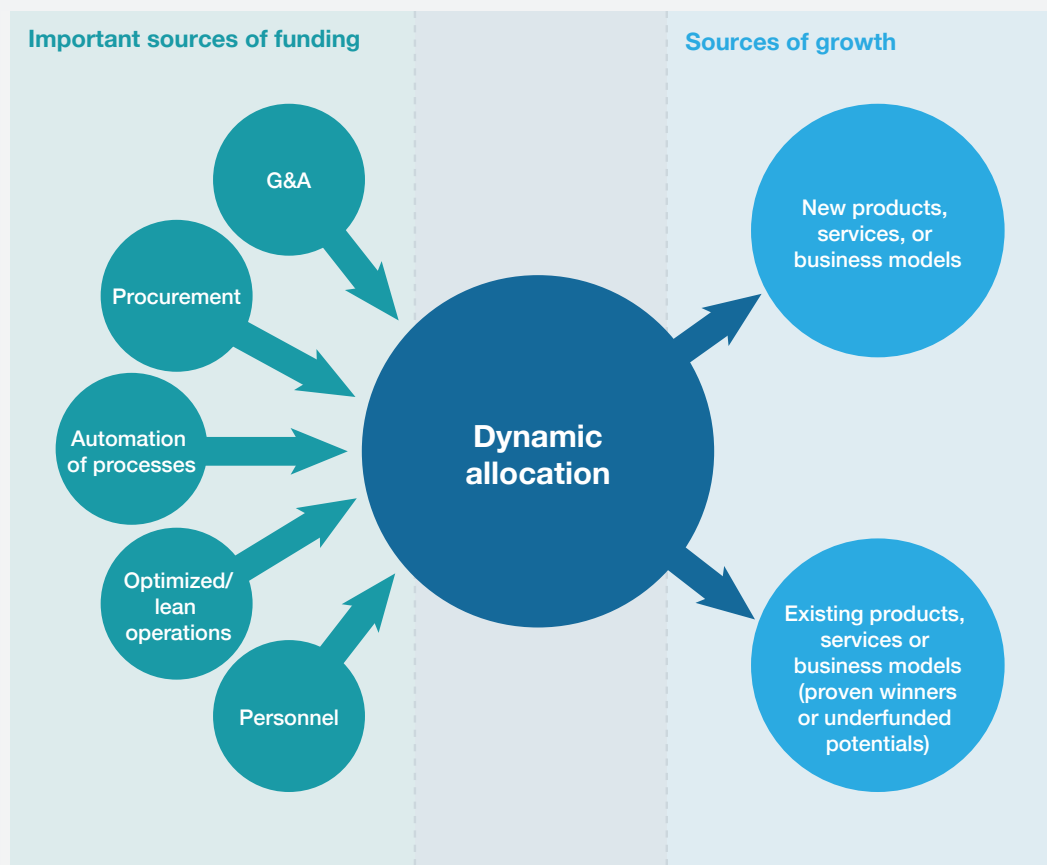
*Drive maximum productivity.*

Just as underperforming programs sometimes continue to receive funding out of inertia, some processes may continue to churn along even

though there are faster, cheaper alternatives. High-performing Investor companies continually scour their organization for outdated, inefficient ways of operating. To get the full benefits of productivity, each process should be in the top 30 percent for the industry.<sup>1</sup> A few of the most promising areas of focus are:

- **Efficiency.** Leading companies engage in detailed process mapping, looking for opportunities to streamline operations, eliminate redundant processes, and hunt down opportunities to rationalize partnerships. Advanced analytics

**Exhibit 2** Overview of the Investor approach to funding your growth



has emerged as a powerful capability in driving new levels of efficiency. Utility transmission and distribution operators, for example, that are able to use advanced analytics to predict maintenance activities can reduce their costs by 10 to 20 percent, while improving asset reliability.<sup>2</sup> Simplification can also be useful in improving efficiency. One telecom provider reduced its product portfolio by 80 percent before streamlining its digital experience and supporting platform.<sup>3</sup>

■ **Procurement.** Adding rigor to procurement of products and services by benchmarking prices, soliciting bids, moving some services in house, and driving for transparency can unlock significant savings. When it comes to marketing, we've found that by analyzing ongoing costs such as agency and overhead, companies can uncover savings of 10 to 20 percent on marketing spend. Digital has the potential to radically increase savings as well. In a recent McKinsey survey, chief procurement officers said they expect their digital procurement programs to increase annual savings by 40 percent.

■ **Automation.** Advances in analytics have allowed companies to unlock significant efficiencies, resulting in enormous savings through reduced time, errors, and personnel costs (often while also improving the customer experience and overall performance.) Robotic process automation, for example, is able to cut policy conversion time by 50 percent for insurance companies while one large financial institution used RPA to reduce processing costs by 80 percent.<sup>4</sup>

### *Trim the excess.*

We have found that in most organizations, general and administration expenses (G&A) and personnel are likely to yield the biggest cost-saving

opportunities. The most effective personnel savings are based on rethinking processes and ways you work as well as revisiting strategic priorities, rather than simply letting go of people. When done correctly, best-in-class businesses reduce overlaps in activities, eliminate inefficiencies, and focus personnel on growth activities. One consumer-goods company readjusted its strategy to focus on customer service and innovation, allowing it to cut back on capabilities that didn't support those specific capabilities. This led to roughly 20 percent in savings in personnel costs. But cuts must be approached with care. G&A includes some critical activities, such as enabling innovation and developing talent. When done correctly, however, the impact can be profound. One global chemical company invested substantial effort in identifying discrete cost-saving opportunities across functions, tracking performance and involving hundreds of employees company-wide. It succeeded in reducing G&A by more than 20 percent within one year and sustaining its improvements for more than three years thereafter. In all, the company realized savings of well over \$100 million and earnings before interest, taxes, and amortization (EBITDA) margin improvements of about three percentage points over two years, and then sustained it.<sup>5</sup>

## **2. Find and fund the opportunities**

The most successful companies prioritize the opportunities they uncover so that they can quickly allocate funds and people to them as they become available. Those opportunities generally come in two flavors: first are proven winners—existing programs that could outperform with greater investment. The second are promising new areas that require funding to acquire or launch. A good example of the first is when Geico dug deep into the return on its marketing spend and found that advertising drove the fastest growth. So over the course of 15 years, it tripled its marketing budget—and increased market

share by 150 percent, in essence pulling money out of underperforming programs to fund a proven growth engine. For other companies, the growth drivers will be different; the important thing is to find what drives growth for *your* company—and fund it.

To be ready to allocate funds quickly to the most promising opportunities, successful companies take the following steps:

■ **Identify and fund the high-potential**

**opportunities:** Most companies have plenty of data on hand to pinpoint the areas of greatest potential. This should yield insights both on where to invest for immediate growth and where investments are most likely to pay off over the long term. Former Comcast Cable CEO Neil Smit said that when he joined the company, it was selling over a million subscriptions a year to its high-speed data (HSD) service, yet HSD had received little investment. “It’s a high-margin product. We’re underpenetrated. That’s the product we have to drive the hardest,” Smit recalls. Chase took a similar approach when creating Sapphire Reserve, a credit card targeting affluent millennials, with a rich set of benefits (travel, experiences) to break through the clutter of the marketplace. The initial launch was so successful that Chase doubled down by cutting \$200 million in selling, general and administrative (SG&A) costs to fund the benefits as they continued to expand the program. This effort led to 13 percent growth in the credit-card business in 2017, with Reserve cardholders spending six times more than the industry average. As companies search for opportunities, they should also mine their frontline workers, who can be an important source of intelligence on trends and opportunities. Many businesses find it helpful to create an “opportunity map” of potentially lucrative hot spots. The best companies, however, run advanced analytics

against internal and external data sets from a variety of sources to build a picture of the future opportunity, not the historical reality.

■ **Reallocate funds and people dynamically:**

High-performing Investor companies have mastered the art of dynamic allocation. Research from McKinsey shows that dynamic reallocators, those that reallocate at least 49 percent of the previous year’s budget, achieve a compound annual growth rate in total return to shareholders of 10 percent, compared with just 6.1 percent for static allocators. Roughly 57 percent of companies in the top quartile for growth actively manage their portfolios based on ROI, according to a recent McKinsey survey. And it’s not just about putting funds to use; it’s about focusing your best talent on where the growth is. One digital healthcare business credits effectively allocating people’s time with making the difference between a 60 percent growth rate and one that’s 20 percent. Effective allocation, however, requires discipline to follow through and a clear set of metrics that decision makers are aligned around. Leadership alignment on priority markets, in fact, is the top Investor activity for top-quartile growth companies.

■ **Fund a continuous, systematic stream of acquisitions.** Programmatic M&A can be a powerful lever for growth. Companies that use it well invest up to 30 percent of their market cap each year in acquisitions that mesh with their strengths. To do that, however, requires constant work to maintain a healthy pipeline of target companies. Corning, for example, did due diligence on an average of 20 companies per year and made an average of five bids to maintain its pace of three acquisitions per year. This approach helped it to break out of the middle tier in its sector to become a top grower.



#### ■ **Be disciplined in prioritizing opportunities.**

To keep the process untainted by bias or territorial thinking, it must be rigorous and transparent, taking into account both the opportunities and the needs of the organization as a whole. One leading CPG set up a “global reinvestment council” of more than 20 leaders from across countries, regions, and functions to review business priorities against investment ideas and to make the tough calls on whether to focus on new ventures or pour funds into existing operations.

### 3. Embed the capabilities

To fund your own growth, disciplined decision making must become the new normal rather than a one-off exercise. Here are some critical steps to take:

■ **Build a rigorous budgeting process.** Rigor in budgeting requires clarity about current budget performance and a commitment to allocating spend to drive growth. Zero-based budgeting (ZBB), for example, requires teams to rebuild their annual budgets from zero, with no carryover from the previous year. This process helps to identify small and not-so-small pockets of waste that can add up to big savings. While it is common for budget owners to use bottom-up budgeting, for truly breakthrough results, they need systematic visibility into budgets, clarity about what to measure, accountability for ambitious targets, and governance mechanisms to challenge budgets and reallocate resources. As Lila Snyder, executive vice president and president of global e-commerce at Pitney Bowes, put it, “We’ve set pretty explicit metrics for each business around the types of margins and the types of investments that we’re willing to make. It’s been very important to have that in the background, because it’s easy to get distracted one quarter to the next when you’re seeing growth but maybe not seeing margin.”

#### ■ **Build mechanisms to surface investment**

**opportunities.** Finding opportunities to save and reinvest requires engagement from across the enterprise, from finance experts to product owners to business-unit leaders. But while the spirit of cooperation may be strong, without dedicated mechanisms to surface opportunities, those good intentions often amount to little. A leading consumer company set up a “fighting fund” where internal sponsors can apply for investment, using a business case and proven ROI. The company implemented a quarterly application cycle, with requalification required at agreed upon stage-gates when teams must submit detailed business cases as part of their reapplication.

#### ■ **Support data-driven decision-making.**

Investors of any sort are only as effective as the data they rely on. Many bring in data scientists to set up a robust analytics capability. Once they identify the highest-potential areas for investment, they use analytics to develop a more granular view of where—and how—to double down, investigating by city, segment, region, product, or even demographics, using a mix of methods. One leading consumer company worked with artificial-intelligence specialist Spark Beyond to analyze hundreds of thousands of inputs. The analysis helped it to identify meta trends in the data that pointed to pockets of growth targeted down to the suburb, nationality, even family size. In developing effective analytics, it’s important to focus on rationalizing data and creating common standards (for KPIs, metrics) so that investment performance across activities is comparable.



While operating like an Investor requires specific capabilities, the key differentiator is mind-set.

# Are you thinking and acting like an Investor?

## Questions to ask the executive team:

- Where are you going to find the next 20 percent of your funds to invest in growth?
- Do you know where the largest pools of funds in your business are?
- What percent of your G&A costs have you reduced in the past year?
- Are you reallocating more than 40 percent of last year's budget into different areas?
- How often do you reallocate your resources?
- Do you know where you'll invest your next incremental dollar?
- What are the five areas of your business that are growing the fastest or have the potential to grow the fastest?
- What data are you using as the basis of your allocation and investment decisions?
- What is your top talent working on, and is that driving growth for the business?

Without a near-fanatical leadership commitment to continually squeezing money from existing programs *and* the discipline to invest in growth, companies will find themselves missing out on their potential. ■

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<sup>1</sup> Chris Bradley, Martin Hirt, and Sven Smit, "Strategy to beat the odds," McKinsey.com, February, 2018

<sup>2</sup> Jiri Franta, David González, Jesús Rodríguez González, and Rui de Sousa, "Harnessing the power of advanced analytics in electricity networks' asset management," McKinsey.com, April 2018.

<sup>3</sup> Shital Chheda, Ewan Duncan, and Stefan Roggenhofer, "Putting customer experience at the heart of next-generation operating models," McKinsey.com, March 2017.

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<sup>5</sup> Alexander Edlich, Heiko Heimes, and Allison Watson, "Can you achieve and sustain G&A cost reductions?" *McKinsey Quarterly*, October 2016.

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# How nimble resource allocation can double your company's value

Companies that actively and regularly reevaluate where resources are allocated create more value and deliver higher returns to shareholders.

Yuval Atsmon



“Dynamic resource reallocation” is a mouthful, but its meaning is simple: shifting money, talent, and management attention to where they will deliver the most value to your company. It’s one of those things, like daily exercise, that helps us thrive but that gets pushed off our priority list by business that seems more urgent.

Most senior executives understand the importance of strategically shifting resources: according to McKinsey research, 83 percent identify it as the top management lever for spurring growth—more important than operational excellence or M&A. Yet a third of companies surveyed reallocate a measly 1 percent of their capital from year to year; the average is 8 percent.

This is a huge missed opportunity because the value-creation gap between dynamic and drowsy reallocators is staggering (exhibit). A company that actively reallocates delivers, on average, a 10 percent return to shareholders, versus 6 percent for a sluggish reallocator. Within 20 years, the dynamic reallocator will be worth twice as much as its less agile counterpart—a divide likely to increase as accelerating digital disruptions and growing geopolitical uncertainty boost the importance of nimble reallocation.

Why this disconnect? In my experience, executives struggle to figure out where they should reallocate, how much they should reallocate, and how to execute successful reallocation. Additionally, disappointment with earlier reallocation efforts can push the issue off top management’s agenda.

To get real value from resource allocation, executives should follow four important principles.

### 1. Go granular

Beware the tyranny of averages. A single unit may have lines of business or geographic pockets with

very different returns. It’s not uncommon to see a 10 percent decline in one area while another is experiencing triple-digit growth. In fact, the variability is often much more significant across granular market segments within one business unit than across large business units.

Segmenting the company and defining the level of granularity can be something of an art, as top executives can’t debate trade-offs across thousands of micromarkets (although some functions, such as marketing and sales, should). You need to drill down to the smallest meaningful business, where a shift in resources will produce a material impact for the overall company (likely more than 1 percent of total revenues). Additionally, each segment you isolate should have a distinct external market—say, premium sports cars in the United Kingdom—even if some resources are not fully divisible. For example, R&D might be shared across premium sports cars regardless of country, but not the marketing spending.

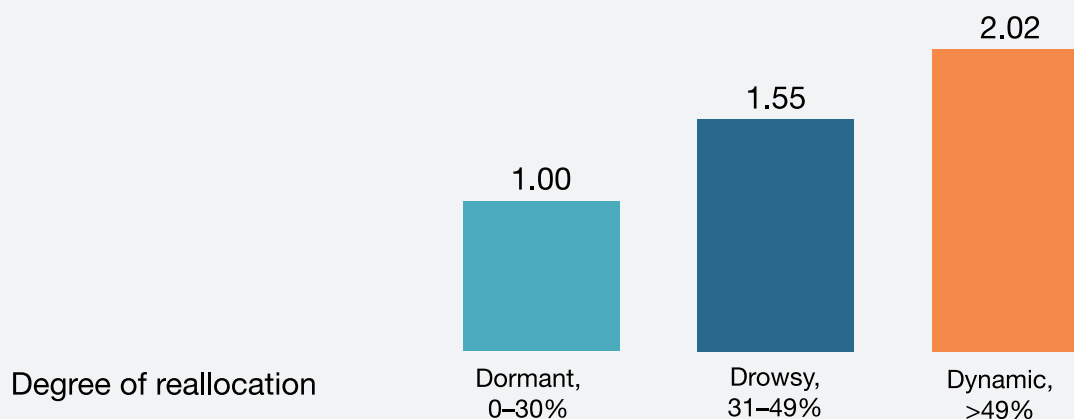
### 2. Focus on value creation

Sometimes investments have a direct business case and you can quantify the net present value of all future cash flows associated with it. A project to invest in a new mine, or to develop a new vehicle, may look like that. In other cases, the overall economic profit (profit created above the cost of capital) of a segment may be an excellent and more consistent method to assess ongoing value creation. Assessing which segments deserve more or less money and attention requires the right metrics.

One of my favorite and relatively simple return-on-investment (ROI) metrics is calculating cumulative expected economic profit and dividing it by the cumulative (financial) resources it will require to produce (for instance, invested capital, additional R&D, or sales and marketing). How quickly the investment pays off will vary according to the

**Exhibit****Actively reallocating resources increases company value, and rewards are high.**

**Relative total returns to shareholders,**  
1990–2010, indexing low reallocator to 1



business life cycle. For example, fast-moving-consumer-goods or services companies may take fewer than three years to realize most of the returns from a major investment, whereas products that are more complex may take longer.

### 3. Overcome biases

Start by acknowledging that everyone has biases. Resource-allocation decisions tend to be heavily affected by these biases: executives are often overconfident, believing they can reverse and improve on past performance, and find it hard to back away from big bets, even when those investments fail to deliver. At the same time, they attribute too much risk to new opportunities and can be slow to embrace them.

Any resource-allocation exercise must be grounded in hard data so that decisions are driven by facts and logic. Some common techniques to overcome biases include these:

- forcing the prioritization of opportunities based on their value creation or ROI
- committing to a minimum annual reallocation—and moving some cash into the bank for new allocations
- role-playing scenarios that force executives to debate against their natural interest or to allocate resources to anonymous business segments that may or may not be their own

My favorite technique is reanchoring, which removes management's optimistic "hockey stick" projections of rapid improvement. This is done by building a model based on outside forecasts and assuming there will be no improvement in performance; leaders then debate whether it is still an attractive investment. If it's not attractive, it's important to test the confidence that a big improvement is achievable before continuing to invest.



#### 4. Be agile

In this volatile business environment, resource allocation should be regularly adjusted, especially when major events occur, such as June's Brexit vote or last year's sudden oil-price decline. Some businesses have a systematic stage-gating process for investments. Typically, when developing new products and services, you hold off some of the investment until there is evidence that it is yielding results. The strategic-planning process needs to recognize material uncertainties—both external (demand growth, competitive launches, regulation) and internal (new technology, changes in talent)—and establish clear threshold levels at which decisions on resource deployment would be revisited.

Some argue that this agile approach creates too much change and does not provide enough time and commitment for new business initiatives to flourish. But by clarifying the metrics for weighing whether investments are paying off, you improve the quality of your governance, deal with genuine uncertainties, and can reevaluate quickly when unforeseen events inevitably occur. By setting clear expectations for value creation in each segment and by clarifying the major assumptions about market evolution and internal performance that underpin those expectations, you ensure that the resource-allocation process is continuous rather than cyclical.

Ultimately, even with the best intentions, resource reallocation can fall victim to organizational inertia and internal power dynamics. In companies where unit heads run their businesses like fiefdoms, with little input from those outside the walls unless they fail to make their numbers, the challenge is particularly daunting.

Managers whose businesses are performing well will naturally resist the argument that their resources might produce even better returns elsewhere. To

change the conversation, try showing them the potential impact of reallocation on share price. In one case, the chief financial officer of a large company demonstrated that just 1 percent more growth in more attractive segments could raise the share price by 30 percent. ■

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# The sales secrets of high-growth companies

The authors of *Sales Growth* reveal five actions that distinguish sales organizations at fast-growing companies.

Mitra Mahdavian, Hodayoun Hatami, Maria Valdivieso, and Lareina Yee



What distinguishes sales organizations at fast-growing companies from their lagging peers? In a wide-ranging survey of more than 1,000 companies, we unearthed five meaningful differences:

### 1. Commitment to the future

That the world is changing ever more quickly may be a cliché, but that makes it no less true: all sales leaders know that they need to anticipate changes that could turn into opportunities or threats. Yet the best leaders move beyond acknowledgement to commitment.

They make trend analysis a formal part of the sales process through systematic investments of time, money, and people. Building and sustaining the capability to take a forward-looking view of the market is not easy. In discussions with more than 200 sales leaders while researching our new

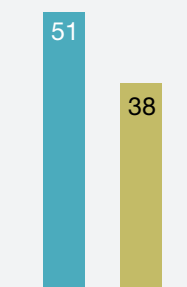
book, *Sales Growth*, two common characteristics emerged: the mind-set of sales leadership and resource commitment.

Sales leaders must consistently monitor the macro-environment in search of sales opportunities, no easy task given the relentless pressure to hit near-term targets. Forward planning must be part of someone's job description—not just part of top management's lengthy to-do list—with sufficient resources to take advantage of the best opportunities. Companies have to be willing to take risks now to create sales capacity long before the revenue will materialize. More than half of the fast-growing companies<sup>1</sup> we analyzed look at least one year out, and 10 percent look more than three years out.

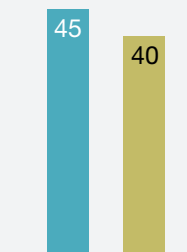
## Exhibit 1 Fast growers have a long-term outlook.

Percentage by growth rate for ● fast growers and ● slow growers

**Sales planning conducted at least a year out<sup>1</sup>**



**More than 6% of sales budget spent on future growth<sup>2</sup>**



<sup>1</sup>Overall 1,013 companies polled; fast growers 270 companies, slow growers 356 companies.

<sup>2</sup>Overall 309 companies polled.

After planning, sales leaders aren't afraid to put their money where they think the growth will be: 45 percent of fast-growing companies invest more than 6 percent of their sales budget on activities supporting goals that are at least a year out—a significant commitment in an environment where sales leaders fight for each dollar of investment.

## 2. Focus on key aspects of digital

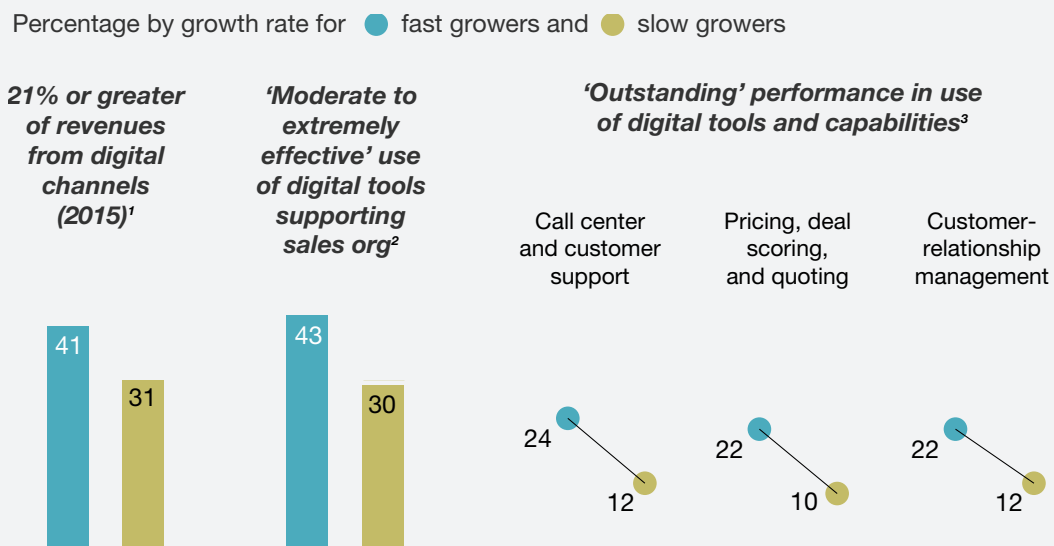
Successful brands don't just "do digital"; they use their full arsenal of capabilities to massively increase the effectiveness of their sales force and to transform the customer buying experience to be "digital first". It pays off: digital channels provided at least a fifth of 2015 revenues for 41 percent of the fast-growing companies we surveyed—both business-to-business and business-to-consumer—

compared with just 31 percent at slow-growing companies.

This trend is only becoming more important, as almost two-thirds of all US retail sales by 2017 will involve some form of online research, consideration, or purchase.<sup>2</sup>

When it comes to customer experience, leading organizations are building out digital routes to market or augmenting traditional direct or indirect sales with digital. For traditional software companies, the focus on SaaS-based products is driving a change toward a digital sales experience where they discover, demo, and trial, all within a few clicks online. Many industrial companies are seeing their products also sold in external marketplaces,

### Exhibit 2 Fast growers make digital a competitive advantage.



<sup>1</sup>Fast growers 242 companies, slow growers 321 companies.

<sup>2</sup>Fast growers 270 companies, slow growers 356 companies.

<sup>3</sup>Fast growers 129 companies, slow growers 168 companies.

which is prompting them to build out their own e-commerce platforms to directly shape the customer experience.

Sales leaders are especially strong at harnessing digital tools and capacities to support the sales organization. Fast-growing companies are more effective than slower-growing ones at using digital tools and capabilities to support the sales organization (43 percent versus 30 percent). They tend to focus on three fronts:

First, they arm sales teams with digital tools that can quickly deliver relevant and usable insights. Second, they treat partners as an extension of the sales force and invest in collaboration tools to improve the flow of data between organizations. Third, they recognize the potential for big micromarket or macrotrend analyses to improve

planning and capture opportunities most effectively. As the technology emerges, they are making targeted investments in tools, technologies, and talent to make the most of these opportunities.

Success in digital comes from fanatical optimization—not as a one-off project, but as a continuous process. It comes from harnessing mobile technologies to drive growth, understanding how customers use and switch between the mobile channel and other channels. And it comes from integrating digital into a great omnichannel experience that spans marketing to post-purchase.

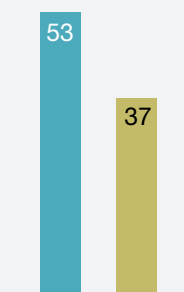
### 3. Harnessing of the full range of sales analytics

Only now is the promise of advanced analytics catching up to the hype. Take customer analytics. Companies that use it extensively see profit improvements 126 percent higher than competitors

#### Exhibit 3 Fast growers are more effective at using analytics.

Percentage by growth rate for ● fast growers and ● slow growers

**'Moderately to extremely effective' use of analytics to make decisions'**



**'Above-average' rating of advanced analytics performance'**



<sup>1</sup>Overall 1,013 companies polled; fast growers 270 companies, slow growers 356 companies.

McKinsey&Company | Source: Sales Growth 2015 Survey



who don't. And when it comes to sales improvements through the extensive use of advanced analytics, the difference is even larger: 131 percent.<sup>3</sup>

The value of advanced analytics is wide ranging, but where sales leaders excel against their peers is in making better decisions, managing accounts, uncovering insights into sales and deal opportunities, and sales strategy. In particular, they are shifting from analysis of historical data to being more predictive. They use sophisticated analytics to decide not only what the best opportunities are but also which ones will help minimize risk. In fact, in these areas three quarters of fast-growing companies believe themselves to be above average, while between 53 and 61 percent of slow-growing companies hold the same view.

But even among fast-growing companies, only just over half—53 percent—claim to be moderately or extremely effective in using analytics to make decisions. For slow-growing companies, it drops to a little over a third. This indicates that there remains significant untapped potential in sales analytics.

#### 4. Investment in people

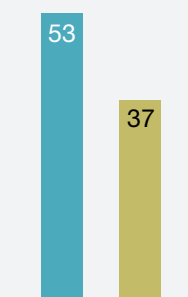
A rigorous focus on sales-force training is a clear differentiator between the fast- and slow- growing companies we surveyed. Just under half the fast growers spend significant time and money on sales-force training, compared to 29 percent of slow growers.

There's room for improvement, though. Among fast growers, just over half believe their organization has the sales capabilities it will need in the future, while

#### Exhibit 4 Fast growers focus on training and talent.

Percentage by growth rate for ● fast growers and ● slow growers

**'Moderately to extremely effective' use of analytics to make decisions'**



**'Above-average' rating of advanced analytics performance'**



<sup>1</sup>Overall 1,013 companies polled; fast growers 270 companies, slow growers 356 companies.

McKinsey&Company | Source: Sales Growth 2015 Survey

a third of the slow growers feel similarly equipped. As few as 18 percent of fast growers think they excel at pipeline management, and even in the most successful area—understanding specific customer needs—only 29 percent claimed to be outstanding.

What is notable from our research, however, is that fast growers are committed to improving sales talent and performance. The head of sales at a North American consumer-services company, for example, tried a new approach to improving sales performance after years of fruitless initiatives. Instead of focusing solely on what the sales force had to do, the program also devoted significant attention to building the talents and capabilities to enable them to do it, making a substantial investment in teaching skills and enforcing their use with specific goals. The result? A 25 percent improvement in rep productivity across all regions within 18 months. More impressive still, the gains stuck, and two years later performance was still improving.

## 5. Marriage of clear vision with leadership action

Two-thirds of fast-growing companies undertook a major performance improvement over the previous three years, and 84 percent considered it successful or very successful.

Sales leaders at these organizations said the two most important factors that contributed to that success were management articulation of a clear and consistent vision and strategy, followed by leadership commitment.

Articulating the vision should be simple. The chief executive officer of an emerging-markets telecommunications firm, for example, announced a “3 × 3 × 3” growth aspiration: three years to expand beyond its home country, three years to expand beyond its region, and three years to become a leading global brand. Besides being simple, the aspiration was bold, specific, and easily measurable.

No sales transformation will work without steadfast support from the very top. Only a committed leader can override internal politics, see the big picture, and focus on the best solution regardless of past practices. Sometimes, the commitment can be very personal. For example, the head of sales at another telecom firm recognized how fundamental customer experience was for success. At the same time that he controversially clamped down on aggressive sales techniques that had a negative effect on customer experience, he proposed to his CEO that customer satisfaction ratings should determine 25 percent of his variable pay.



Sales leaders face a dizzying array of issues and opportunities to manage, often at speeds that seemed unimaginable even a few years ago. But by focusing on what really matters, sales leaders can break away from their competitors. ■

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<sup>1</sup> Defined as companies with revenue growth of at least 6 percent and above-average growth for the sector.

<sup>2</sup> Amy Dusto, “60% of U.S. retail sales will involve the web by 2017,” October 2013, [internetretailer.com](http://internetretailer.com).

<sup>3</sup> “Five facts: How customer analytics boosts corporate performance,” McKinsey on Marketing & Sales, July 2014.

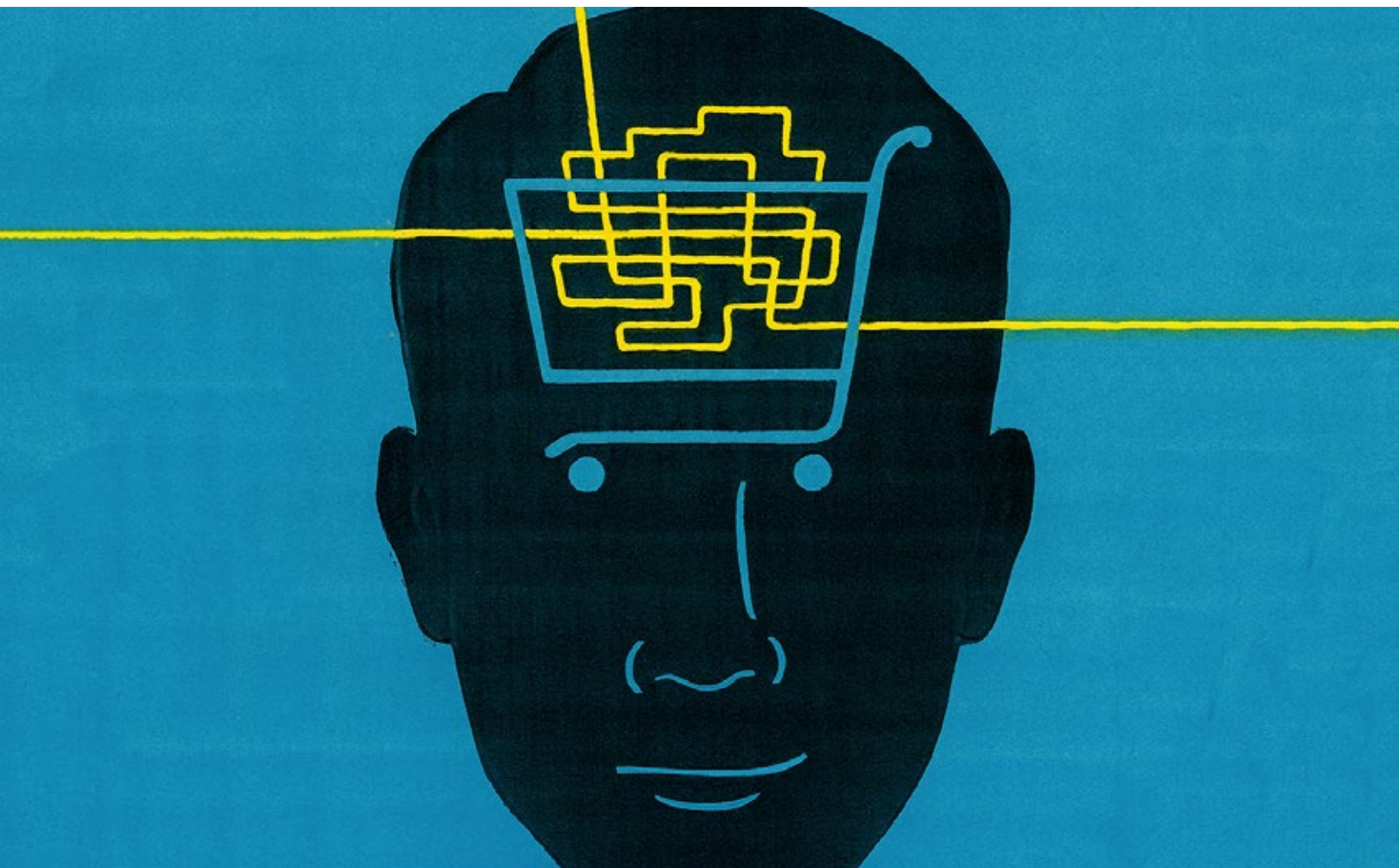
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# The new battleground for marketing-led growth

In the digital age, consumers are always shopping around. New research shows that hooking them early is the strongest path to growth.

David Court, Dave Elzinga, Bo Finneman, and Jesko Perrey



The CEO of a branded apparel company was troubled and began putting some tough questions to the marketing department. The company had spent substantially on promotions and loyalty-rewards programs to drive much-needed growth based on studies showing that targeting current consumers with marketing investments offered the highest return. Yet sales results were disappointing, and an alarming number of customers were drifting away after their initial purchases. They were often going to a rival with a different marketing approach, one that deployed social media to lure shoppers to its website, where—even the chief marketing officer had to admit—creative interactions were attracting new consumers to consider the rival’s brand.

If you’re the CEO of, say, a consumer-products company—or one in banking, travel, autos, or other categories where it’s easy for your consumers to compare products—you may be finding yourself similarly perplexed, and with reason. Powerful new currents are disrupting established patterns of behavior. And consumers, including those you may have thought loyal, are considering someone else’s offerings more often than you realize. With top-line growth at the top of every CEO’s agenda, cracking the code of consumer behavior is more critical than ever.

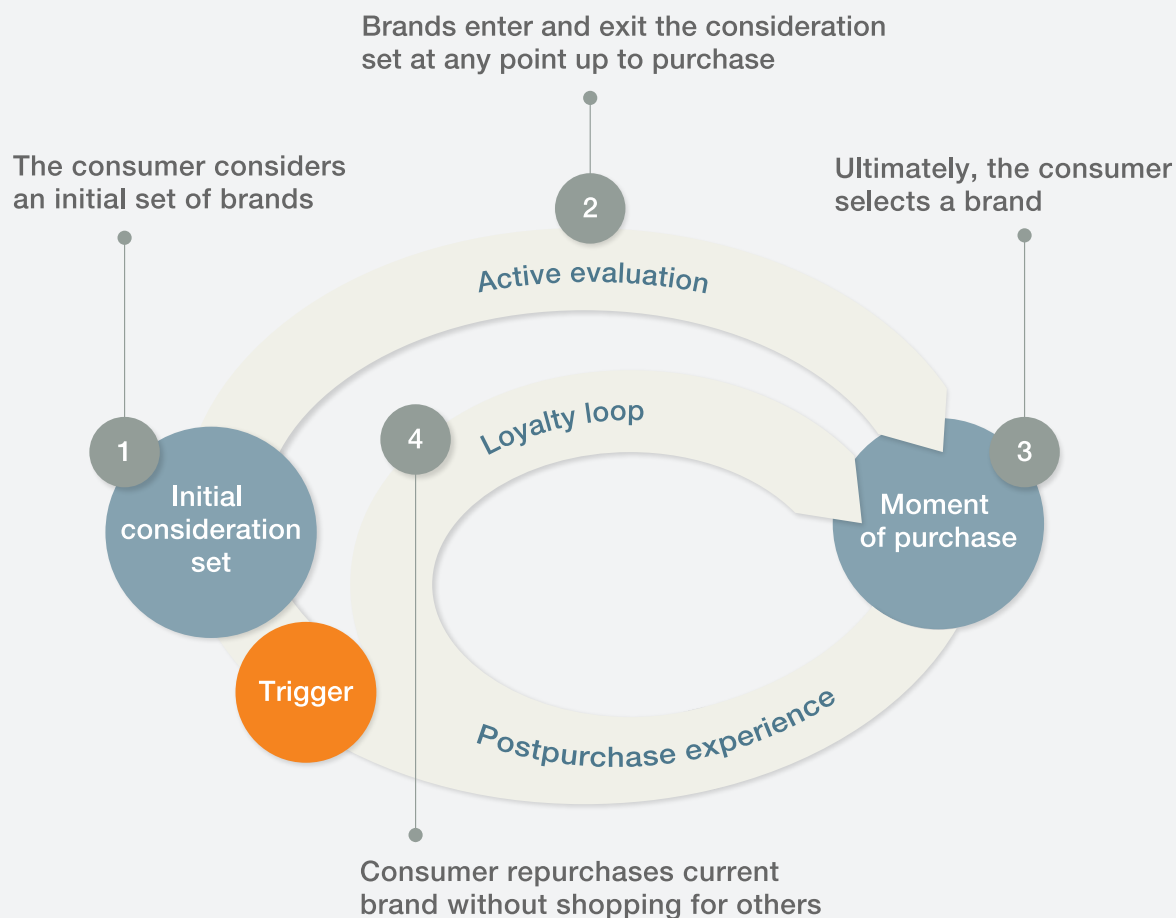
Since 2009, McKinsey has studied the emergence of consumer decision journeys (CDJs)—the often irregular paths consumers take as they move from brand awareness through to purchase and loyalty—as a critical lever to driving top-line growth (Exhibit 1). Like the apparel company described above, many have responded to nonlinear consumer behavior by doubling down on customer-retention and loyalty programs. Selling more to consumers who are already buying seems a dependable, low-risk, and potentially quick way to boost sales growth. Recent research shows a 26 percent increase in loyalty-program memberships between 2013 and 2015.<sup>1</sup>

Evidence has begun emerging, however, that consumer bonds with many brands is simultaneously slipping, with active engagement in those same loyalty programs falling by two percentage points and 58 percent of loyalty members not using the programs for which they are signed up. We see such data as an important signal that new technologies and greater choice are changing how consumers are thinking and acting across their consumer journeys. As one executive puts it, “In the digital world, your consumers can’t help but shop around.” The past few years have seen exponential growth in tools that have made researching and purchasing products online vastly easier. An explosion of mobile shopping apps that showcase options, simplify pricing, compare product specifications, and facilitate peer reviews is making it possible to size up brands effortlessly. In addition, social media lets consumers know exactly what their friends are buying and what they like and don’t like about those purchases. The sheer weight of all this encourages even your best consumers to shop around and changes paradigms that marketers have counted on for years.

To better understand the magnitude of change in consumer behavior, we turned to our CDJ database, which now covers more than 125,000 consumers, shopping for more than 350 brands. The numbers tell a startling story. Of the 30 categories we researched, only 3 were loyalty driven, with consumers predominantly making the same brand choices from one purchase to the next rather than shopping around. In the other 27 categories, consumers exhibited strong shopping tendencies (Exhibit 2).

The elusiveness of loyalty suggests marketers need to place more emphasis on the moments when consumers are initially considering which products or services to buy. They’ll need a fine-tuned understanding of who those increasingly

**Exhibit 1 The consumer decision journey has four key battlegrounds.**



fickle consumers are, what triggers them to shop, and how best to enter what's known as the initial consideration set. And of course, once a brand is in a consumer's consideration set, marketers will still need to fend off competitors as they attempt to dislodge it during a round of active evaluation, thus increasing the odds of converting shoppers at the moment of purchase.

**Your new 'shop-around' consumers**

We sought further to understand the extent to which shopping led to either a repurchase or, alternatively,

a switch to another brand. Within the 27 categories where shopping around was dominant, we divided consumers into three groups based on what the data said about their buying behavior. Loyalists were those who remained faithful to the last brand they purchased without considering other choices. Vulnerable repurchasers gave in to the urge to shop around and considered other brands at least briefly, but ended up returning to the fold. Switchers took the next step and purchased another brand.

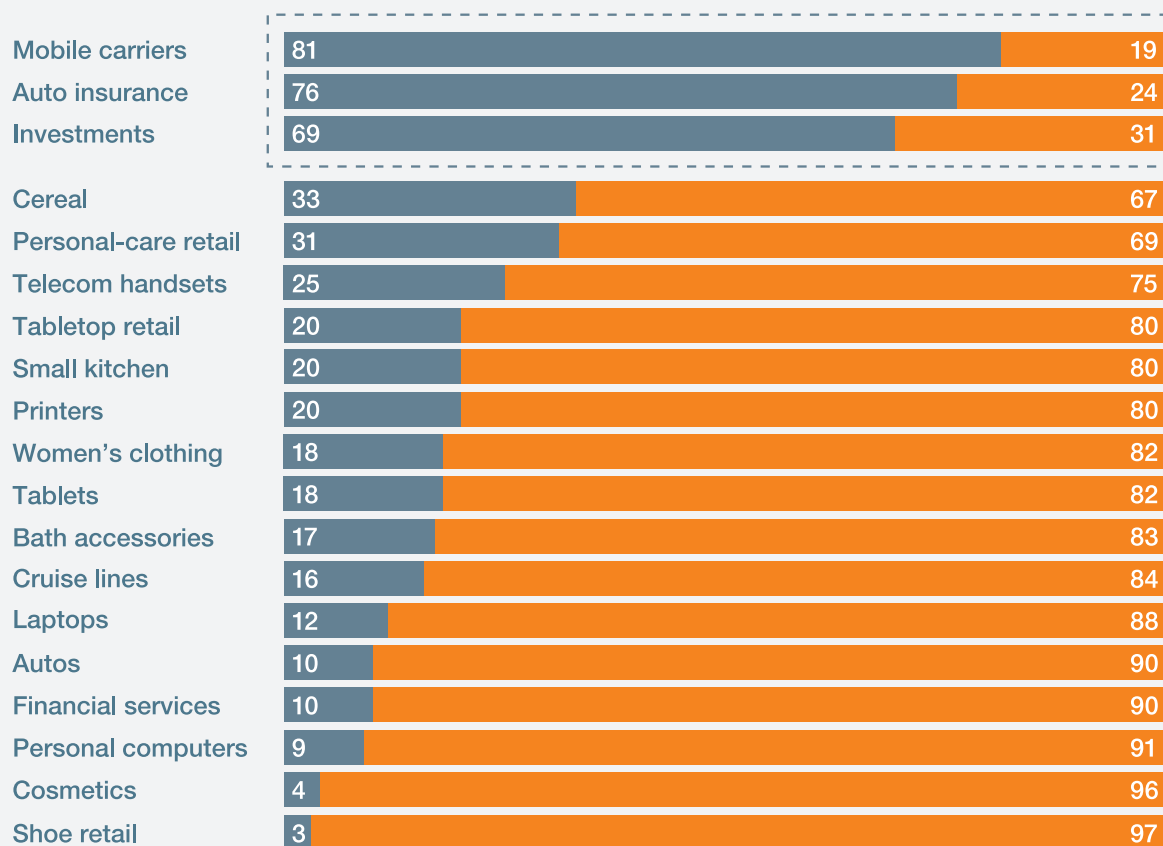


## Exhibit 2 Purchases in most categories are driven more by shopping than by loyalty.

Share of purchases that are loyalty driven vs shopping driven, selected categories, %

■ Loyalty ■ Shopping

□ Loyalty-driven categories

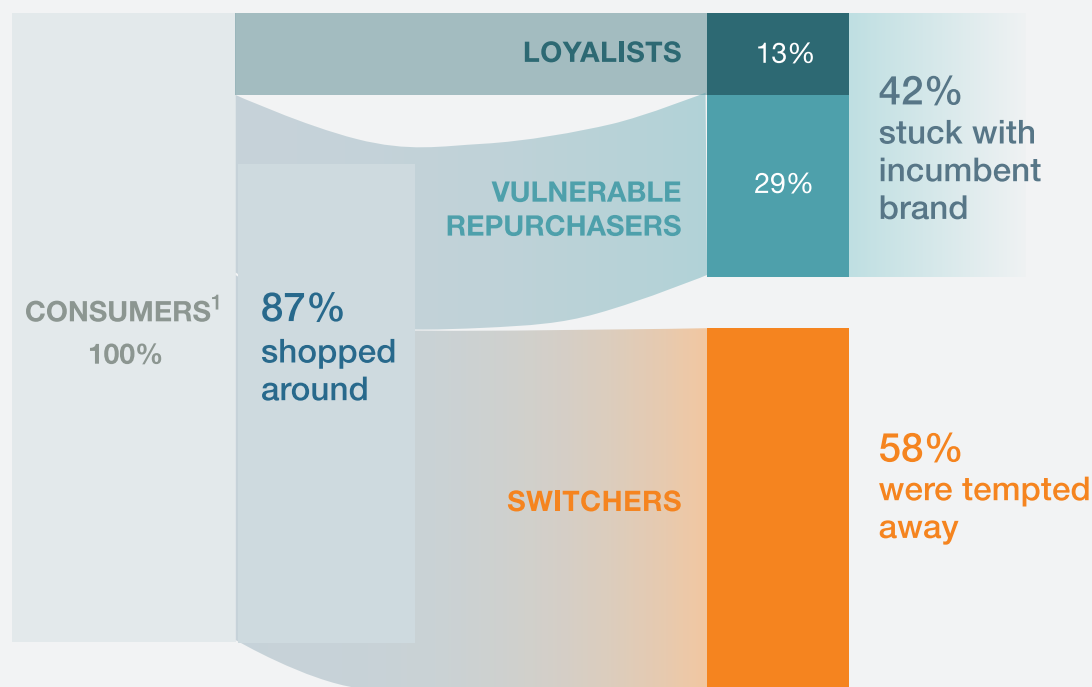


What surprised us was not only how ephemeral loyalty is, but also how often consumers switched brands once they decided to shop. In the categories where we examined purchase behavior, only 13 percent of consumers were loyalists. A full 87 percent of consumers, in other words, were shopping around. A portion of this group—the vulnerable repurchasers, who represented 29 percent of all consumers studied—ultimately didn't change

brands. But the remainder, comprising 58 percent of our sample, became switchers. Incumbent brands held their own just 42 percent of the time (Exhibit 3).

Digging deeper, we discovered just how vital it is to be included in the set of brands that first come to a consumer's mind when he or she is triggered to make a purchase decision. These brands in the initial consideration set were more than two times

**Exhibit 3 Loyalty is elusive in today's market.**



<sup>1</sup>Excludes consumers in categories characterized by loyalty: auto insurance, investments, and mobile carriers.

as likely to be purchased as were brands considered only later in the decision journey. (Downstream consideration might take place, for example, when a buyer performs a more thorough comparison of products using online tools or evaluates products like televisions in a retail store.) Overall, 69 percent of the brands purchased by consumers who switched brands were part of their initial consideration set when they started shopping.

We're not suggesting that marketers ignore other parts of the consumer decision journey. Providing quality and service, or rewarding your most loyal customers during the postpurchase experience,

remains important. After all, as we have noted, 42 percent of purchases are still made by consumers who return to their incumbent brand and are responsive to repurchasing incentives.

But investing too much of your marketing dollars in loyalty is risky when today's shop-around environment means it's easy to lose consumers faster than you add new ones. Instead, companies that hope to move the growth needle need more focus on innovative programs for the 87 percent of consumers out there who are likely to look beyond their current brand.

### The link between initial consideration and growth

In a world where most categories are shopping driven, consideration and growth should be strongly correlated—and they are. We used our survey data to identify how frequently a consumer put a given brand in his or her initial consideration set versus other brands in the category. We then divided that consideration measure by the brand's market share and multiplied it by 100.

This metric, which we call the customer growth indicator (CGI), takes into account the consideration a brand is able to command, as well as the fact that as a brand's share grows, greater consideration is needed to keep up the pace of growth.

For most categories in our research, CGI explains a full 60 to 80 percent of the variation in sales growth from one purchase to the next (Exhibit 4). The tight linkage between CGI and growth underscores the importance of initial consideration to a company's brand strategy and suggests the new metric should be a useful benchmark for assessing brand health.

In fact, we would suggest that companies augment current metrics to include the CGI as a way to better understand their potential growth relative to competitors. Today's recommendation metrics are a valuable means of understanding whether marketing programs are delivering loyalty and customer satisfaction, but research has found they can explain only 20–60 percent of variations in growth.

Further evidence for the rising importance of engaging shoppers early came when we tested the relationship between growth and total consideration, which includes those brands considered at the initial shopping trigger point, as well as those added throughout the full shopping process. We found that initial consideration, isolated as a factor, is generally

much better than total consideration at explaining the variance in near term (within one year) growth. That explanatory power confirms the need for marketers to win attention for their brands at the very beginning of a shopper's journey.<sup>2</sup>

### Marketing to increase consideration

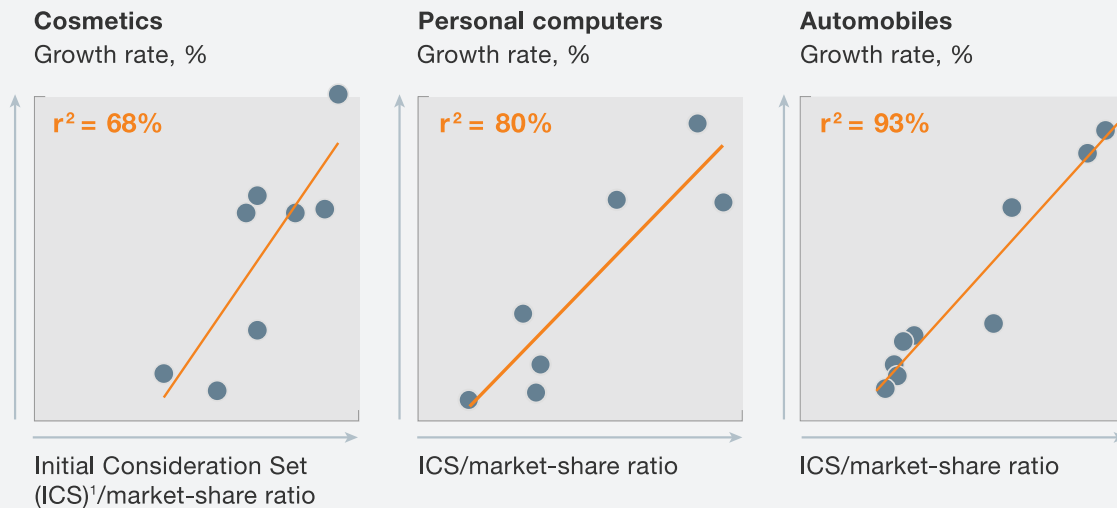
Earning initial consideration goes well beyond getting shoppers to be aware of your brand name. They also need to have a clear enough sense of its unique benefits and value to include it among products they plan to evaluate as they begin their journey toward a purchase. While traditionally, this would have prompted companies to increase spending on television advertising, today many additional avenues are open to drive shoppers to brands. We'll focus here on three proactive moves companies can take to boost initial consideration, drawing some lessons from companies that have category-leading CGIs.

### Resegment the consumers you don't target

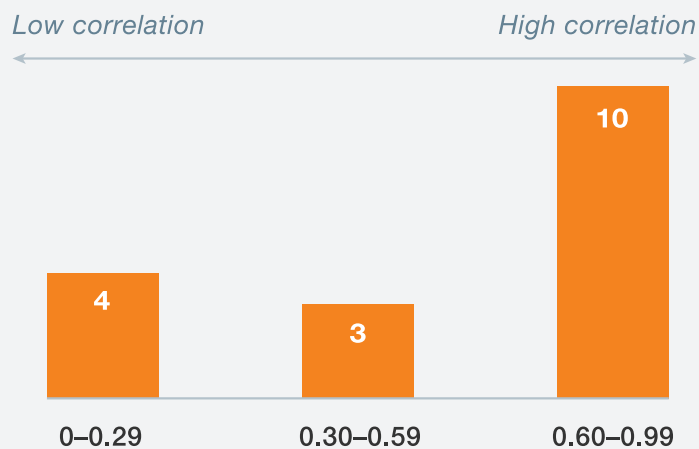
Loyalty-based marketing doubles down on a narrow selection of high-value consumers and then spends on incentives to retain them. By contrast, marketing geared to growing initial consideration will exploit a more diverse and wider set of consumer segments, many with limited or perhaps even no experience with the brand. The name of the game is expanding your window for growth potential, which is likely to demand quite different approaches for shoppers who have and have not previously engaged with the brand. Consider first consumers who have had a positive experience with the brand in the past but have stopped buying. These "lapsed" customers may hold high potential: our research shows the most important touchpoint for driving initial consideration is previous interaction with a brand, even if the interaction happened several years before. So marketers need to look hard at the reasons behind consumers' "no repurchase" decisions. In some cases, a better offer may have

**Exhibit 4 In most shopping-driven categories, the ratio of initial consideration to market share explains more than 60 percent of the variance in growth.**

Selected industry examples



**Distribution of  $r^2$  values, number of industries<sup>2</sup>**



Note:  $r^2$  is the proportion or percentage of variance explained by a regression.

<sup>1</sup>The brands a consumer thinks of when first deciding to make a purchase.

<sup>2</sup>Calculated as growth to ICS/market share ratio; includes 17 shopping-driven categories; excludes 3 loyalty-driven categories and 10 shopping-driven categories for which data were unavailable.

stolen away a lapsed customer; in others, lifestyles or habits have changed. Some consumers may never have connected emotionally to your brand. The task of rekindling initial consideration is likely to look quite different across consumer groups like these.

For consumers who have had no experience with the brand, the underlying issues can be even more complex. The consumers in question may not understand the brand, often have never considered it, and sometimes even harbor feelings that the entire category just isn't for them. Take vacation cruises, which some consumers reject out of hand because of preconceived notions about the cost or nature of the cruising experience. Disney, though, has built on its well-known brand in entertainment to expand into the vacation-cruise category. With a sharp focus on creating unique experiences, Disney has attracted consumers who ordinarily would not have considered a cruise vacation. Disney led its category in our CGI measure and has experienced above-average growth compared to other cruise providers.

#### Rebalance marketing budgets, giving more weight to what counts most

While the importance of consideration is hardly a new concept, the need to elevate initial consideration requires new focus. The basic playbook for driving more of it is straightforward: deemphasize lower returning marketing investments, many of which may ignore initial consideration, and spend more to encourage it.

#### Prune spending on closing the sale and loyalty.

Although many marketers emphasize sales incentives and rewards for loyalty, such initiatives are poor at driving consideration and also can run into diminishing returns. Airlines, for instance, have been cutting back their loyalty programs and raising the requirements to achieve elite status for several years because the programs, while effective, simply became too expensive. Many consumer marketers including packaged-goods, automotive,

and financial-services companies are also taking a deeper look at the true return on spending from short-term sales incentives and finding significant opportunities to reduce spending. Actions like these that shift budgets away from lower-productivity spending are critical since they free up resources for initiatives that drive initial consideration among promising segments. For example, during the recession that started in 2008, rather than just follow the usual auto-industry playbook by trying to stop the bleeding with short-term sales incentives, Hyundai used an innovative marketing campaign to build consideration. It promised to take back cars from customers who had lost their jobs to drive up consideration among consumers financially unsettled by the recession. Hyundai had an impressive CGI score, and it also was one of the very few auto companies to grow at a time when the industry was widely losing ground—a signal of the importance of initial consideration not only in up markets, but also in tough environments.

*Encourage consideration.* With funding freed up, you need to begin expanding initial consideration across two horizons of marketing engagement. First, you'll need new ways of boosting broad awareness of your products, services, and brand—likely using major media or social channels—that give consumers a reason for learning more about your brand. Second, you'll need an innovative approach for translating traffic beyond simple awareness to real brand consideration, often on your website, where there's an opportunity to convey a fuller picture of the brand's value through creative interactions.

Cosmetics firm L'Oreal and financial-services player Charles Schwab suggest how this can be done. Both used social media and display ads to drive a wide cross section of consumers to their websites, where they offered them user-friendly tools that encouraged brand interactions. For L'Oreal, it was



teaching consumers the right way to apply makeup; for Charles Schwab, it was a tool to help learn the basics of financial planning. Gilt Groupe, the online luxury-goods site, took a different approach. It used broad-reach banners ads, each of which highlighted very low prices for designer brands. Once the consumer followed the link to the website, he or she learned of the brand's innovative business model and value proposition—an inside track on great deals. The goal in each case has been to use the broad reach of social and digital channels to highlight a unique offer that persuades consumers to learn more about the brand, thereby building consideration.

#### Build a pipeline of innovative product, service, and brand news

Creating more innovative and exciting products or variations can grow consideration organically. News about a brand often is a powerful trigger for new consumers to add it to their initial consideration set. It also keeps current customers engaged. While the news must of course be relevant, it can range from announcements about new products or features to messages that position products creatively to new types of consumers who don't have the brand in their consideration set. Credit-card marketers, for instance, often design new product offerings that spur current and new consumers to reevaluate preferences. For example, Bank of America's BankAmericard Better Balance Rewards credit card, Capital One's Quicksilver card, Citi's Double Cash card, and the Discover It card have all promoted innovations that increase the likelihood of consideration by rewarding consumers for card usage in new and differentiated ways.

The CGI leaders in our database have a tradition of building buzz with brand news as part of an integrated plan. Consider Apple, which earns high CGI scores and has outgrown competitors by offering product innovation and a differentiated consumer experience. It has long used product news

on innovations to stoke the interest of shoppers who then place the brand in their initial consideration set.



Every company we know is sweating out efforts to increase revenue from their brands. Earning a spot in consumer' highly valuable initial consideration sets has never been more crucial. Measures like the initial consideration index can help companies understand how their brands stack up against those of competitors while offering a way to track progress as they encourage consumers to consider their brands first.

None of this, of course, diminishes the need for a well-orchestrated program across the consumer decision journey, including staying in the mix during active evaluation, converting sales at the moment of purchase, and ensuring loyalty and retention. Yet in a world where market noise will inevitably increase, initial consideration has emerged as marketing's most critical battleground. ■

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<sup>1</sup> See "U.S. customer loyalty program memberships top 3 billion for first time, 2015 Colloquy census shows," Colloquy, February 9, 2015, colloquy.com.

<sup>2</sup> As an example, in personal computers, the r-squared value is stronger (80) when using initial consideration than when using total consideration (37).

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# Marketing's Holy Grail: Digital personalization at scale

Personalization drives growth. But to scale it, companies need to do four things.

Hussein Kalaoui, Joel Maynes, Gustavo Schuler, and Brian Gregg



Customers decide very quickly—in a matter of seconds—whether they like your marketing message. Provide something relevant and you’ve got a satisfied customer. Miss the mark, however, and they’re gone.<sup>1</sup>

This issue of relevance in our era of instant gratification is particularly pronounced because consumers are bombarded with messages, most of which are off target. Personalization—the tailoring of messages or offers to individuals based on their actual behavior—promises to address this issue.

While many companies have been able to personalize with a few product lines or segments, most still struggle to scale across all the ways they engage with customers. And although technology has an important role to play, in our experience, most companies already have plenty of tools. The real challenge is to transform the marketing organization’s processes and practices to achieve the full potential of personalization.

Done right, personalization enhances customers’ lives and increases engagement and loyalty by delivering messages that are tuned to and even anticipate what customers really want. These benefits to the customer translate into benefits for the company as well. Personalization can reduce acquisition costs by as much as 50 percent, lift revenues by 5 to 15 percent, and increase the efficiency of marketing spend by 10 to 30 percent.<sup>2</sup>

Through more than a hundred engagements over the past five years, we’ve found four steps that lead to successful digital personalization at scale:

#### **Step 1: Take a journey lens: Use behavioral data to find where the value is**

The foundation of personalization is acting on behavioral data. The first step is to group customers with similar behaviors and needs. For example, mothers who exclusively shop a brand for their

children or fashion-conscious young women who buy new private-label styles. Most companies find it useful to start with eight to ten such behaviorally based segments as a first step in their evolution to 1:1 marketing.

The next task is to understand, for each segment, the customer journey<sup>3</sup>—the series of interactions with a brand from initial consideration, to purchase and use, and then to subsequent purchases. Marketers can do this by integrating information from internal sources such as visits to the company website, purchases at a store, or calls to the contact center, with information that can be acquired from external sources, such as prospects’ visits to a competitor’s website.

Combining these segments and customer journeys creates hundreds if not thousands of “microsegments,” which form the basis of 1:1 personalization. Not all microsegments are created equal, of course. The potential of each must be evaluated and prioritized carefully, based on relative value. For example, a leading retailer we worked with determined that it is more valuable to engage its customers within their “resupply” window—e.g., by reminding them they may be running out of toothpaste and their favorite brand has a limited-time offer—than by pushing them to go deeper in the category by suggesting other oral-care products such as mouthwash or teeth whiteners.

#### **Step 2: Listen and respond: Plan in advance to react quickly to customer signals**

Personalized marketing is a two-way street: The customer provides signals—information about his or her needs and intentions—through activities like purchases, online browsing, and social media posts. The company responds to the signal with a relevant and timely message, which we call a trigger, that is sent to the individual customer.

Doing this effectively requires careful advance planning. The marketing team needs to develop a library of trigger messages matched to individual signals.

Trigger messages can be of different types—images, copy, titles, offers—that can be combined dynamically to match the situation.

Coming up with trigger events involves creative problem solving grounded in sound analytics. For example, a next-product-to-buy algorithm based on machine learning could send a message suggesting a set of related products triggered when mothers have clicked on a different product but not bought it (see sidebar, “How personalization that works creates value for customers”).

For all the preparation, getting the full value from triggers requires a test-and-learn process: sending an initial message, evaluating the results, altering the trigger, and measuring the results again. It typically takes four to five attempts to refine a personalized trigger to capture 80 percent of its potential value. For example, a leading apparel retailer we worked with went through four different iterations of a next-product-to-buy email until it found the winning formula, which ended up yielding twice the impact of the first iteration. Additional refinement after that usually yielded diminishing returns.

These sorts of personalized triggers have been shown to be three to four times more effective than blast messages. They can also introduce the customer to new products and new modes of interaction (such as buying online vs. in store) that are more convenient, further enhancing their experience.

Once a signal and associated trigger have been shown to be valid and refined, it becomes a business

rule, and all future customers associated with the signal automatically receive the appropriate trigger message.

### Step 3: Build the war room: Empower a small group of the right people

Going from the traditional marketing calendar to personalized triggers sent in response to individual customer’s signals means shifting to a radically different way of working. This is where we see many organizations get stuck. The secret to kick-starting this change is to empower a small group of the right people. To quote cultural anthropologist Margaret Mead: “Never doubt that a small group of thoughtful, committed citizens can change the world; indeed, it’s the only thing that ever has.” The same can be said of your company.

We call these small groups “war-room teams.” They are staffed with 8–15 carefully selected people, including a campaign manager and staff from creative, digital media, analytics, operations, and IT. A medium-sized e-commerce company might need just one such team; we have seen large organizations with as many as eight teams like this working at once. To be successful, the war-room teams need executive sponsorship at the very top of the organization to remove roadblocks and empower them to get things done, often through creative workarounds.

This is not a task force where people come together a few hours a week while staying in their prior jobs; the team members must be dedicated full-time to the war room. Their job is to drive business results—not merely clickthroughs or page views, but a materially better customer experience and actual dollars. At a wireless carrier, for example, the objective might be lower churn for multiline households; at a retailer, increased follow-on sales to new customers in their first 90 days by introducing them to more-convenient online purchases or products they did not know about.



## How personalization that works creates value for customers

- Signal 1** Mary is a mother with two children in primary school. Early last August, she visited one of the retailer's stores to buy items for her kids, including several she'd previously viewed online. Those items were logged and attached to Mary's profile in the store's database.
- Signal 2** This July, Mary browses children's clothes on the same retailer's website but does not click "buy." Her combined offline + online behavior during the back-to-school shopping period as well as the items in which she's shown interest in create the signal that Mary may be open to making her first back-to-school online purchase for her young children.
- Trigger** Within 24 hours of her most recent browsing action, she receives a personalized email offering a 10 percent discount on select items she's been reviewing, if she purchases them online. The message explains that the process is safe and easy and includes tips on how to move selections into the shopping cart and check out. It also suggests additional items she might consider, based on analysis of her past purchases and recent browsing behavior.

A war-room team does this by day-in and day-out searching for the signals with the highest potential value and developing, launching, and iterating on personalized messages that get results. At the start of a personalization program, each team should launch one to two new triggers per week. As they gain experience, they should be launching one to two new triggers per day.

### **Step 4: Rewire and hardwire: Focus on the processes and technology that really help teams work faster**

To work at this pace at scale, agile processes have to replace the old ones. For example, in the new world where copy, creative content, and templates can be quickly mixed and matched to create a near-infinite number of personalized variations, cumbersome and lengthy approval processes simply have to go. Teams need to be empowered to act on their own to quickly test and iterate different ideas and zero in on

what works. Mistakes will happen, but leadership needs to be ready to accept that, learn lessons, and move on.

The second thing needed to work at this pace at scale is the right automation technology. Assembling and operating a marketing-automation tech stack, however, can be a challenge.<sup>4</sup> There are literally thousands of providers of tools, and despite vendors' claims, no single party offers a true end-to-end solution. Companies are left on their own to filter the hype, figure out what to buy, and do the integration themselves. The result is all too often automation software spitting out millions of messages that amount to little more than spam.

The technology's job should be to help the war room teams find signals and deliver triggers more efficiently. So the work of these teams should



guide the evolution of the tech stack. Proceeding in this way, the organization can set the right requirements and parameters to help narrow in on the tech stack solutions that will create real value.



Growth is difficult, but our research shows that it's possible to bring a disciplined approach to improving your growth trajectory. Build momentum through well-sequenced initiatives. Support them with the right capabilities. And get your organization on board with a multifaceted approach that often will rest on a strong foundation of resource allocation and execution before taking on the tougher discipline of innovation. While this may challenge some traditional growth tenets, it also offers a reason to start moving—with confidence. What you do well today prepares the way for the next leg of the climb. ■

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<sup>1</sup> Eyequant, “How many seconds does your website have to capture user attention?” April 8, 2013.

<sup>2</sup> Matt Ariker, Jason Heller, Alejandro Diaz, and Jesko Perrey, “How marketers can personalize at scale,” *Harvard Business Review*, November 23, 2015.

<sup>3</sup> David Court, Dave Elzinga, Susan Mulder, and Ole Jørgen Vetvik, “The customer decision journey,” *McKinsey Quarterly*, June 2009. David C. Edelman and Marc Singer, “Competing on customer journeys,” *Harvard Business Review*, November 2015.

<sup>3</sup> Scott Brinker and Jason Heller, “Making marketing technology work,” May 2015, McKinsey.com; Matt Ariker, Nimal Manuel, and Marc Singer, “The big data trinity: Creating an analytics system to support a learning culture,” August 2015, McKinsey.com.

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# How retailers can drive profitable growth through dynamic pricing

The secret is in customization: dynamic-pricing solutions must be tailored to a retailer's business context, objectives, and ways of working.

Gadi Benmark, Sebastian Klapdor, Mathias Kullmann, and Ramji Sundararajan



When it comes to dynamic pricing, Amazon is still the retailer to beat. Other retailers continue to marvel at—and attempt to emulate—the e-commerce giant’s ability to rapidly and frequently change prices on millions of items. Amazon continually burnishes its low-price reputation by undercutting competitors on top-selling, high-visibility products, while protecting margins by charging more for less price-sensitive items. Indeed, the success of Amazon and a handful of other leading online players has made clear that dynamic pricing is a critical capability for competing in e-commerce, omnichannel, and even brick-and-mortar retail to drive revenue and margin growth.

But as retailers have begun to invest in dynamic-pricing solutions—whether off-the-shelf or custom-built by third-party providers—they’ve often run into the “black box” problem: none of the end users actually understand the math or logic behind the algorithms. The tools somehow crunch data and spit out pricing recommendations, which are sometimes much higher or lower than current retail prices. The pricing staff thus ends up rejecting them entirely because they don’t trust the recommendations.

Overcoming that trust barrier requires customizing every part of the solution, *including the implementation*. In our experience, a dynamic-pricing solution should be optimized for use by category managers and pricing managers. These end users should be involved in developing, refining, and rolling out the tool and be able to override the pricing recommendations. Only when this happens can businesses expect to capture significant and sustained impact—typically, sales growth of 2 to 5 percent and increases of 5 to 10 percent in margins, along with higher levels of customer satisfaction through improved price perception on the most competitive items.

### Five modules of dynamic pricing

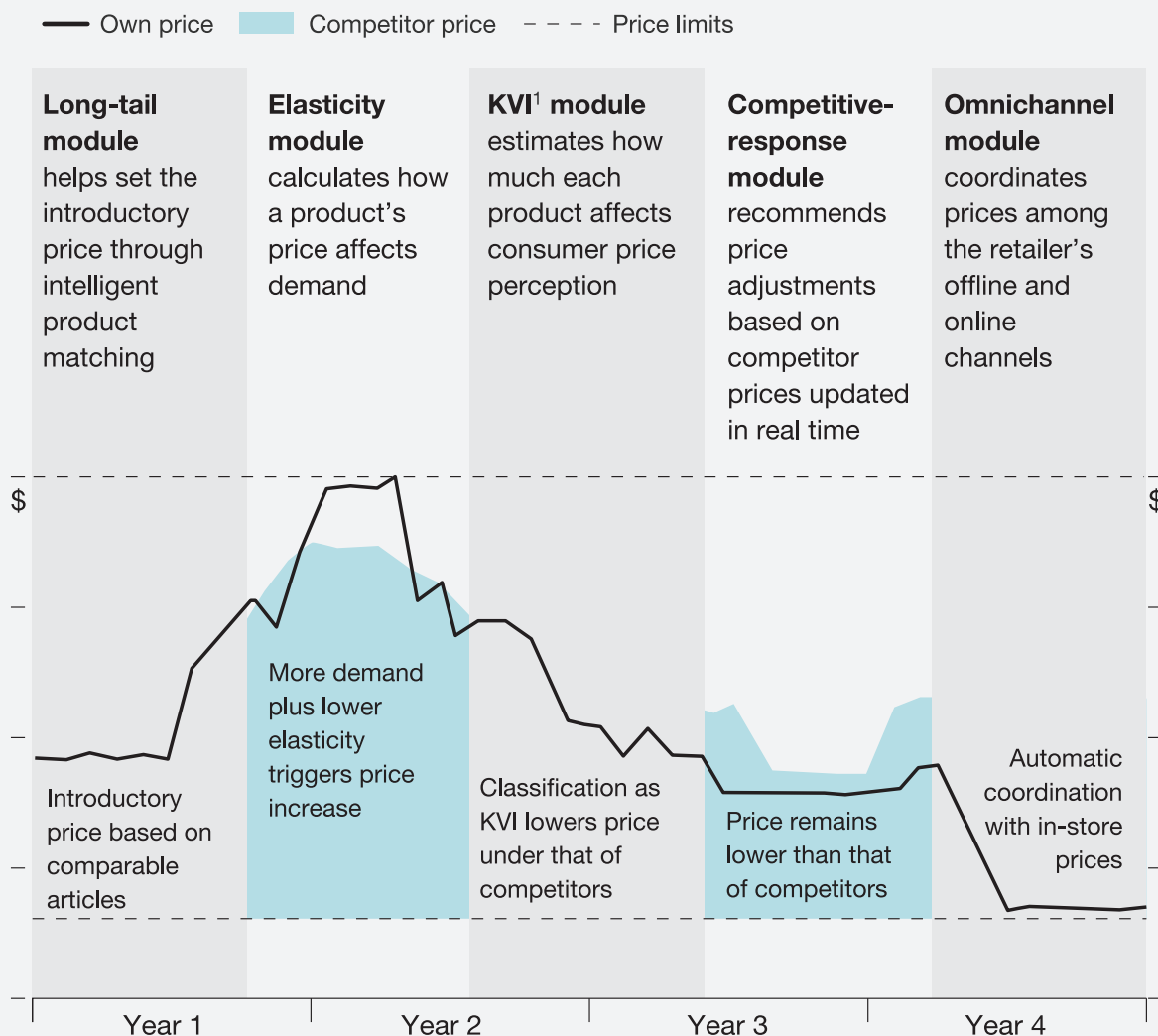
Dynamic pricing plays a crucial role in boosting both consumer price perception and retailer profitability. Many retailers sell about one-fifth of their assortment at very low prices to shape their price image and remain competitive. These key value items (KVIs) are usually top sellers, traffic generators, or highly-searched SKUs whose prices consumers tend to remember. Key-value categories can account for up to 80 percent of an average retailer’s revenue but only half of its profit. The retailer therefore needs to make up margins in the rest of the assortment—the “long tail” items. However, identifying KVIs isn’t as easy as it sounds, and setting and validating prices for long-tail items is difficult precisely because of the sparse historical data on such items.

Dynamic-pricing solutions help retailers overcome both of these challenges. Generally speaking, a robust dynamic-pricing solution should consist of five modules, all working in parallel to generate price recommendations for every SKU in the assortment (Exhibit 1).

- The **long-tail module** helps a retailer set the introductory price for new or long-tail items through intelligent product matching—that is, the module determines which data-rich products are comparable to new items (which have no history) or long-tail items (which, as mentioned, have limited historical data).
- The **elasticity module** uses time-series methods and big data analytics to calculate how a product’s price affects demand, accounting for a wide variety of factors including seasonality, cannibalization, and competitive moves.
- The **KVI module** estimates how much each product affects consumer price perception, using actual market data rather than consumer surveys. This enables the module to

## Exhibit 1 Dynamic-pricing solutions should include five modules.

### How the modules might generate price recommendations over a product's life cycle



<sup>1</sup>Key value item.

- The **competitive-response module** recommends price adjustments based on competitor prices updated in real time.
  - The **omnichannel module** coordinates prices among the retailer's offline and online channels.
- While a best-in-class solution includes all five modules, retailers can often begin with only the KVI and competitive-response modules. These

help retailers nimbly respond to competitive moves on key items. Retailers can then add the rest of the modules over time.

Developing a world-class dynamic-pricing solution starts with a thorough understanding of the retailer's business context and objectives, and then translating those into mathematical "recipes" that can be executed repeatedly. Careful selection of the inputs, as well as the sophistication of the underlying analytics, will largely determine the accuracy of each module's calculations. The tool needs to be flexible and adaptable enough for businesses to customize the inputs and features based on their particular objectives and existing capabilities, which greatly increases confidence in the outputs. And of course, whether category managers and pricing managers will ultimately use the solution in their daily work depends partly on how intuitive the interface is and how easily it integrates into the retailer's existing systems and work flows.

To build a case for dynamic pricing, a retailer could first quantify the potential of introducing dynamic pricing into the organization—for instance, by systematically comparing the retailer's price levels to those of its chief competitors, assessing how frequently competitors change their prices, and studying how competitors react to the retailer's own price changes. The findings from such an exercise will almost certainly spur the retailer to take action on dynamic pricing.

The next logical step would be to conduct a pilot in a handful of categories for concept design and testing. Done right, the pilot—and the subsequent rollout of dynamic pricing across all product categories—will yield meaningful improvements in revenue, profit, and customer price perception.

### Customizing the modules: Three case examples

The following examples illustrate how retailers can tailor dynamic-pricing modules to their particular

business needs and objectives. In each case, the retailer collected massive amounts of granular data, used advanced analytics, and made sure that category managers and pricing managers participated in developing and testing the solution.

#### A US retailer's long-tail module

A US-based general retailer with more than two million SKUs in its assortment had two high-priority business objectives that required frequent trade-offs: to maximize absolute revenues and to increase productivity. The objective functions of the algorithms in each of its modules therefore had to be adjusted accordingly—a level of customization that wouldn't have been feasible with an off-the-shelf solution.

To build its long-tail module, the retailer assembled a rich set of data, including daily sales data for its 100,000 top-selling SKUs, competitor prices (gathered via web scraping) for those SKUs, data on customer browsing and purchasing behavior, product attributes and descriptions, and online metrics such as impressions and search rankings. With algorithm-design experts and analysts working alongside category managers, the team codified a set of product-association rules specific to the retailer, using factor analysis to assign "attribute similarity scores" that indicated which products its customers find comparable. The retailer set simple ground rules for its product groupings—for example, a grouping should have minimum sales of 20 units a week, or all products in a grouping should be in the same life-cycle stage. The algorithms also helped the retailer understand which of its product prices should move in concert so as to avoid cannibalization effects.

In just eight weeks, the team built working prototypes of both the long-tail module and a competitive-response module. Both were designed and tested with pricing managers to integrate simply into the retailer's regular pricing processes



and cadence. The impact: up to 3 percent increases in both revenue and margins in the pilot categories.

#### An Asian online retailer's elasticity module

A leading Asian e-commerce player aspired to develop an item-level pricing strategy that could optimize for both profit and gross merchandise value (GMV). To that end, the company knew it needed to be able not only to change prices frequently, but also to take many more factors into consideration when setting or changing prices.

As part of a broader dynamic-pricing effort, the company built an elasticity module. At its core was a multifactor algorithm that drew on data from approximately ten terabytes of the retailer's transaction records. Data for each product included the price of the product, the price of a viable substitute product, promotions, inventory levels, seasonality, and estimates of competitors' sales volumes—creating a custom module unique to the retailer's available data and pricing strategy. The module then generated pricing recommendations, taking into account both of the retailer's business objectives.

Recommendations were displayed on an easy-to-read dashboard that category managers helped design and test. Category managers, who on any given day would be weighing other important trade-offs with regard to, say, a product's growth potential or expected additional inventory, could then accept or reject the pricing recommendations. The retailer felt strongly that category managers should have the final word on pricing decisions.

After only a few months of using the module, the company saw a 10 percent rise in gross margin and a 3 percent improvement in GMV in the pilot categories.

#### A European nonfood retailer's KVI module

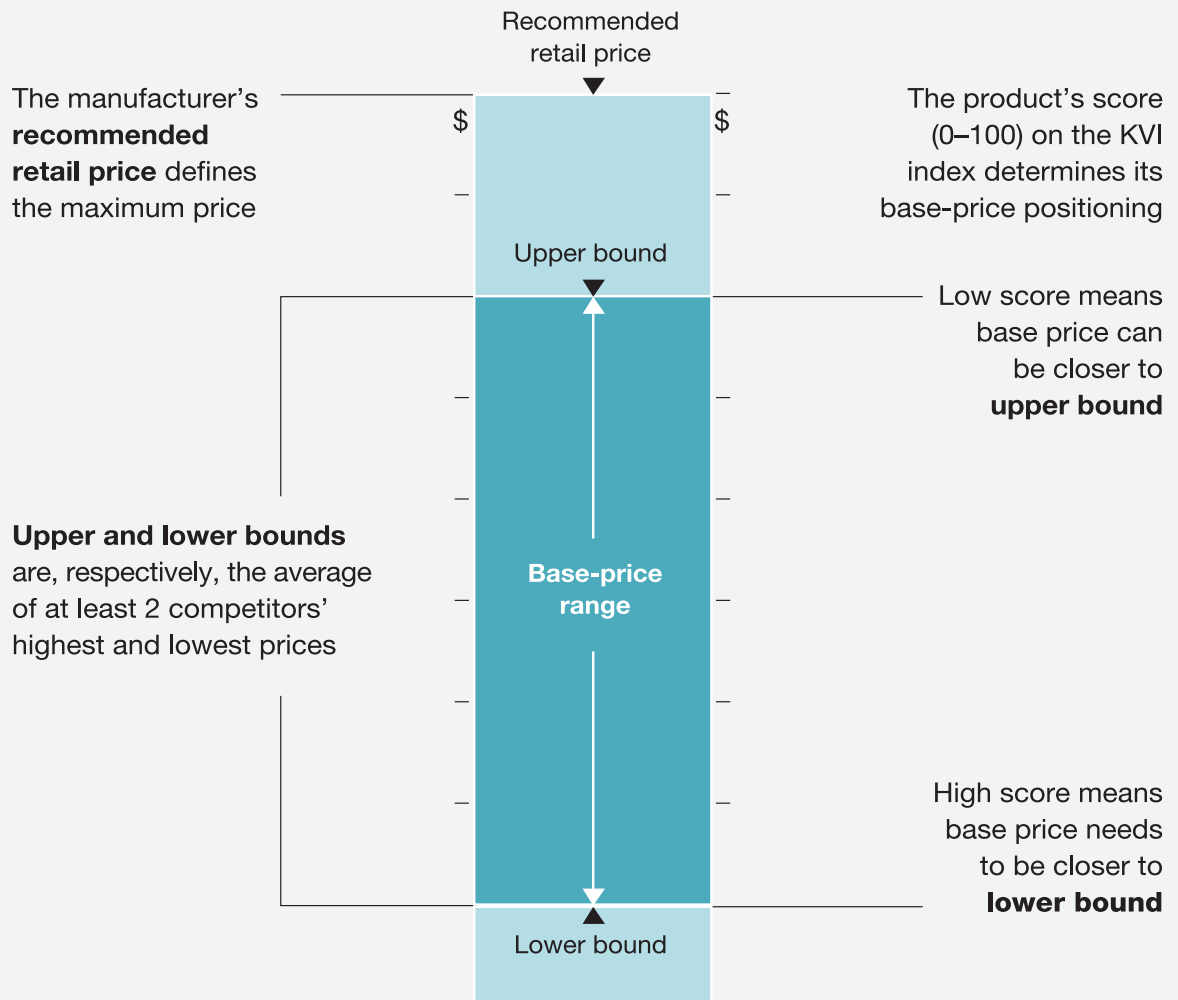
Looking to stand out from competitors, a leading European nonfood retailer sought to identify and prioritize the KVIs in its assortment. It built a tailored KVI module that could statistically score each item's importance to consumer price perception on a scale of 0 to 100. The module generated this "KVI index" by analyzing granular internal and external data, including shipping costs, return rates, search volume, number of competitors carrying the product, and competitor pricing. It also identified which other retailers were the true competitors for that specific item. Importantly, the module was flexible enough that category managers could adjust the weighting of each parameter.

The module defined the price range, or the upper and lower price bounds, for each item (Exhibit 2). Each product's exact price position within the range would then be based on its score in the KVI index.

But a KVI index to help set the base price was only the first step. Via the competitor-matching module, the retailer also programmed into its dynamic-pricing solution a set of business rules that would trigger pricing changes. For instance, if inventory levels for a certain SKU were high or if a competitor reduced the price of that SKU, the solution might recommend a price drop for the SKU. These rules would all feed into the solution's recommended price, which the category manager could either accept or reject based on additional indicators and considerations.

At the end of a three-month pilot, the retailer saw a 4.7 percent improvement in earnings before income and taxes in the pilot categories and identified a 3 percent improvement potential in overall return on sales. And it had a trusted solution that category managers could incorporate into their work flows.

**Exhibit 2 A retailer's KVI<sup>1</sup> module helps define a price range for every item in the assortment.**



<sup>1</sup>Key value item.

**Building dynamic-pricing capabilities**

In each of these examples, the retailer custom-built the algorithms and invested time and effort to ensure that the tool was adopted by end users. A test-and-learn approach, beginning with a pilot in a few categories, will help produce a solution that builds trust and yields market-proven, statistically sound

results. Just as important, the testing process can pinpoint how best to embed the solution into end users' existing work flows.

Each of the three retailers invested in detailed documentation and thorough training to strengthen the organization's skill base and

capabilities in dynamic pricing. One of the retailers even established a certification program for dynamic pricing, creating a pipeline of employees who would be qualified to manage and continually improve the pricing process.



In light of the explosive growth of e-commerce, dynamic pricing is fast becoming a must-have capability to drive growth while sustaining margins. By understanding how to move quickly and customize solutions, retailers can build this capability into a significant competitive advantage.



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# The most perfect union: Unlocking the next wave of growth by unifying creativity and analytics

Companies that harness creativity and data in tandem have growth rates twice as high as companies that don't. Here's how they do it.

Brian Gregg, Jason Heller, Jesko Perrey, and Jenny Tsai



“Ideas and numbers” have always had an uneasy alliance in marketing. To creative directors, designers, and copywriters, creativity is an instinctual process of building emotional bonds with consumers. Bring in too much quantitative analysis and the magic dies.

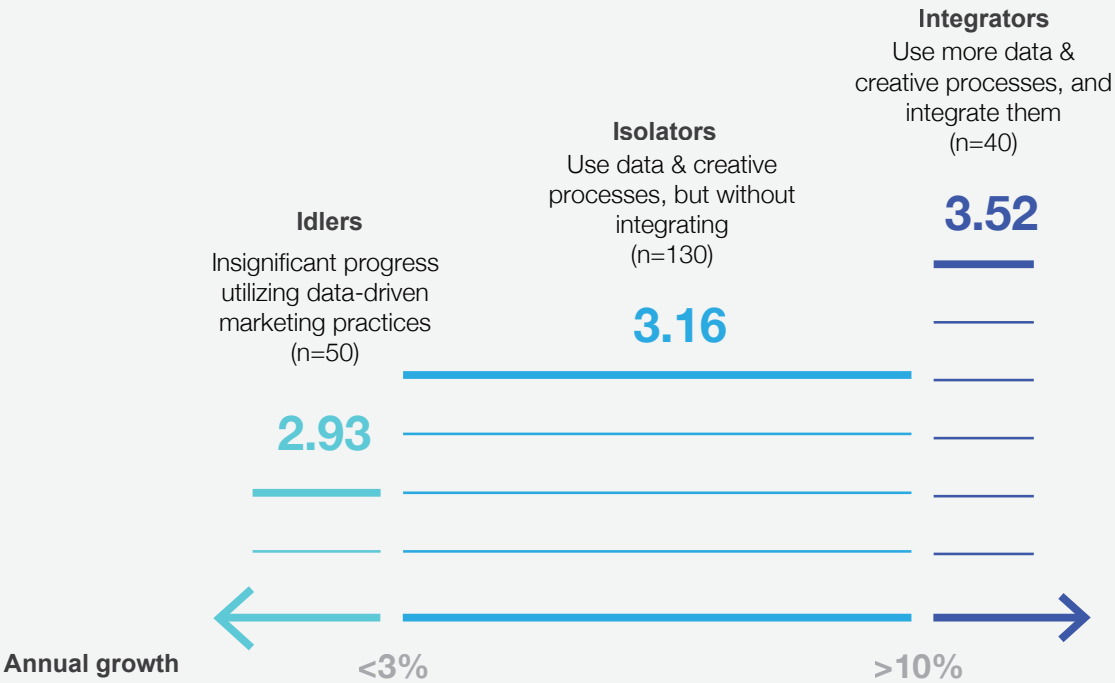
“[As marketers] we have to understand and connect with customers,” the CMO of a hospitality company recently told McKinsey. “I’m afraid the data people will win, and it will all become a commodity if brand and creativity don’t matter anymore. I’m afraid the creative process will lose its soul.”

Despite such understandable concerns, the notion that creativity and data are adversaries is simply outdated. Combining the power of human ingenuity and the insights gleaned from data analytics is a good start. But the best marketers are going a step further and integrating this power combo into all functions across the marketing value chain—from

brand strategy and consumer insights, to customer experience, product, and pricing to content and creative development, media—even measurement. Far from robbing a brand of its soul, this fusion of skills and mind-sets is an essential part of the modernization of marketing to drive growth.

As part of an ongoing series of studies in conjunction with the Cannes Lions Festival and the Association of National Advertisers, McKinsey recently surveyed more than 200 CMOs and senior marketing executives (including interviews with 25+ of the CMOs) and tracked the performance of their companies. We found that marketers who are what we call “integrators”—those who have united data and creativity—grow their revenues at twice the average rate of S&P 500 companies: at least 10 percent annually versus 5 percent (Exhibit 1). This is a welcome development for CMOs, who no longer see themselves primarily as stewards of the company’s brand, but as drivers of company growth.

**Exhibit 1     Marketers who integrate creativity and data drive more growth.**





One CMO told McKinsey that he has shifted the entire C-suite's view of marketing spend from a P&L expense to an investment the company is making in its future.

The study also revealed that while marketers rarely consider their creative output “world class” or “iconic,” those integrators with the 10+ percent growth see their efforts as “engaging,” “unique,” and a core contributor to the creation of brand equity. Some go so far as to call their creative output a key part of what sets them apart from competitors.

Here are three distinct ways in which these integrators are modernizing marketing:

### 1. They treat creativity and data as equal partners.

In companies that are integrators, creative functions are becoming more data driven, and data-driven

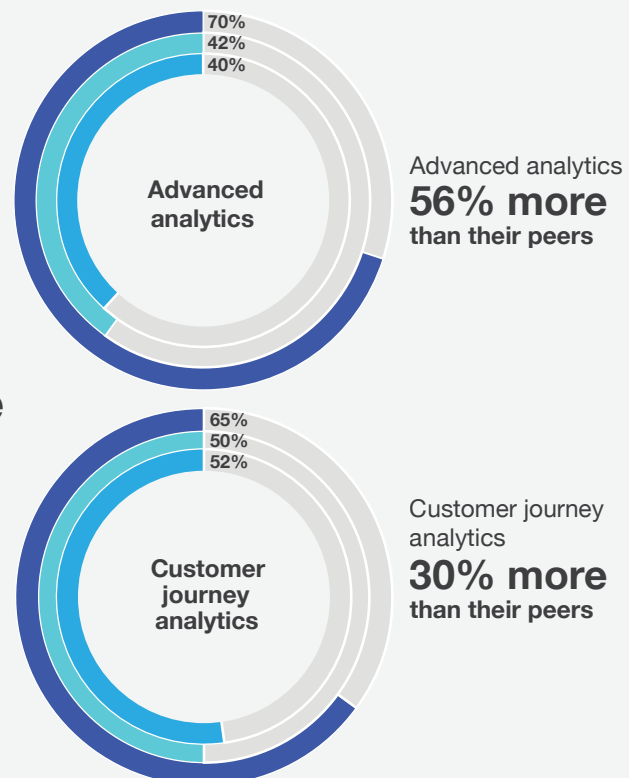
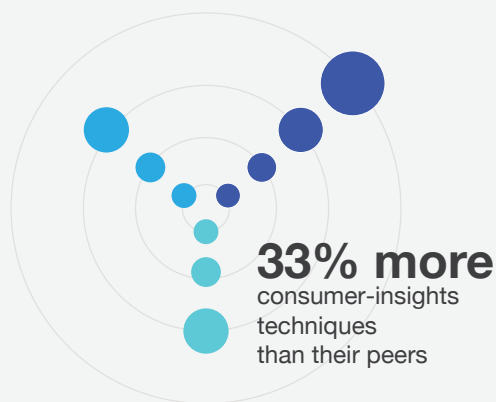
functions are growing more creative. Two areas where we see this happening most clearly are customer experience and consumer insights.

First, customer experience: Historically, this is a function overseen by people who think creatively and strategically about how to meet and exceed customer expectations. But today, data analytics can uncover customer intentions, triggers, and interests that reveal subtle pain points and unmet needs. We found that the integrators in our study continuously and rigorously mine for such insights as part of the day-to-day process of improving customer experience instead of using analytics in a separate, adjacent process (Exhibit 2). On average, they use four or more types of insights and analytic techniques, both traditional (focus groups, primary research, third-party research) and data driven (customer-journey analytics, advanced analytics,

Exhibit 2

## Integrators make better use of creativity and data than peers.

- Idlers
- Isolators
- Integrators



and artificial intelligence), whereas their non-integrator peers use three or fewer. A majority (70 percent) of integrators employ advanced analytics for consumer insights, compared with only 40 percent of companies with average growth. And 65 percent of integrators use customer-journey analytics, versus 50 percent of average growers. We call this latter category of companies “isolators” because, while they are using both data-driven and creative processes, they are doing so in isolation without integrating them across their marketing functions. The final category in our survey is “idlers”: companies that are growing 3 percent a year or less and have made insignificant progress in utilizing data-driven marketing practices.

At the same time, all this information about customers, traditionally the domain of data scientists and other left-brained talent, is now being utilized in collaboration with people in creative roles, such as content producers and experience designers. Moving advanced consumer insights out of the background and onto the dynamic front lines of customer engagement gives analysts a new voice within the creative process. They participate in the process of making their work come to life—a new campaign created, an email test sent to a new customer segment, a new on-site or in-store experience deployed. This fosters a sense of empowerment among analysts and helps uncover ideas that would otherwise never see the light of day.

## 2. They make integration a way of life through an agile marketing operating model.

Integrators have set up structures that allow them to innovate more effectively. At a higher rate than their peers, they have embraced agile marketing and have created small, nimble, cross-functional, colocated, and relatively autonomous teams that execute on single, laser-focused business objectives. Staffed with talent from throughout the marketing department and other areas of the organization, such as IT and operations, these agile teams (or

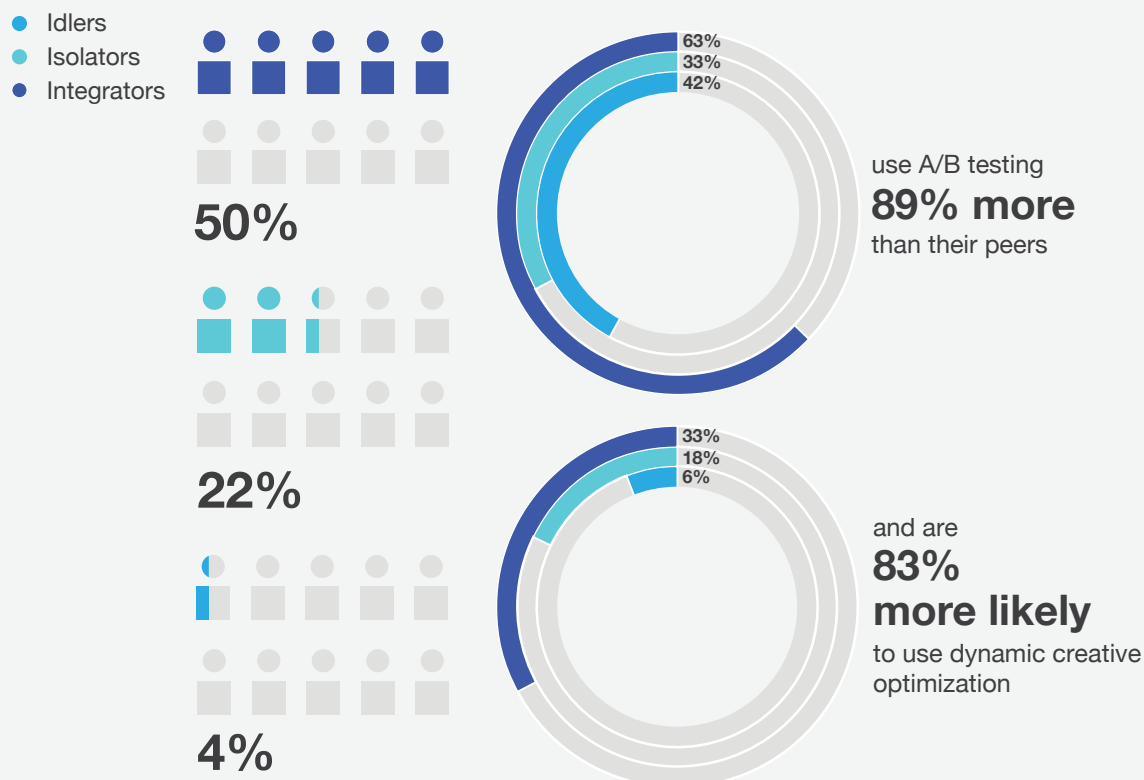
“squads”) enable people with different skills sets and backgrounds to sit side-by-side and collaborate with each other on a daily basis. This model brings several marketing functions into a single high-performing team that provides the IT and operations resources needed to bring new ideas to market. In addition, there are typically resources from legal and finance on call to support quick decision making.

This daily and tangible integration bears fruit in three important ways. First, data experts are part of the front-line marketing team. Second, integrated agile teams are able to do more faster. The absence of bottlenecks such as inter-departmental approvals enables frequent and rapid testing of new ideas, content, messages, and value propositions. As a result, the process of creating new campaigns or marketing initiatives often shrinks from months to weeks or even days. Over the last 12 months, integrators in our study were twice as successful as isolators at significantly increasing their speed to market for campaigns or marketing experiments and four times more successful than the idlers.

Finally, there is a quicker and more seamless implementation of technology solutions, thanks to a closer collaboration between marketing and IT (Exhibit 3). Half of the integrators in our study say that marketing and IT work together on a shared vision, versus 22 percent of isolators and 4 percent of idlers. Integrators also use A/B testing 68 percent more often than their peers and are 83 percent more likely to have adopted dynamic creative optimization, a technology that enables modular and dynamic personalized ads and content based on data about the individual consumer. At the other end of the spectrum, 52 percent of companies with the lowest rates of growth admit that their CMO and CTO rarely interact. This lack of coordination takes a toll on the entire marketing organization’s ability to deliver omnichannel customer experiences and to track and measure performance in proliferating channels.

Exhibit 3

## Integrators are 2x more likely to have Marketing / IT collaboration than their peers.



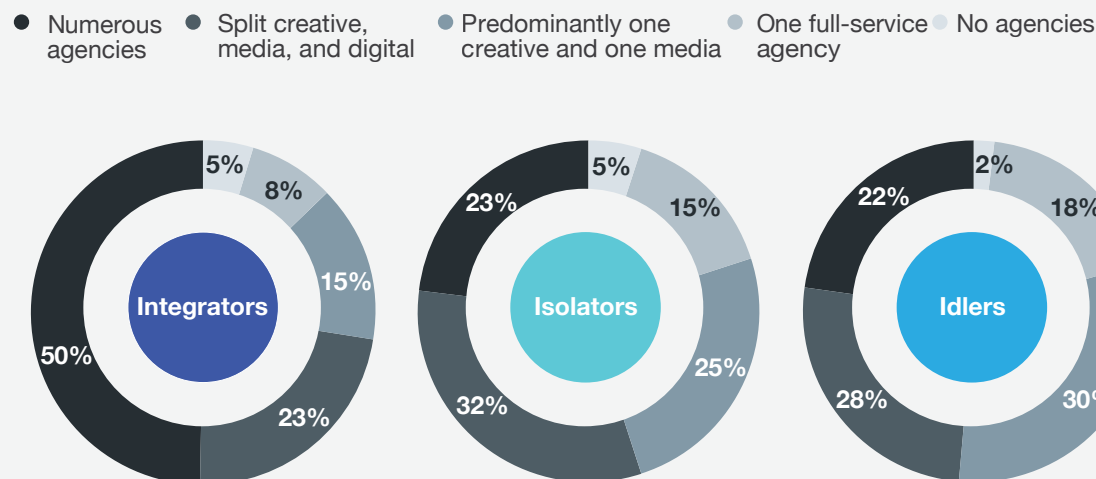
### 3. They seek “whole-brain” talent.

Hiring an award-winning creative director or a top-flight data scientist used to be enough to up the ante in a marketing department’s ability to improve performance. Integrators are now looking for something different. They want talented people who have both left- and right-brain skills, even though their primary function will utilize one more than the other. “There’s a misconception that our engineers are not creative and are just ‘numbers guys,’” the CMO of a leading tech company said. “Actually, they keep us on our toes because they’re so creative. They have extraordinary imagination and turn code into extraordinary products.” Additionally, integrators are focused on finding and nurturing people nimble enough to work with colleagues who have different skills and mind-sets than they do.

To ensure that this valuable talent pool has full control over its work product, integrators are increasingly bringing certain marketing functions in-house, particularly those closest to the customer experience, such as consumer insights and data analytics. And because rapid experimentation and testing and learning with new campaigns and designs is so critical, they are insourcing more digital media and content-creation roles. Integrators are the least likely of the three groups we’ve defined to have one large, full-service ad agency, preferring to use one or more boutique firms that specialize in emerging channels such as augmented and virtual reality, or such innovative capabilities as voice-activated commerce (Exhibit 4).

Exhibit 4

### Integrators are 50% more likely to use a variety of agencies for different types of work than their peers.



Even these leading marketing organizations don't often achieve their ideals for the recruitment and nurturing of top talent—most say that their talent is somewhere between “on par with our competitors” and “better than competitors but not best in class.” Yet they have a clear understanding of the types of people they want, and they aim high to get them (Exhibit 5).

#### Room for improvement

Although the integrators in our study excel in data-driven customer experiences, creative use of consumer insights, implementation of agile working models, and collaboration between marketing and technology staff, virtually no companies in our survey stood out across all of the capabilities needed to maximize creativity. There are several for which most companies have much room for improvement, particularly in the area of talent acquisition (Exhibit 6):

#### Measurement

Most companies can track the impact of specific marketing components in direct-response channels such as email and search-engine marketing but

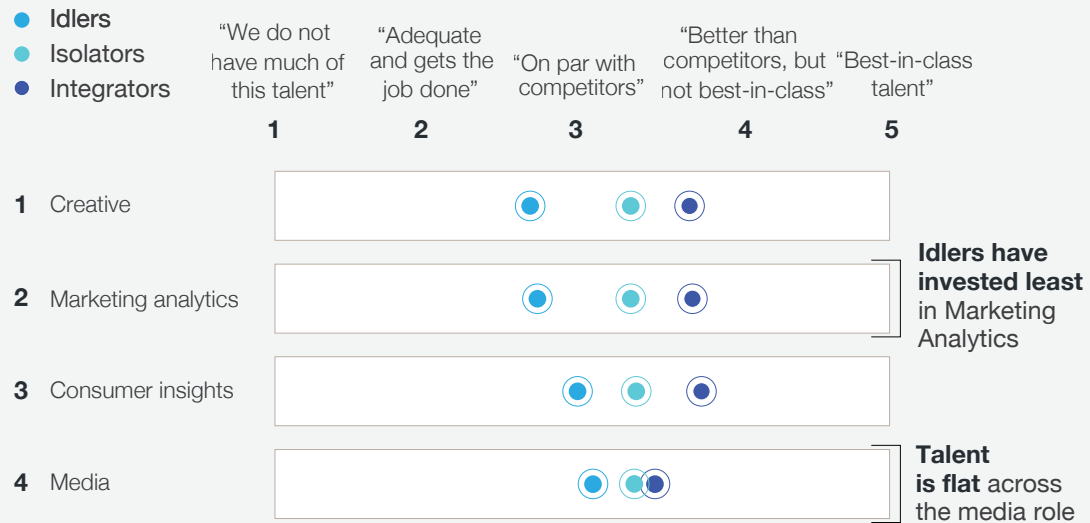
struggle to holistically measure channels (both online and offline) *and* attribute the success of a campaign to individual creative, content, and messages. Addressing this challenge requires a “mash-up” of existing technologies and approaches like media-mix modeling, which tracks both online and offline marketing channels; multitouch attribution, which allows companies to track the addressable touchpoints across a customer's journey; and advanced machine learning, which helps combine the two and use adaptive modeling to forecast the impact of shifts in marketing spending. At the moment, very few companies are doing any of this. Even among integrators, only 33 percent say they have the ability to track the ROI of their creative content for all campaigns and in all channels (versus 15 percent of their peers).

#### AI-driven consumer insights

Artificial intelligence (when thoughtfully applied to protect consumer privacy) can help marketers learn things even the most creative humans can't. By using natural-language processing, for instance, companies can figure out that a

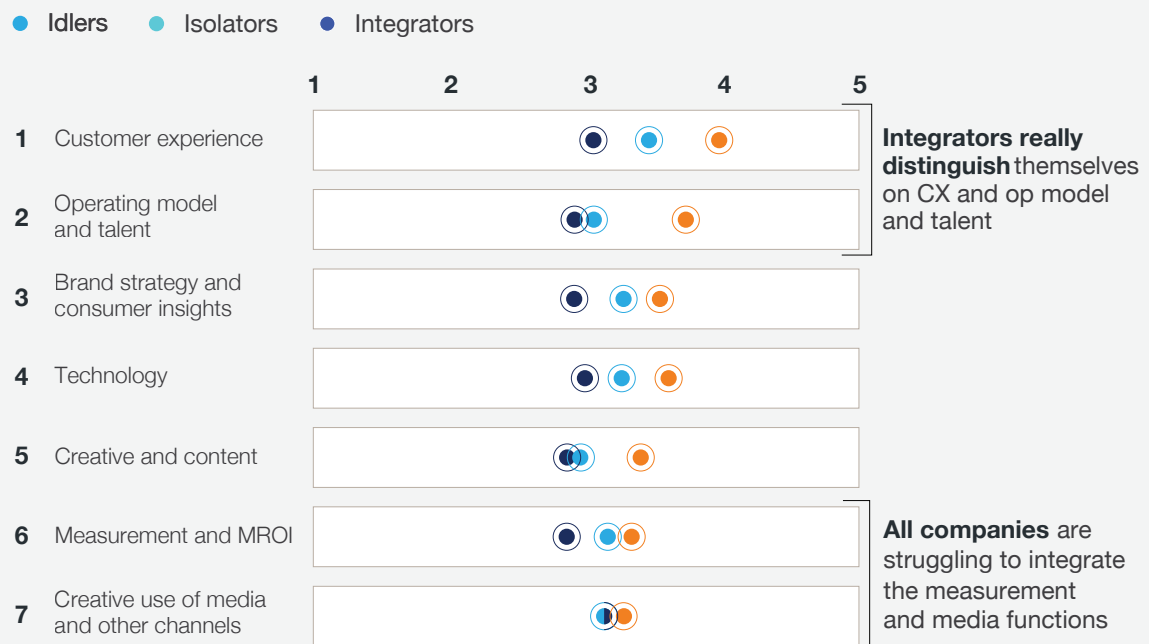
## Exhibit 5 Integrators have better talent across the board though very few best-in-class.

Average score (out of 5)



## Exhibit 6 Data driven creativity scores

Average score (out of 5)





consumer is interested in sports cars without the person ever having said so. Computer vision can analyze the videos and images people engage with and infer relevant themes and interests. This deeper understanding of consumer interests, motivations, and attitudes can help develop new value propositions, campaigns and experiences and can drive a pipeline for new products, product extensions, and ecosystem plays that wouldn't be obvious otherwise. Yet despite this potential, only 25 percent of integrators are employing it, versus 10 percent of isolators.

#### New and creative use of media

All the marketers we surveyed and interviewed, integrators included, felt they were not being creative enough in using media channels, whether dynamic video ads based on content a viewer has watched, mobile video, addressable TV advertising, digital billboards, or custom content integrations with big traditional media players. Aware of the need to engage with their audiences in new ways, traditional media companies have created new ad formats and invested in branded content studios that use their storytelling capabilities to help marketers create more immersive brand experiences.

And despite years of lip service to the need for digital-first content, a majority of companies are still repurposing content and campaigns from traditional channels. This represents a missed opportunity for mobile-tailored ad experiences, heightened consumer engagement with the content, and personalized experiences across all addressable channels.



One CMO in our survey said, “You don’t create exciting things for people by figuring out things from data.” Actually, we believe that’s exactly what data can do. At the end of the day, analytics are what companies have learned about people’s behavior. Such insights can guide and inform where imagination needs to go. In the best cases, they can

even inspire. Marketers that are leading the pack in driving growth understand that data and human ingenuity are two sides of the same coin. ■

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# REDEFINING CREATIVITY IN THE DATA- DRIVEN AGE

**"INTEGRATOR"  
COMPANIES UNITE  
CREATIVITY &  
ANALYTICS**

**AND GROW  
REVENUE  
2X  
FASTER THAN  
AVERAGE  
S&P 500 ORGS**

**1 INTEGRATORS  
TREAT DATA AND  
CREATIVITY AS  
EQUAL PARTNERS.**

**33%**  
MORE **CONSUMER  
INSIGHTS AND  
ANALYTICS  
TECHNIQUES**

**55%**  
MORE **AI AND  
ADVANCED ANALYTICS**

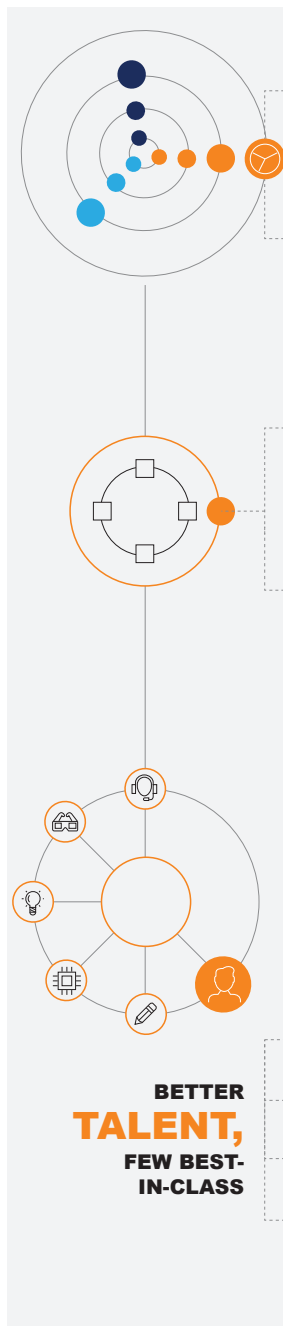
**65%**  
USE **CUSTOMER  
JOURNEY ANALYTICS**  
VS. 50% OF PEERS

**2 INTEGRATORS  
EMPLOY  
AN AGILE  
MARKETING  
OP MODEL.**

**80%**  
MORE **A/B TESTING,  
DYNAMIC CREATIVE  
OPTIMIZATION**

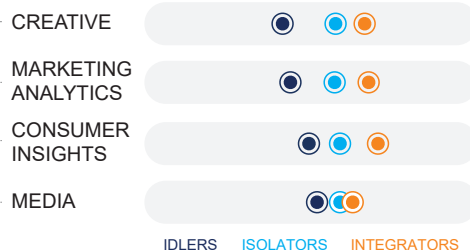
**2X**  
MORE LIKELY FOR  
**MARKETING AND IT  
TO COLLABORATE ON  
A SHARED VISION**

**50%**  
MORE LIKELY TO USE  
**MULTIPLE AGENCIES  
FOR VARIOUS  
TYPES OF WORK**



**BETTER  
TALENT,  
FEW BEST-  
IN-CLASS**

**3 INTEGRATORS  
SEEK WHOLE-  
BRAINED TALENT.**



# From lab to leader: How consumer companies can drive growth at scale with disruptive innovation

In the era of “fast products” and digital disruption, delivering growth requires putting in place new predictive consumer-growth capabilities, including innovation, based on speed, agility, and scale.

Mark Dzierski, Stacey Haas, Jon McClain, and Brian Quinn



Innovation is central to the mission, values, and agenda of most consumer-packaged-goods (CPG) companies. However, in the last several years, incumbent CPGs have struggled to keep pace with start-ups, which have reinvigorated and reinvented categories ranging from ice cream to diapers.

Our analysis of the food and beverage market from 2013–17 reveals that the top 25 manufacturers are responsible for 59 percent of sales but only 2 percent of category growth. Conversely, 44 percent of category growth has come from the next 400 manufacturers.<sup>1</sup> Our experience in working with large consumer companies suggests that they don't suffer from a lack of ideas; where they struggle is in knowing where to make bets, moving products quickly to launch, and then nurturing them to scale. Effectively driving growth through innovation requires CPG companies to evolve many of the assets and capabilities already in place and adopt significantly different and new ways of working.

This change will not be easy. Many of the innovation systems that need to evolve are deeply entrenched. They have their own brand names, dedicated IT systems, firmly established management routines, and more. However, our work with CPG organizations has convinced us that these changes are necessary and can return significant value. Our analysis of ~350 CPG companies across 21 subcategories found that growth leaders excelled at harnessing commercial capabilities, including innovation. Additional McKinsey analysis has shown that CPG “Creator” companies—those that consistently develop new products or services—grow more than their peers. These winning Creators have adopted a formula that borrows the best from progressive new players while fully leveraging existing advantages in scope and scale.

### How did we get here?

For the past two decades, CPG innovation models have been designed to maintain and steadily grow

already at-scale brands. This meant that most innovations were largely incremental moves with the occasional one-off disruptive success. This slow and steady approach worked because CPGs didn't really need disruptive innovation to grow. Geographic expansion, pricing, and brand extensions were all successful strategies that kept the top line moving. As a result, most of the systems designed to manage these innovations were optimized for fairly predictable and low-volatility initiatives. They emphasized reliability and risk management.

That very success, however, led to calcified thinking as companies built large brands and poured resources into supporting and protecting them. In recent years, as they have tried to respond to new entrants and rapidly changing consumer needs, CPGs found their innovation systems tended to stifle and stall more disruptive efforts. As the returns from innovation dwindled, companies cut marketing, insights, and innovation budgets to cover profit shortfalls. This created a negative cycle. As a stopgap, many large consumer companies have turned to M&A to fill holes in the innovation portfolio—but on its own, M&A can be a very expensive path to growth with its own difficulties in scalability and cultural fit.

How new upstarts “do” innovation—speed, agility, consumer-first—is not exactly a secret. Many CPGs have made concerted efforts to embrace those attributes by setting up incubators, garages, or labs. They have tried to become agile and use test-and-learn programs. But while there have been notable successes, they tend to be episodic or fail to scale because they happen at the periphery of the main innovation system, or even as explicit “exemptions” from standard processes. Scaled success requires making disruptive innovation part of the normal course of business.



## What to learn from today's innovators

Despite the many challenges, there are consumer companies winning in the market and driving profitable growth. Here are four shifts they're making:

**1. Focus on targeted consumer needs.** All of us can think of innovative products that are competing head to head in established categories (some of our favorites include Halo Top, SkinnyPop, and Blue Buffalo). A common denominator for most of them is that they didn't start big but focused instead on a targeted and unmet consumer need that turned out to have broad reach.

That approach stands in stark contrast to the standard CPG model, where companies look for the products that satisfy the largest group ("gen pop"). An important reason for this focus is that many CPGs need an idea to be big enough to make a dent in their business. They also look to get the highest ROI for innovations to amortize the high costs historically required to launch (especially ad campaigns and capital expenditures for new manufacturing). But in a world where it is less expensive and easier than ever for companies to address more targeted needs, and where consumers have never had more choices at their fingertips, gen pop is becoming less and less viable as an objective or requirement.

This isn't to suggest that large CPG firms should stop looking for large and growing opportunities. But the evidence is clear that there are plenty of products that start small and would normally be killed off at a large CPG company, that explode once in the market.

All strong innovation begins with the ability to identify a consumer need that the marketplace isn't addressing. That happens by:

- *Exploring granular consumer needs with advanced analytics.* CPG leaders explore opportunities through highly granular,

data-rich maps of product benefits, consumer needs, and usage occasions rather than just segments or categories (we call these Growth Maps). These can reveal how a seemingly niche and emerging trend could have surprisingly broad reach and applicability.

- *Combining many data sources to quickly address tipping-point trends.* Leaders combine various data sources (consumer, business, technology) to identify market trends that are hitting relevant tipping points. They understand where the most promising trends are, where they have existing capabilities to play, and where they might need to build new muscle. And they bring all this together to rapidly prioritize where to take action.
- *Using design thinking.* By using empathy to uncover unspoken and unmet needs, designing new solutions with consumers and channel partners, and rapidly prototyping and testing, design thinking produces distinctive answers. Importantly, true design thinking continues to incorporate consumer insights and iterate product designs even after initial product launch (see more below). Two leading consumer companies in Japan recently set up "innovation garages" to integrate design thinking into product development methods. They were excited by the power of integrating design into product development methods to produce better, more consumer-driven products radically faster.

**2. Launch more "speedboats"—accepting that some of them will sink.** There is a prevailing myth that consumer companies need to do a few big launches a year. Even if that were once true, it no longer is. This approach required large R&D investments, extensive consumer testing to validate willingness to purchase, and massive resources (large advertising, promotion, and distribution budgets)—all in an attempt to predict success and perfect a product before a large, potentially



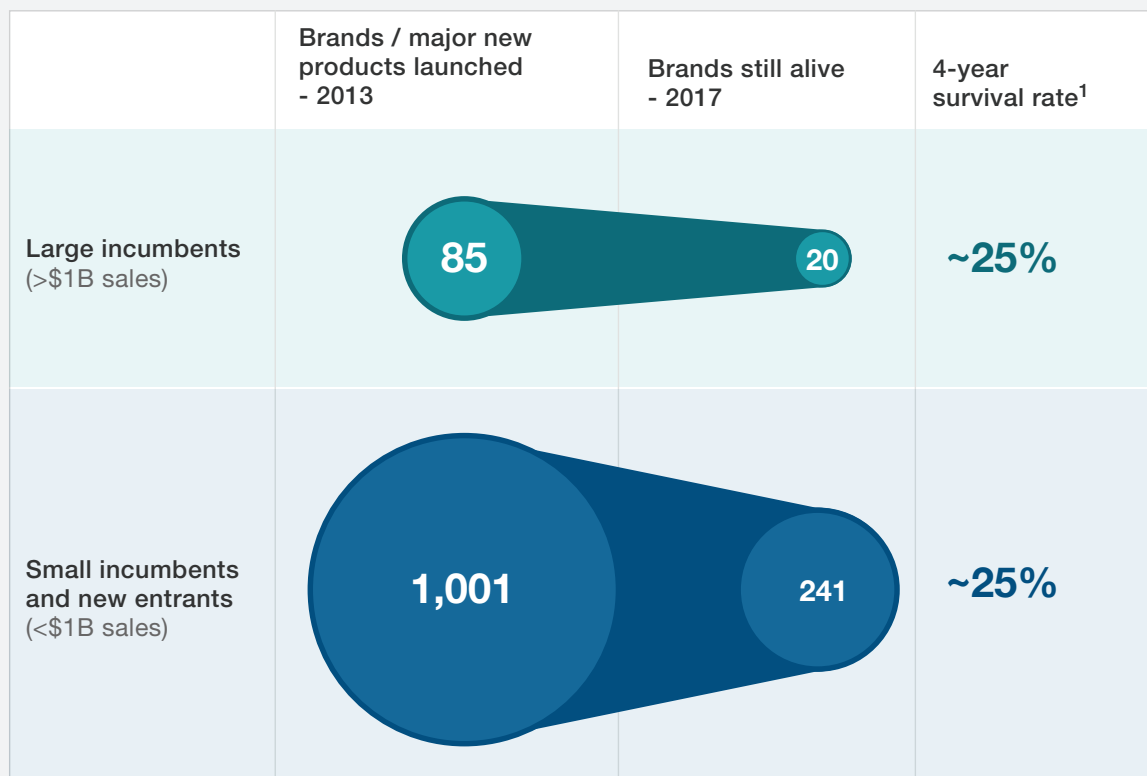
multicountry launch. This mentality assumed the resulting product could not fail once it hit the open market.

However, our findings suggest that putting all this effort and funding to drive a successful launch has not actually provided the desired results.

In packaged food, for example, a review of new brands and disruptive innovations launched in 2013 by large CPG companies found that only 25 percent were still around four years later. This success rate is no better than what start-ups and small CPGs achieved with much smaller budgets and programs (Exhibit 1).

**Exhibit 1 The ‘few big bets’ approach by large incumbents has not improved outcomes—winning requires getting more products successfully into market.**

**Packaged food, US,  
2013-17**



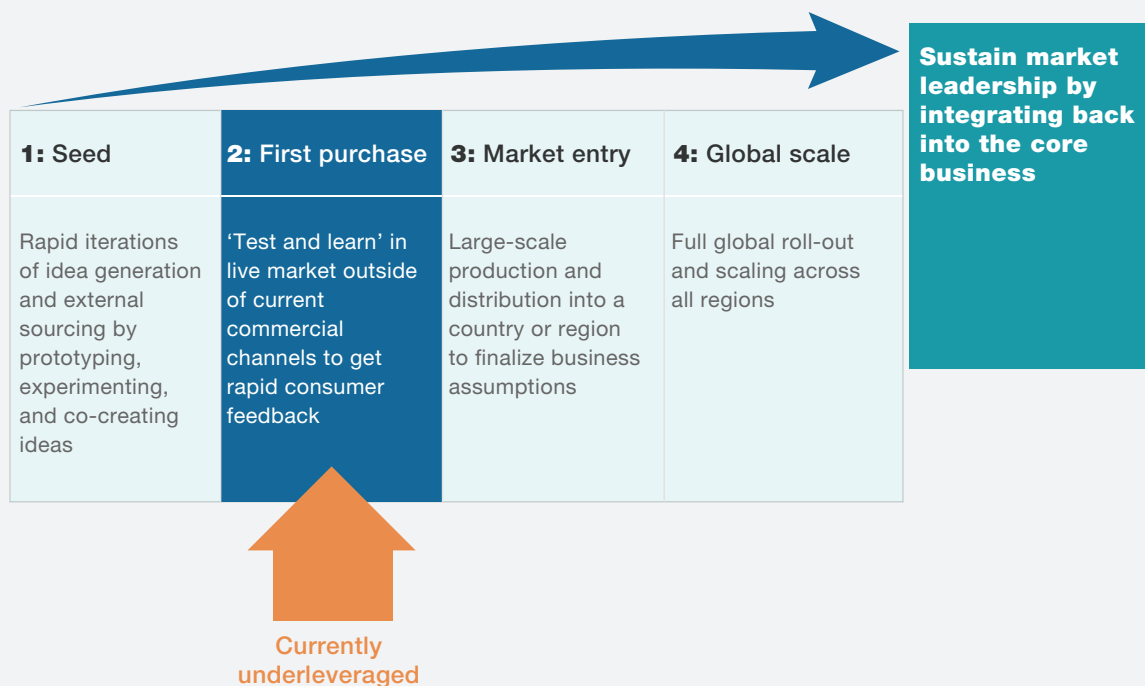
<sup>1</sup> Based on brands available and fulfilled by Amazon in Aug 2017 and/or recognized by market reports as share leaders  
Source: GNPD, Euromonitor, web search, McKinsey analysis

Winning innovators, in contrast, increasingly rely on speedboats: smaller launches where the product is tested and refined in-market. Take the example of one global CPG that is extensively using “first-purchase testing” to understand *why* consumers are/are not purchasing a product, then integrating that feedback into further iterations (Exhibit 2). It has been testing real products in multiple nontraditional settings including office buildings, juice shops, and yoga studios. The insights gained from these live settings allow the company to rapidly iterate the product design. Once indicators of success are seen, it moves to rapidly scale the product via Amazon and traditional retailers. The approach works, because

in today’s ecosystem, there are many distribution channels and digital and social-media outlets to reach consumers less expensively, as well as external networks that can support efficient and productive discovery and development.

The Internet also provides an under-utilized testing ground for speedboats. Many disruptive brands start by marketing direct to consumers, which allows them to hone the product and messaging, while capturing detailed data on purchase behavior. Even without e-commerce, most start-ups are heavily using social media like Facebook to reach targeted audiences with lower cost and risk.

**Exhibit 2 Leaders work differently within and across four distinct phases for breakthrough success.**



More speedboats, however, can mean more headaches for general managers who have to keep track of more projects and then nurture products to scale. CPG leaders address this through strong portfolio management. They make clear, prioritized choices about the categories and segments in which they will innovate and which ones they will maintain or exit from. They put in place clear processes for tracking performance and new allocation mechanisms to quickly get funds to promising programs. And when they need to scale new bets, they fund them by reinvesting initial proceeds from the speedboats.

### *3. Think (and act) like a venture investor.*

Traditional stage gate processes are very efficient for managing a large pipeline of similar ideas through a relatively standard development pathway. However, when they are used for more disruptive initiatives, they tend to systematically smother or starve them. A different system is required for disruptive innovation.

Consider how venture-capital firms manage their portfolio of investments. They analyze each investment on its own merits, adapting as businesses evolve. They couple funding closely to the progress of the new business and meet at the speed of its progress versus on a predefined calendar. The hurdle rates and KPIs are also different, with emphasis on whether they are gaining consumer traction in addition to improving financials. And more than anything, they are relentless in pushing the pace and urgency of growth.

To deliver on this capability, we often recommend that companies establish their own venture board comprising their strongest leaders. Even though the scale may be small, this is some of the hardest work in the company and the most important to its future. Along with a few outsiders to inject a more objective perspective, this board is responsible

for maximizing the return of the more aggressive portfolio—and has complete autonomy to quickly make decisions about it.

*4. First to scale beats first to market.* Launching disruptive innovation doesn't mean a company always has to be the original inventor. Rather than focusing on first to market, we recommend focusing on first to scale. We found that leading CPG innovators who actively scan the market for high-potential ideas, watch for emerging consumer acceptance and new behaviors, and then jump in before the market landscape has fully evolved have reaped significant rewards. We evaluated 25 high-growth categories in four countries across North and South America, Asia, and Europe. In each, the players who took this approach are winning ~60 to 80 percent of the time; in the US, they win the highest market share 80 percent of the time.

Incumbent CPGs can turn to their ingrained advantages to identify and scale these ideas. Their wealth of consumer data can be used to spot trends earlier than others. Their significant financial and human resources can be disproportionately allocated to hot opportunities. The distribution and account relationships incumbents have across multiple retailers can be used to expand the market for new products more easily and quickly than new players with a smaller network of relationships. Large CPGs are also attractive partners for innovators with insightful ideas but insufficient resources to develop and scale them.

All of the above are incumbents' advantages that many smaller players would love to acquire. Using these advantages to their fullest requires CPGs to adopt a much stronger orientation toward speed, nurture more disruptive bets until they can be scaled, and reallocate resources to the strongest opportunities.

## How to get started

Embracing the above shifts will require meaningful changes. In our experience, the changes are not only eminently achievable, but also reenergize the organization as they make innovation and delighting consumers more central and less cumbersome to accomplish. We recommend CPG leaders do five things now:

### 1. Address the culture.

Business leaders understand how important culture is but tend to think of it as a vague byproduct of other activities. Building an innovation culture begins with making innovation essential to the day-to-day business, and it's critical that it start at the top, with the CEO and senior executive team. As one consumer executive—who grew her company to a billion-dollar valuation in less than 15 years—put it, “Innovation is simply everyone’s job. . . . Everyone is expected to look for insights, to bring ideas, to be ready to help drive an initiative.” Other ingredients include: a near-maniacal focus on the consumer—by which we mean putting the consumer at the center of every decision; incentives to reward innovation; metrics that track innovation—consumer excitement, word of mouth, adoption rates; and a clear understanding of how each person’s role adds value to the process. Reward learning and make learnings easily available and easy to share.

### 2. Create high aspirations and hard metrics.

“Let’s increase growth by 2 to 3 percent!” That kind of aspiration won’t motivate people and drive new thinking. Contrast that rather vague hope with this one from a mining (!) company: “Generate \$150 million of incremental EBITDA over the next five years by discovering new applications for our products, moving closer to our end customers, and leading our industry in production processes.” This is bold, actionable, measurable, and gives teams some sense of where and how they should innovate. To track progress against aspirations, metrics need to be specific, of course, but they also need to evolve.

For example, metrics on market share or growth rate will be better in the earlier phase of a product’s lifecycle. Shift the focus to value and margin as the project scales and matures. Metrics also must be in the business-unit (BU) leader’s performance objectives.

### 3. Define the hunting grounds.

Make clear choices about where you will innovate. Be careful to define them by working backward from the consumers and markets you serve rather than the way you currently define your brand and category structures, particularly in multibrand organizations. Too often we see outdated guardrails unnecessarily limit brands from exploring new spaces. As one CEO, whose company was acquired by a leading global CPG incumbent, put it, “If your consumers want your brand to move into a space and you don’t, then rest assured someone else will.”

### 4. Reallocate resources.

In our experience, most incumbent CPGs have too many resources committed to initiatives that are unlikely to drive meaningful growth. The first step in liberating resources is to take a hard look at the portfolio and reallocate people to more aggressive growth opportunities. Crucially, this cannot be an annual or even quarterly exercise. Leading innovators continually and ruthlessly reallocate resources and make sure scarce people and dollars are put to the best use. As one innovative CPG leader in Asia Pacific said, “I established three simple mandates: bigger (more top-line potential), better (more differentiated), and faster (time to market).” These mandates drove top-line growth at four to five times the underlying category growth.

### 5. Put a new disruptive innovation “system” in place based on agile models.

Driving success at scale requires a new model. Innovative ideas can initially generate a lot of excitement and promise. But that drive often wilts when it needs to work with the full business to scale

the idea. While there is a broad range of elements in a new innovation system, we find that the following are a few of the most important:

- *Establish cross-functional teams with a complementary set of problem-solving skills*, such as people from insights, marketing, personnel, sales, UX, and tech. The team should “live” together, using an agile development model, and ideally drive one to two initiatives at any given time.
- *Focus on constant learning and de-risking throughout development*. Rather than a standard checklist of activities and stages, teams should constantly identify and prioritize the greatest uncertainties in a concept and conduct quick tests to resolve them.
- *Set up and prequalify your “speedboat” network*. These can be factories, partners, agencies, and vendors who can support small-scale procurement and manufacturing, run first-purchase tests, and even support a riskier new product’s first few years of manufacturing before committing the capital expenditure for scaled/global manufacturing.
- *Hardwire points of contact between the innovation labs and the “mother ship.”* Embed people from the sponsor BU as a core part of the innovation team, and rotate people from the main business through the innovation labs. Assign respected leaders from the legacy business to manage innovation projects. Create a central innovation roadmap that business units agree on, and track it on the CEO/COO agenda.

The growth game has changed, but that doesn’t mean that CPG companies can’t change with it. With a commitment to new mind-sets and approaches, CPG companies can harness speed and agility to move again to the forefront of innovation. ■

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<sup>1</sup> McKinsey analysis on Nielsen xAOC data, 2014-2017, US CPG manufacturers—food, beverage, personal care, and household care.

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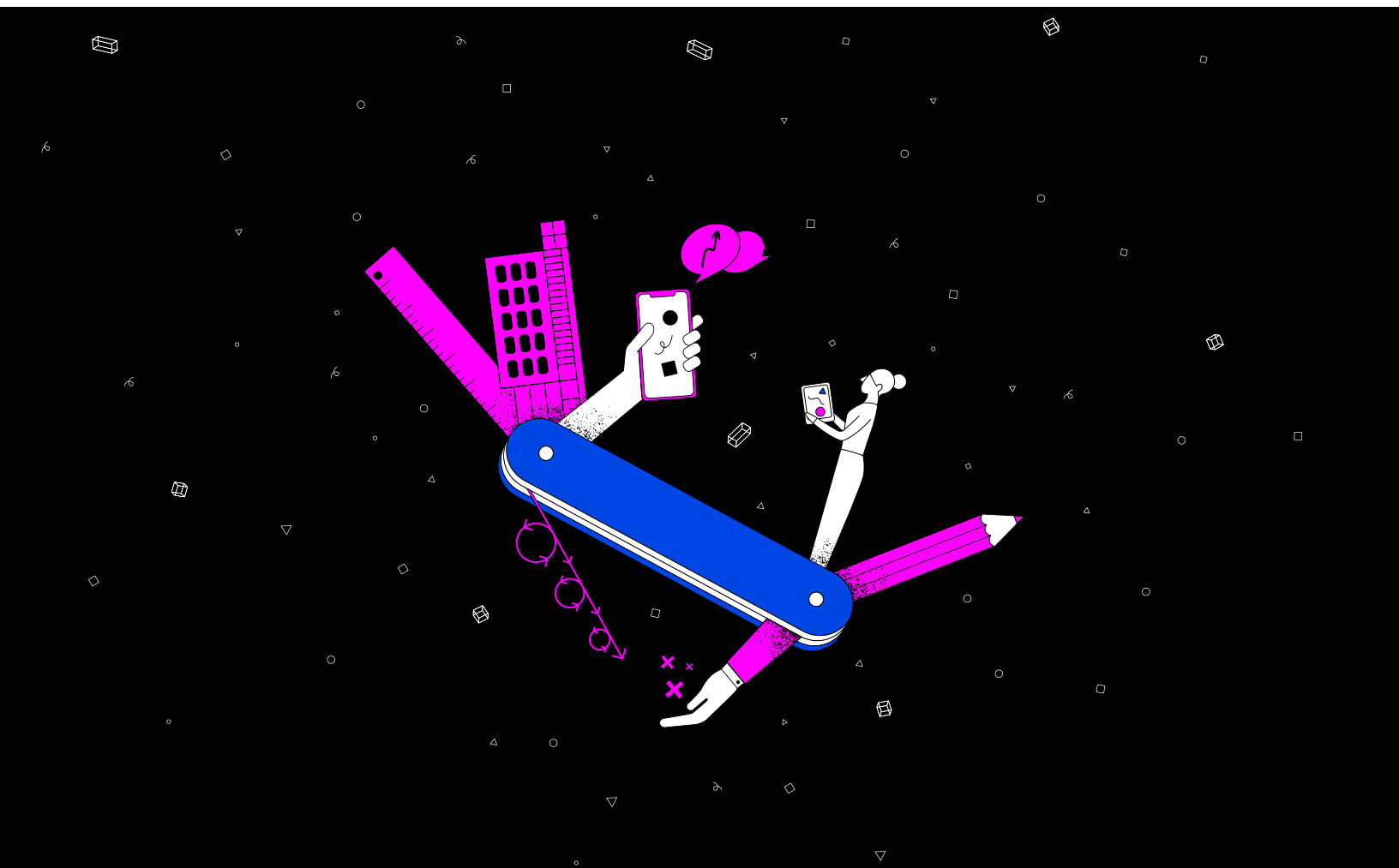
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# The business value of design

How do the best design performers increase their revenues and shareholder returns at nearly twice the rate of their industry counterparts?

Benedict Sheppard, Hugo Sarrazin, Garen Kouyoumjian, and Fabricio Dore



We all know examples of bad product and service design. The USB plug (always lucky on the third try). The experience of rushing to make your connecting flight at many airports. The exhaust port on the Death Star in Star Wars.

We also all know iconic designs, such as the Swiss Army Knife, the humble Google home page, or the Disneyland visitor experience. All of these are constant reminders of the way strong design can be at the heart of both disruptive and sustained commercial success in physical, service, and digital settings.

Despite the obvious commercial benefits of designing great products and services, consistently realizing this goal is notoriously hard—and getting harder. Only the very best designs now stand out from the crowd, given the rapid rise in consumer expectations driven by the likes of Amazon; instant access to global information and reviews; and the blurring of lines between hardware, software, and services. Companies need stronger design capabilities than ever before.

So how do companies deliver exceptional designs, launch after launch? What is design worth? To answer these questions, we have conducted what we believe to be (at the time of writing) the most extensive and rigorous research undertaken anywhere to study the design actions that leaders can make to unlock business value. Our intent was to build upon, and strengthen, previous studies and indices, such as those from the Design Management Institute.

We tracked the design practices of 300 publicly listed companies over a five-year period in multiple countries and industries. Their senior business and design leaders were interviewed or surveyed. Our team collected more than two million pieces of financial data and recorded more than 100,000 design actions.<sup>1</sup> Advanced regression analysis

uncovered the 12 actions showing the greatest correlation with improved financial performance and clustered these actions into four broad themes.

The four themes of good design described below form the basis of the McKinsey Design Index (MDI), which rates companies by how strong they are at design and—for the first time—how that links up with the financial performance of each company (Exhibit 1).

Our research yielded several striking findings:

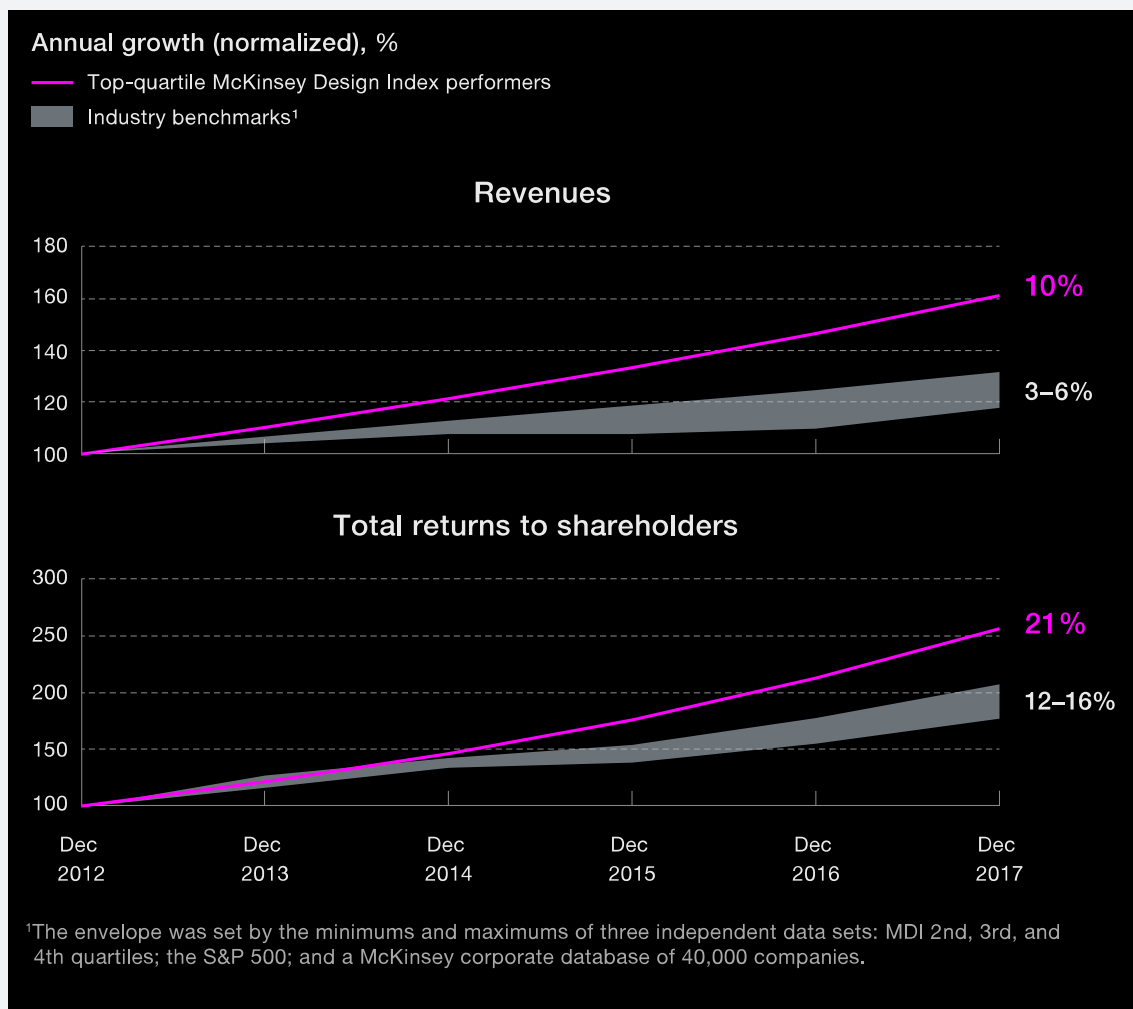
1. *We found a strong correlation between high MDI scores and superior business performance.* Top-quartile MDI scorers increased their revenues and total returns to shareholders (TRS) substantially faster than their industry counterparts did over a five-year period—32 percentage points higher revenue growth and 56 percentage points higher TRS growth for the period as a whole.
2. *The results held true in all three of the industries we looked at:* medical technology, consumer goods, and retail banking. This suggests that good design matters whether your company focuses on physical goods, digital products, services, or some combination of these.
3. *TRS and revenue differences between the fourth, third, and second quartiles were marginal.* In other words, the market disproportionately rewarded companies that truly stood out from the crowd (Exhibit 2).

### **An elusive prize**

In short, the potential for design-driven growth is enormous in both product- and service-based sectors (Exhibit 3). The good news is that there are more opportunities than ever to pursue user-centric, analytically informed design today.

Exhibit 1

**Companies with top-quartile McKinsey Design Index scores outperformed industry-benchmark growth by as much as two to one.**



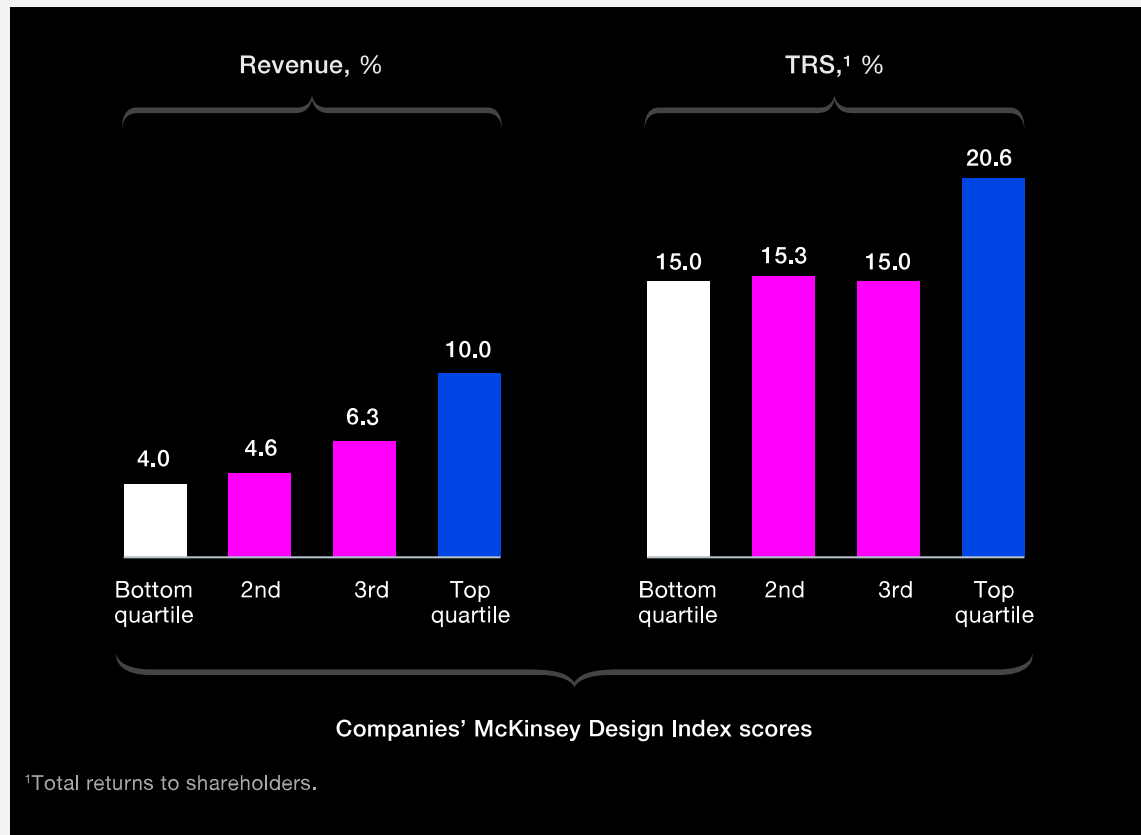
Customers can feed opinions back to companies (and to each other) in real time, allowing design to be measured by customers themselves—whether or not companies want to listen.

Lean start-ups have demonstrated how to make better decisions through prototyping and iterative learning. Vast repositories of user data and the advance of artificial intelligence (AI) have created powerful new sources of insights and unlocked the

door for new techniques, such as computational design and analytics to value. Fast access to real customers is readily available through multiple channels, notably social media and smart devices. All of these developments should place the user at the heart of business decisions in a way that design leaders have long craved.

What our research demonstrates, however, is that many companies have been slow to catch up. Over 40 percent of the companies surveyed still aren't

**Exhibit 2** Higher McKinsey Design Index scores correlated with higher revenue growth and, for the top quartile, higher returns to shareholders.



talking to their end users during development. Just over 50 percent admitted that they have no objective way to assess or set targets for the output of their design teams. With no clear way to link design to business health, senior leaders are often reluctant to divert scarce resources to design functions. That is problematic because many of the key drivers of the strong and consistent design environment identified in our research call for company-level decisions and investments. While many designers are acutely aware of some or all of the four MDI themes (Exhibit 4a), these typically can't be tackled by designers alone and often take years of leadership commitment to establish.

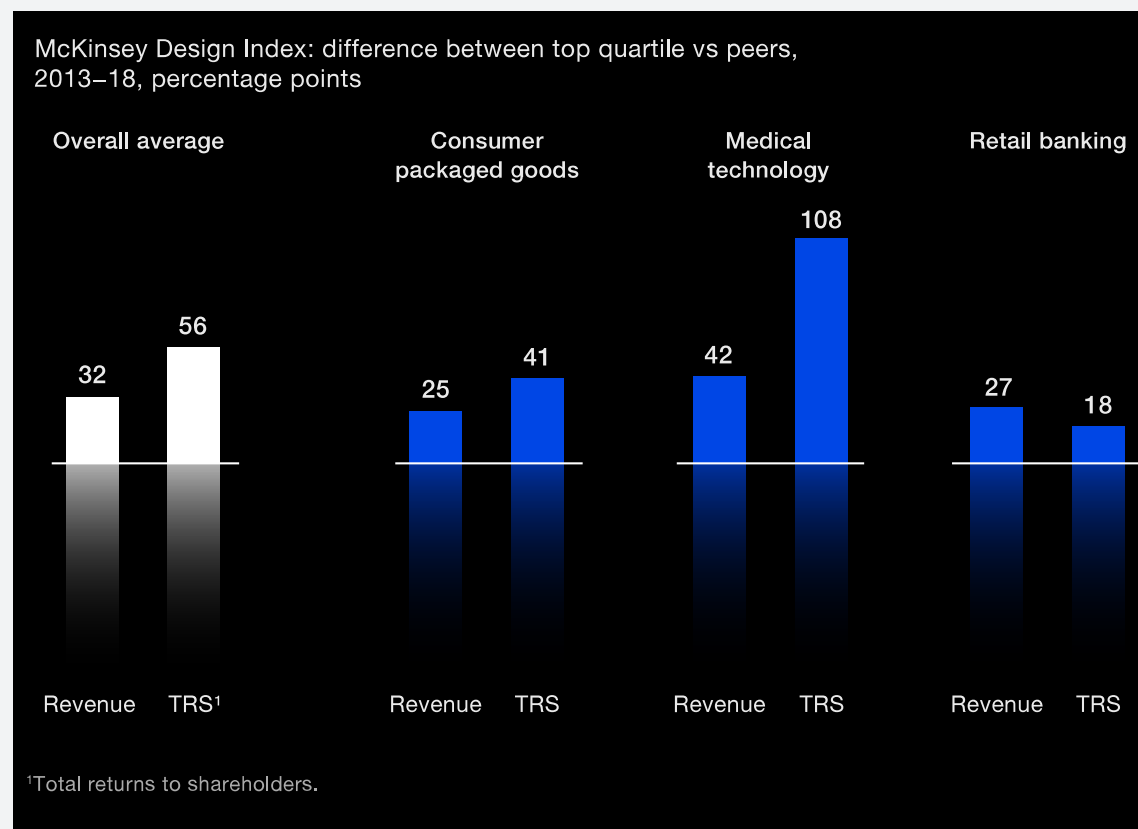
Top-quartile companies in design—and leading financial performers—excelled in all four areas. What's more, leaders appear to have an implicit understanding of the MDI themes. When senior executives were asked to name their organizations' single greatest design weakness, 98 percent of the responses mapped to the four themes of the MDI (Exhibit 4b).

### Unpacking the MDI

In the remainder of this article, we'll describe the four clusters of design actions that showed the most correlation with improved financial performance: measuring and driving design

### Exhibit 3

## The financial outperformance of top-quartile companies holds true across the three industries studies.



performance with the same rigor as revenues and costs; breaking down internal walls between physical, digital, and service design; making user-centric design everyone's responsibility; and de-risking development by continually listening, testing, and iterating with end users.

### More than a feeling: It's analytical leadership

The companies in our index that performed best financially understood that design is a top-management issue, and assessed their design performance with the same rigor they used to track revenues and costs. In many other businesses, though, design leaders say they are treated as second-class citizens.

Design issues remain stuck in middle management, rarely rising to the C-suite. When they do, senior executives make decisions on gut feel rather than concrete evidence.

Designers themselves have been partly to blame in the past: they have not always embraced design metrics or actively shown management how their designs tie to meeting business goals. What our survey unambiguously shows, however, is that the companies with the best financial returns have combined design and business leadership through a bold, design-centric vision clearly embedded in the deliberations of their top teams.



Exhibit 4a The value of design



**Exhibit 4b** When senior executives were asked to name their organizations' single greatest design weakness, their unprompted responses indicated an implicit understanding of the four themes.



A strong vision that explicitly commits organizations to design for the sake of the customer acts as a constant reminder to the top team. The CEO of T-Mobile, for example, has a personal motto: “shut up and listen.” IKEA works “to create a better everyday life for the many people.” And as Pixar cofounder Ed Catmull told readers in a *McKinsey Quarterly* interview, to “wow” movie-goers continually, his company encourages its teams to take risks in their new projects: Pixar considers repeating the formulas of its past commercial successes a much greater threat to its long-term survival than the occasional commercial disappointment.

It’s not enough, of course, to have fine words stapled to the C-suite walls. Companies that performed best in this area of our survey maintain a baseline level of customer understanding among all executives. These companies also have a leadership-level curiosity about what users need, as opposed to what they say they want. One top team we know invites customers to its regular monthly meeting solely to discuss the merits of its products and services. The CEO of one of the world’s largest banks spends a day a month with the bank’s clients and encourages all members of the C-suite to do the same. Through personal exposure or constant engagement with researchers, executives can act as role models for their businesses and learn firsthand what most frustrates and excites customers.

Many companies, though, acknowledge a worrying gap in understanding at the top of their organizations.

Less than 5 percent of those we surveyed reported that their leaders could make objective design decisions (for example, to develop new products or enter new sectors). In an age of ubiquitous online tools and data-driven customer feedback, it seems surprising that design still isn’t measured with

the same rigor as time or costs. Companies can now build design metrics (such as satisfaction ratings and usability assessments) into product specifications, just as they include requirements for grades of materials or target times to market.

The value of such accurate insights is significant—one online gaming company discovered that a small increase in the usability of its home page was followed by a dramatic 25 percent increase in sales. Moreover, the company also discovered that improvements beyond these small tweaks had almost no additional impact on the users’ value perceptions, so it avoided further effort that would have brought little additional reward.

#### More than a product: It’s user experience

Top-quartile companies embrace the full user experience; they break down internal barriers among physical, digital, and service design. The importance of user-centricity, demands a broad-based view of where design can make a difference. We live in a world where your smartphone can warn you to leave early for your next appointment because of traffic, and your house knows when you’ll be home and therefore when to turn on the heat. The boundaries between products and services are merging into integrated experiences.

In practice, this often means mapping a customer journey (pain points and potential sources of delight) rather than starting with “copy and paste” technical specs from the last product. This design approach requires solid customer insights gathered firsthand by observing and—more importantly—understanding the underlying needs of potential users in their own environments. These insights must be championed at every meeting. Yet only around 50 percent of the companies we surveyed conducted user research before generating their first design ideas or specifications.

Combining physical products, digital tools, and “pure” services provides new opportunities for companies to capture this range of experience. A hotel, for example, might do more than just focus on the time between check-in and check-out (the service element) by promoting early engagement through social media or its own apps (the digital dimension) and providing physical mementos aimed at encouraging customers to rebook. The reception team of one big hotel chain we know gives departing guests a rubber duck adorned with an image of their host city (such as clogs and tulips for Amsterdam). The team includes a note suggesting that guests might like to keep the duck at home as a reminder of their stay and could build a collection by visiting the group’s other properties. This small touch led to a 3 percent improvement in retention over time.

Design-driven companies shouldn’t limit themselves to their own ecosystems. The best businesses we interviewed think more broadly. Ready-made meals are popular with the hard-working singles who grab them on their way home. A retailer of these meals has considered teaming up with Netflix to devise a one-click meal-ordering system, which would come into play two hours into an evening’s binge viewing when the customer would receive a screen prompt. Mobile-payment services such as Google Pay and Apple Pay were the result of a willingness to think across boundaries to devise easier ways to access cash. A piece of plastic in your wallet is one solution, but how much easier is it to use a device you already carry in your pocket?

#### More than a department: It’s cross-functional talent

Top-quartile companies make user-centric design everyone’s responsibility, not a siloed function. In the tired caricature of traditional design departments, a group of tattooed and aloof people operate under the radar, cut off from the rest of the

organization. Considered renegades or mavericks by their colleagues, these employees (in the caricature) guard access to their ideas, complaining that they have too often been burned by narrow-minded engineering or marketing heads unwilling to (or incapable of) realizing the designers’ grand visions.

We are not suggesting that this stereotype is still common—or that other functions are necessarily to blame—but it can be surprisingly resilient. One company we know, for example, unveiled a new flagship design studio to much jubilation from the design community. Before long, all the designers had moved their desks inside the studio, and had deactivated door access for the marketing, engineering, and quality teams. These moves drastically reduced the level of cooperative work and undermined the performance of the business as a whole.

Our research suggests that overcoming isolationist tendencies is extremely valuable. One of the strongest correlations we uncovered linked top financial performers and companies that said they could break down functional silos and integrate designers with other functions. This was particularly notable in consumer-packaged-goods (CPG) businesses, where respondents from companies that were top-quartile integrators reported compound annual growth rates some seven percentage points above those that were weakest in this respect.

Nurturing top design talent—the 2 percent of employees who make outsized contributions in every business—is another important dimension of team dynamics. Getting the basic incentives right is a part of this: in our survey, companies in the top quartile for design overall were almost three times more likely to have specific incentive programs for designers. These programs are tied to design outcomes, such as user-satisfaction metrics or major awards.

Crucially, though, retaining great design talent requires more than promising a big bonus or a career path as a top-flight manager. Carrots such as these are not enough to retain top design talent if not accompanied by the freedom to work on projects that stir their passion, time to speak at conferences attended by their peers, and opportunities to stay connected to the broader design community. Talented designers at a CPG company well-respected for its design credentials started leaving because of the amount of time they had to spend styling slideshow packs for the marketing team. Conversely, Spotify's appeal to top designers is often attributed to its autonomy-with-connectivity culture and to a working environment characterized by diversity, fun, and speed to market.

Design already touches many parts of a business: human-machine interactions, AI, behavioral economics, and engineering psychology, not to mention innovation and the development of new business models. While not a new concept, "T-shaped" hybrid designers, who work across functions while retaining their depth of design savvy, will be the employees most able to have a tangible impact through their work.

They will only be able to do so, though, if they have the right tools, capabilities, and infrastructure. That calls for the sort of design software, communication apps, deep data analytics, and prototyping technologies that drive productivity and accelerate design iterations. All of this requires time and investment. We found a strong correlation between successful companies and companies that resisted the temptation to cut spending on research, prototyping, or concept generation at the first sign of trouble. Formal design allocations should be agreed to in partnership with design leaders instead of appearing (as they often do) as line items in the marketing or engineering budgets.

### More than a phase: It's continuous iteration

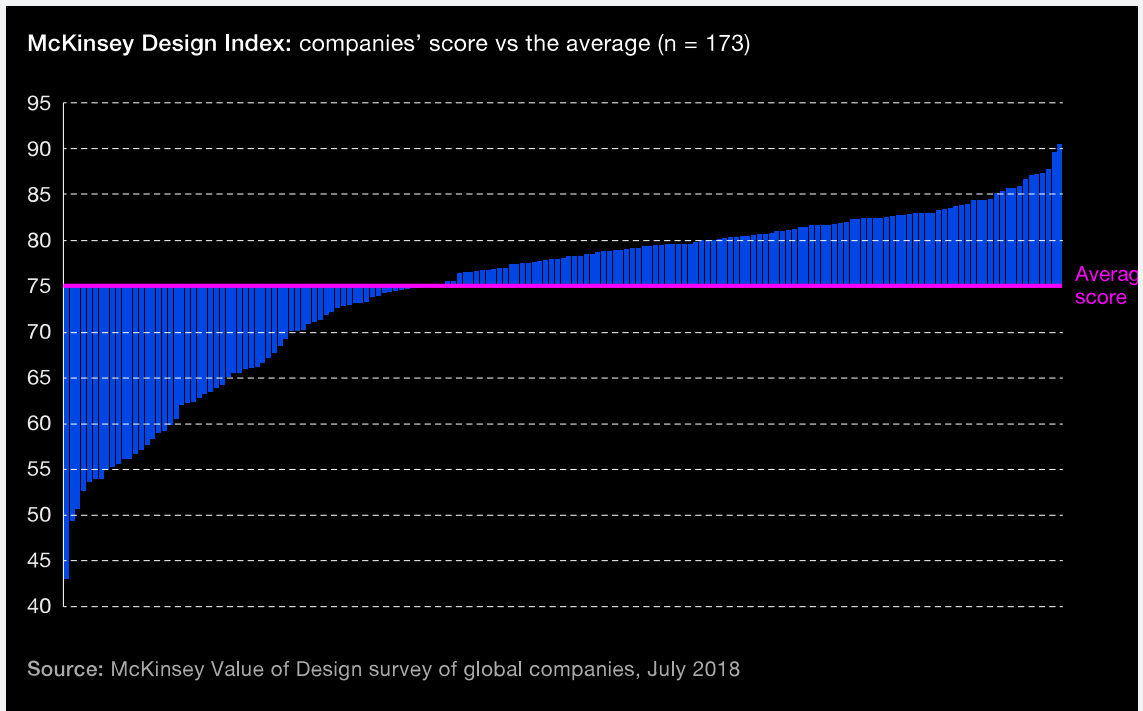
Design flourishes best in environments that encourage learning, testing, and iterating with users—practices that boost the odds of creating breakthrough products and services while simultaneously reducing the risk of big, costly misses. That approach stands in contrast to the prevailing norms in many companies, which still emphasize discrete and irreversible design phases in product development. Compartmentalization of this sort increases the risk of losing the voice of the consumer or of relying too heavily on one iteration of that voice.

The best results come from constantly blending user research—quantitative (such as conjoint analysis) and qualitative (such as ethnographic interviews). This information should be combined with reports from the market-analytics group on the actions of competitors, patent scans to monitor emerging technologies, business concerns flagged by the finance team, and the like. Without these tensions and interactions, development functions may end up in a vacuum, producing otherwise excellent work that never sees the light of day or delights customers.

In a successful effort to improve the user experience, one cruise company we know talked directly to passengers, analyzed payment data to show which food and activities were most popular at different times, and used AI algorithms on security-camera feeds to identify inefficiencies in a ship's layout. At a medical-technology company, blending sources of inspiration meant talking to a toy designer about physical ergonomics and to a dating-app designer about the design of digital interfaces. These moves helped the company to refine a device so that it appealed to customers with limited dexterity. The resulting product was not only safer and easier to use but also beat the market by more than four percentage points when launched.



**Exhibit 5 Initial survey results reveal a wide range of design performance.**



Despite the value of iteration, almost 60 percent of companies in our survey said they used prototypes only for internal-production testing, late in the development process. In contrast, the most successful companies consciously foster a culture of sharing early prototypes with outsiders and celebrating embryonic ideas. They also discourage management from driving designers to spend hours perfecting their early mock-ups or internal presentations.

Design-centric companies realize that a product launch isn't the end of iteration. Almost every commercial software publisher issues constant updates to improve its products postlaunch. And the Apple Watch is one among many products that have been tweaked to reflect how customers use them "in the wild."

**A first step toward great design**

We realize that many companies apply some of these design practices—a strong voice in the C-suite, for example, or shared design spaces. Our results, however, show that excellence across all four dimensions, which is required to reach the top quartile, is relatively rare. We believe this helps account for the dramatic range of design performance reflected in the observed companies' MDI scores, which were as low as 43 and as high as 92 (Exhibit 5).

The diversity among companies achieving top-quartile MDI performance shows that design excellence is within the grasp of every business, whether product, service, or digitally oriented. Through interviews and our experience working with companies to transform their strength in design, we've also discovered that one of the most

powerful first steps is to select an important upcoming product or service and make a commitment to using it as a pilot for getting the four elements right. This approach showed far better financial results than trying to improve design as a theme across the whole company—for example, conducting trials of cross-functional work in isolation from real products or services.

One medical-equipment group we know rallied around the design of a new surgical machine as it sought to head off a growing threat from competitors. The commitment of the CEO and senior executives was intense; executive bonuses were tied to the product's usability metrics and surgeon-satisfaction scores. Cross-functional and co-located teams carried out more than 200 user tests over two years, from the earliest concepts to the detailed design of features. In all, more than 110 concepts and prototypes were created and iterated. The final design's usability score—a measure of customer satisfaction—exceeded 90 percent, compared with less than 76 percent for the machines of its two main competitors. The ultimate solution combined a physical device, a digital data pad that could seamlessly connect with more than 40 third-party operating-theater devices, and a service contract.

In the past six months, the company's market share has jumped 40 percent, in part as investors understand the upcoming user-centric products and services that set the company apart from its competition and—even more important—that will improve patients' lives.



The McKinsey Design Index highlights four key areas of action companies must take to join the top quartile of design performers. First, at the top of the organization, adopt an analytical approach to design by measuring and leading your company's performance in this area with the same rigor the

company devotes to revenues and costs. Second, put the user experience front and center in the company's culture by softening internal boundaries (between physical products, services, and digital interactions, for example) that don't exist for customers. Third, nurture your top design people and empower them in cross-functional teams that take collective accountability for improving the user experience while retaining the functional connections of their members. Finally, iterate, test, and learn rapidly, incorporating user insights from the first idea until long after the final launch.

Companies that tackle these four priorities boost their odds of becoming more creative organizations that consistently design great products and services. For companies that make it into the top quartile of MDI scorers, the prizes are as rich as doubling their revenue growth and shareholder returns over those of their industry counterparts. ■

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<sup>1</sup> An example of a design action would be putting someone on the executive board with a responsibility for design, user experience, or both. Another would be tying management bonuses to design quality or customer-satisfaction metrics.

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# The CEO guide to customer experience

Companies that create exceptional customer experiences can set themselves apart from their competitors.

Executive Briefing, *McKinsey Quarterly*



What do my customers want? The savviest executives are asking this question more frequently than ever, and rightly so. Leading companies understand that they are in the customer-experience business, and they understand that *how* an organization delivers for customers is beginning to be as important as *what* it delivers.

This CEO guide taps the expertise of McKinsey and other experts to explore the fundamentals of customer interaction, as well as the steps necessary to redesign the business in a more customer-centric fashion and to organize it for optimal business outcomes. For a quick look at how to improve the customer experience, see the summary infographic.

Armed with advanced analytics, customer-experience leaders gain rapid insights to build customer loyalty, make employees happier, achieve revenue gains of 5 to 10 percent, and reduce costs by 15 to 25 percent within two or three years. But it takes patience and guts to train an organization to see the world through the customer's eyes and to redesign functions to create value in a customer-centric way. The management task begins with considering the customer—not the organization—at the center of the exercise.

### Observe: Understand the interaction through the customer's eyes

Technology has handed customers unprecedented power to dictate the rules in purchasing goods and services. Three-quarters of them, research finds, expect “now” service within five minutes of making contact online. A similar share want a simple experience, use comparison apps when they shop, and put as much trust in online reviews as in personal recommendations. Increasingly, customers expect from all players the same kind of immediacy, personalization, and convenience that they receive from leading practitioners such as Google and Amazon.

Central to connecting better with customers is putting in place several building blocks of a comprehensive improvement in customer experience.

### Identify and understand the customer's journey.

It means paying attention to the complete, end-to-end experience customers have with a company from their perspective. Too many companies focus on individual interaction touchpoints devoted to billing, onboarding, service calls, and the like. In contrast, a customer journey spans a progression of touchpoints and has a clearly defined beginning and end.

### The advantage of focusing on journeys is twofold.

First, even if employees execute well on individual touchpoint interactions, the overall experience can still disappoint (Exhibit 1). More important, McKinsey research finds that customer journeys are significantly more strongly correlated with business outcomes than are touchpoints. A recent McKinsey survey,<sup>1</sup> for example, indicates customer satisfaction with health insurance is 73 percent more likely when journeys work well than when only touchpoints do. Similarly, customers of hotels that get the journey right may be 61 percent more willing to recommend than customers of hotels that merely focus on touchpoints.

### Quantify what matters to your customers.

Customers hold companies to high standards for product quality, service performance, and price. How can companies determine which of these factors are the most critical to the customer segments they serve? Which generate the highest economic value? In most companies, there are a handful of critical customer journeys. Understanding them, customer segment by customer segment, helps a business to maintain focus, have a positive impact on customer satisfaction, and begin the process of redesigning functions around customer needs. Analytical



# To improve customer experience, move from touchpoints to journeys



## Observe

Customer journeys consist of a progression of touchpoints that together add up to the experience customers get when they interact with companies. Seeing the world as their customers do helps leading companies better organize and mobilize their employees around customer needs.

## Shape

Designing the customer experience requires reshaping interactions into different sequences and, though the effort may start small, soon entails digitizing processes, reorienting company cultures, and nimbly refining new approaches in the field.



## Perform

Rewiring a company to provide leading customer experiences is a journey in itself, often taking two to four years and requiring high engagement from company leaders and frontline workers alike.

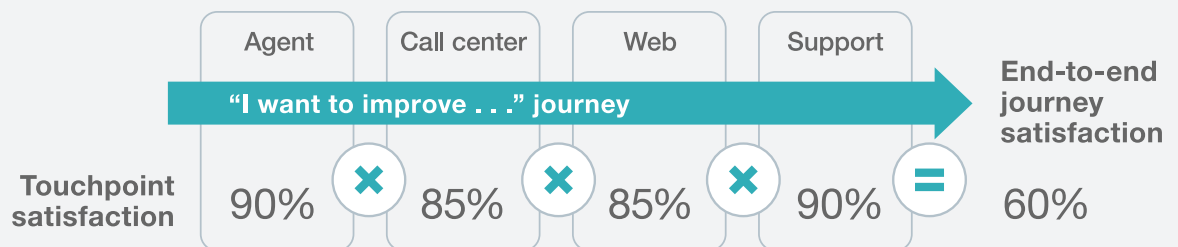


**Exhibit 1 Best-in-class companies optimize customer journeys, not just touchpoints.**

Customers experience companies through end-to-end experiences, not touchpoints



Individual touchpoints may perform well even if the overall experience is poor



Source: McKinsey Digital Labs

tools and big data sources from operations and finance can help organizations parse the factors driving what customers say satisfies them and also the actual customer behavior that creates economic value. Sometimes initial assumptions are overturned. In one airport case study, customer satisfaction had more to do with the behavior of security personnel than with time spent in line (Exhibit 2). For a full view of the airport’s insightful customer-satisfaction exercise, see “Developing a customer-experience vision.”

**Define a clear customer-experience aspiration and common purpose.**

In large, distributed organizations, a distinctive customer experience depends on a collective sense of conviction and purpose to serve the customer’s true needs. This purpose must be made clear to every employee through a simple, crisp statement of intent: a shared vision and aspiration that’s authentic and consistent with a company’s brand-value proposition. The most recognizable example of such a shared vision might be the Common Purpose<sup>2</sup>

**Exhibit 2 Airport-security issues make up 4 of the top 10 consumer complaints about airports.**

**Top complaints by customers after airport travel**



**Confusing layout of security-screening checkpoint**



**Unfriendly security personnel**



**Lengthy security-screening process**



**Complete lack of seating after security screening**

of the Walt Disney Company: “We create happiness by providing the finest in entertainment for people of all ages, everywhere.” The statement of purpose should then be translated into a set of simple principles or standards to guide behavior all the way down to the front line.

Customer journeys are the framework that allows a company to organize itself and mobilize employees to deliver value to customers consistently, in line with its purpose. The journey construct can help align employees around customer needs, despite functional boundaries. As McKinsey’s Ron Ritter elaborated in a recent video, rallying around customers can bring the organization together.

**Shape: Redesign the business from the customer back**

Customer-experience leaders start with a differentiating purpose and focus on improving the most important customer journey first—whether it be opening a bank account, returning a pair of shoes,

installing cable television, or even updating address and account information. Then they improve the steps that make up that journey. To manage expectations, they design supporting processes with customer psychology in mind. They transform their digital profile to remove pain points in interactions, and to set in motion the culture of continuous innovation needed to make more fundamental organizational transformations.

Apply behavioral psychology to interactions.

Deftly shaping customer perceptions can generate significant additional value. One tool leading customer-experience players deploy is behavioral psychology, used as a layer of the design process. Leading researchers have identified the major factors in customer-journey experiences that drive customer perceptions and satisfaction levels.<sup>3</sup> For example, savvy companies can design the sequence of interactions with customers to end on a positive note. They can merge different stages of interactions to diminish their perceived duration and engender

a feeling of progress. And they can provide simple options that give customers a feeling of control and choice. One pilot study at a consumer-services firm found that improvements in customer-satisfaction scores accrued from “soft” behavioral-psychology initiatives as well as from “hard” improvements in operations (Exhibit 3).

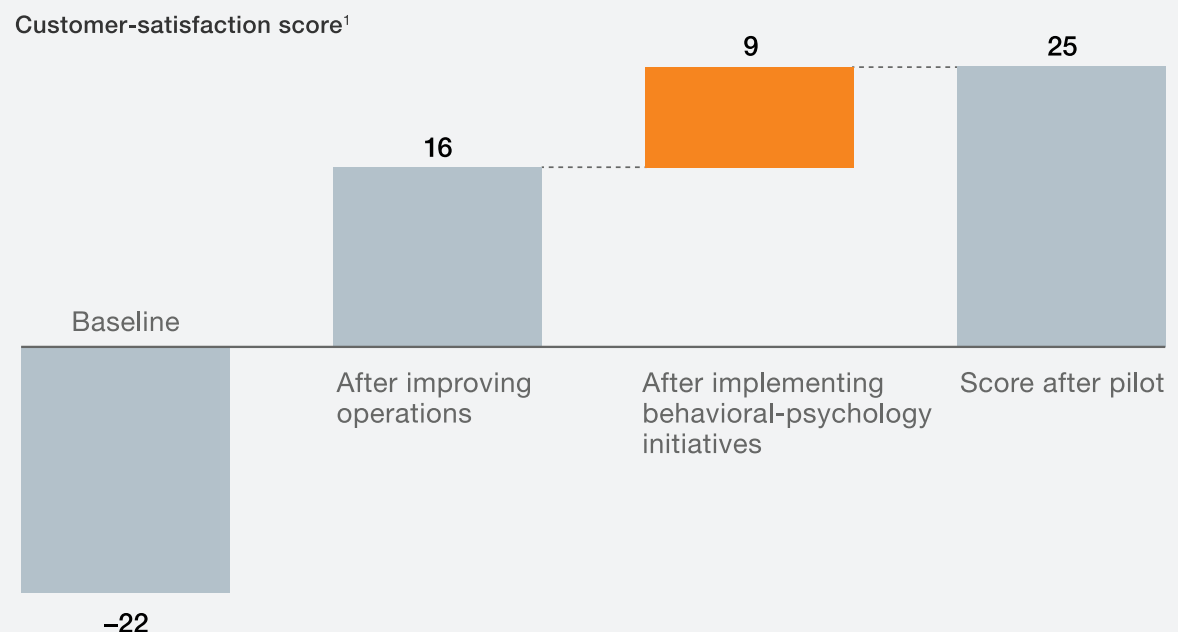
#### Reinvent customer journeys using digital technologies.

Customers accustomed to the personalization and ease of dealing with digital natives such as Google and Amazon now expect the same kind of service from established players. Research shows that 25

percent of customers will defect after just one bad experience.

Customer-experience leaders can become even better by digitizing the processes behind the most important customer journeys. In these quick efforts, multidisciplinary teams jointly design, test, and iterate high-impact processes and journeys in the field, continually refining and rereleasing them after input from customers. Such methods help high-performing incumbents to release and scale major, customer-vetted process improvements in less than 20 weeks. Agile digital companies significantly outperform their competitors,

**Exhibit 3 In one consumer-services pilot, operational improvements and behavioral-psychology initiatives raised customer-experience scores.**



<sup>1</sup>Likelihood that respondent would recommend the company, product, or service to a friend or colleague; rated on a scale of 0 to 10, where 10 is most likely; score reflects the sum of responses of 9 and 10 minus the sum of responses of 0 through 6.

according to some studies.<sup>4</sup> To achieve those results, established businesses must embrace new ways of working.

### **Perform: Align the organization to deliver against tangible outcomes**

As the customer experience becomes a bigger focus of corporate strategy, more and more executives will face the decision to commit their organizations to a broad customer-experience transformation. The immediate challenge will be how to structure the organization and rollout, as well as figuring out where and how to get started. Applying sophisticated measurement to what your customers are saying, empowering frontline employees to deliver against your customer vision, and a customer-centric governance structure form the foundation. Securing early economic wins will deliver value and momentum for continuous innovation.

### **Use customer journeys to empower the front line**

Every leading customer-experience company has motivated employees who embody the customer and brand promise in their interactions with consumers, and are empowered to do the right thing. Executives at customer-centered companies engage these employees at every level of the organization, working directly with them in retail settings, taking calls, and getting out into the field. In the early years, for example, Amazon famously staged “all hands on deck” sessions during the year-end holidays, a tradition that lives on in the employee-onboarding experience.<sup>5</sup> Some organizations create boards or panels of customers to provide a formal feedback mechanism.

### **Establish metrics that capture customer feedback.**

The key to satisfying customers is not just to measure what happens but also to use the data to drive action throughout the organization. The type of metric used is less important than the way it is applied. The ideal customer-experience

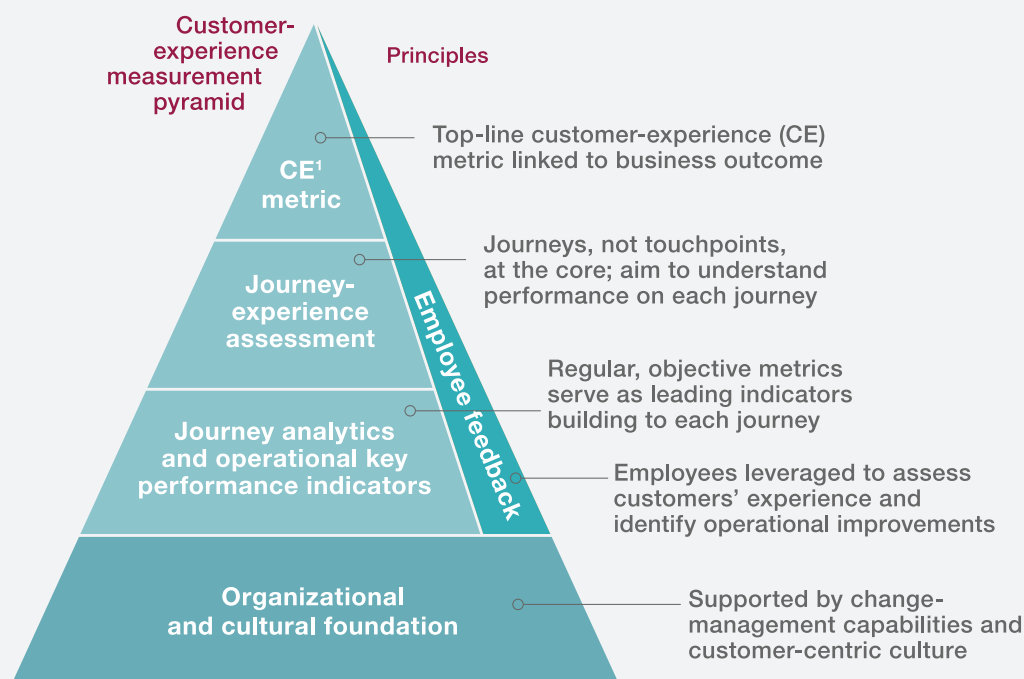
measurement system puts journeys at the center and connects them to other critical elements such as business outcomes and operational improvements. Leading practitioners start at the top, with a metric to measure the customer experience, and then cascade downward into key customer journeys and performance indicators, taking advantage of employee feedback to identify improvement opportunities (Exhibit 4).

Even for companies that collaborate smoothly, shifting to a customer-centric model that cuts across functions is not an easy task. To move from knowledge to action, companies need proper governance and leadership. Best-in-class organizations have governance structures that include a sponsor—a chief customer officer—and an executive champion for each of their primary cross-functional customer journeys. They also have full-time teams carrying out their day-to-day work in the existing organization. To succeed, the transformation must take place within normal operations. To foster understanding and conviction, leaders at all levels must role-model the behavior they expect from these teams, constantly communicating the changes needed. Formal reinforcement mechanisms and skill-building activities at multiple levels of the organization support the transformation, as well. In a recent video, McKinsey’s Ewan Duncan describes how rewiring a company in this way is typically a two- to four-year journey.

### **Log early wins to demonstrate value creation.**

Too many customer-experience transformations stall because leaders can’t show how these efforts create value. Executives, citing the benefits of improved customer relations, launch bold initiatives to delight customers that end up having clear costs and unclear near-term results. The better way is to build an explicit link to value creation by defining

**Exhibit 4 The ideal customer-experience measurement system puts journeys at the center and connects them to other critical elements.**



Source: McKinsey analysis

the outcomes that really matter, analyzing historical performance of satisfied and dissatisfied customers, and focusing on customer satisfaction issues with the highest payouts. This requires discipline and patience, but the result will be early wins that will build confidence within the organization and momentum to innovate further.



Delighting customers by mastering the concept and execution of an exceptionally good customer experience is a challenge. But it is an essential

requirement for leading in an environment where customers wield growing power. ■

<sup>1</sup> See Nicolas Maechler, Kevin Neher, and Robert Park, "From touchpoints to journeys: Seeing the world as customers do," March 2016, on McKinsey.com.

<sup>2</sup> McKinsey US cross-industry customer-experience survey, June–October 2015 data.

<sup>3</sup> For more about journeys versus touchpoints, see the video "Linking customer experiences to business outcomes," embedded in the article "Are you really listening to what your customers are saying?," by Harald Fanderl, Kevin Neher, and Alfonso Pulido, March 2016, on McKinsey.com.



- <sup>4</sup> The Common Purpose is the intellectual property of the Walt Disney Company. See Talking Points, “Be our guest. . . again,” blog post by Jeff James, December 22, 2011, on [disneyinstitute.com/blog](http://disneyinstitute.com/blog).
- <sup>5</sup> Richard Chase and Sriram Dasu, *The Customer Service Solution: Managing Emotions, Trust, and Control to Win Your Customer’s Business*, Columbus, OH: McGraw-Hill Education, 2013.
- <sup>6</sup> See John DeVine and Keith Gilson, “Using behavioral science to improve the customer experience,” February 2010, on [McKinsey.com](http://McKinsey.com).
- <sup>7</sup> See “Infographic: The cost of crappy customer experiences,” August 6, 2015, on [thunderhead.com](http://thunderhead.com).
- <sup>8</sup> See *The 2015 Customer Experience ROI Study*, Watermark Consulting, [watermarkconsult.net](http://watermarkconsult.net).
- <sup>9</sup> Brad Stone, *The Everything Store: Jeff Bezos and the Age of Amazon*, first edition, New York, NY: Little, Brown, 2013.
- <sup>10</sup> See Dilip Bhattacharjee, Jesus Moreno, and Francisco Ortega, “The secret to delighting customers: Putting employees first,” March 2016, on [McKinsey.com](http://McKinsey.com).
- <sup>11</sup> See Harald Fanderl, Kevin Neher, and Alfonso Pulido, “Are you really listening to what your customers are saying?,” March 2016, on [McKinsey.com](http://McKinsey.com).
- <sup>12</sup> See Ewan Duncan, Harald Fanderl, and Katy Maffei, “Designing and starting up a customer-experience transformation,” March 2016, on [McKinsey.com](http://McKinsey.com).
- <sup>13</sup> See Joel Maynes and Alex Rawson, “Linking the customer experience to value,” March 2016, on [McKinsey.com](http://McKinsey.com).

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# How to make sure your next product or service launch drives growth

Fifty percent of launches don't hit their targets. Launch champions follow these four rules.

Alessandro Buffoni, Alice de Angelis, Volker Grüntges, and Alex Krieg



Any company looking to boost revenue growth needs to launch new products or services. More than 25 percent of total revenue and profits across industries comes from the launch of new products, according to a McKinsey survey (Exhibit 1).<sup>1</sup>

Recent research has also shown that companies that focus on creating new products and services while maintaining core competencies across functions grow faster than their peers. And as companies look to future growth, the overwhelming majority expect it to come from creating new products, services, or business models.<sup>2</sup>

In the search for growth, companies have been increasing R&D spend year-on-year since 2005, now totaling over \$1.5 trillion globally (equivalent to the GDP of Canada). Yet despite this investment and the importance of developing successful new products, our research has shown that more than 50 percent of all product launches fail to hit business targets.

### Why is it so difficult to launch a product or service?

Technology has made good product launches more challenging. It has lowered the bar for product development, allowing companies and startups to roll out more launches more quickly and cheaply. Digital technologies in particular have allowed companies to rapidly pilot and scale new services, from loyalty programs to support for existing products.

On top of that, myriad digital platforms from email to Snapchat have led to a barrage of messaging and communications, making it harder for products to stand out. That fact might explain why American families repeatedly buy the same 150 products that make up some 85 percent of their household needs.<sup>3</sup>

In analyzing product and service launches across industries, we noted plenty of variation in terms of frequency, average spend, and launch type—

especially between completely new products, which dominate in pharma, as opposed to just upgrades or line extensions, as is often the case in consumer companies. Despite the variation, average failure rates are high across the board—over 40 percent—with consumer and retail performing worst and pharma performing best.

Interestingly, this failure rate holds across different launch types. While one might expect the launch of completely new products to be less successful because of the complexities of changing consumer perceptions and habits, their failure rate is comparable to the launch of incremental changes in familiar products. Clearly, the complexity of the product doesn't have much of an effect on the launch.

Neither does money, as it turns out. Our research showed no correlation between the amount invested in a launch and the rate of success. Nor is there a correlation with the average frequency of launches. Just because you do it more doesn't mean that you get any better at doing it, according to the data.

### Launch champions: What they do right

What turns out to really matter is having in place a specific set of core capabilities, the most important of which are team collaboration, incorporation of market insights, rigorous planning of upcoming launches, and growing talent (Exhibit 2).

Whichever the sector, however, most businesses do not have a clear sense of which launch capabilities really matter, nor do they have a systematic program for investing in them. More worrisome, many companies rate themselves as poor performers across the most crucial launch capabilities, with only a few rating themselves above average, e.g. 55 percent of pharma executives rating their “tracking/monitoring progress” as good while industrial executives give “Scenario planning to prepare for uncertainties” their top rating.

## Exhibit 1 More than 25 percent of total revenue and profits come from the launch of new products

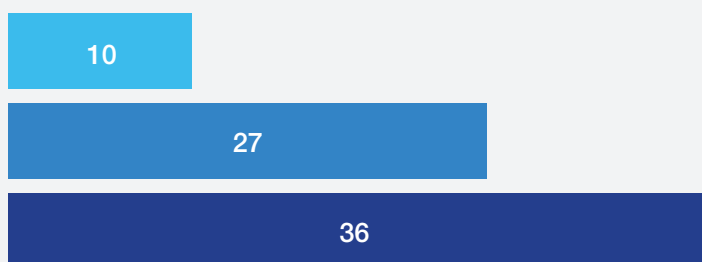
Revenue and profit from new products, past 3 years

%, N=211

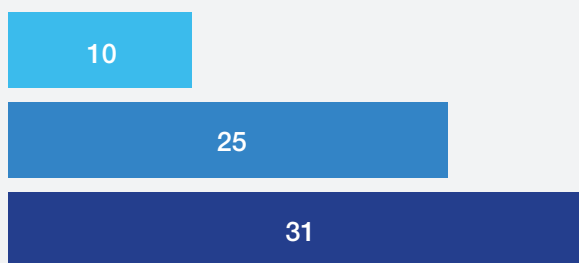
■ Top 25% ■ Average ■ Bottom 25%



% of **revenue**  
from new products



% of **profit**  
from new products



Source: American Productivity & Quality Center (APQC) and Product Development Institute (PDI) study, 2011

Here is what the best companies do to win when it comes to product and service launches:

### Build an organization for collaboration

In our survey, the single most important driving force behind successful commercial launches (averaged across sectors) was team collaboration, especially the ability to unite around one direction and to execute as a team. That level of collaboration is hard to achieve in most businesses, since different functions with different reporting structures and incentives are responsible for different elements of the product launch.

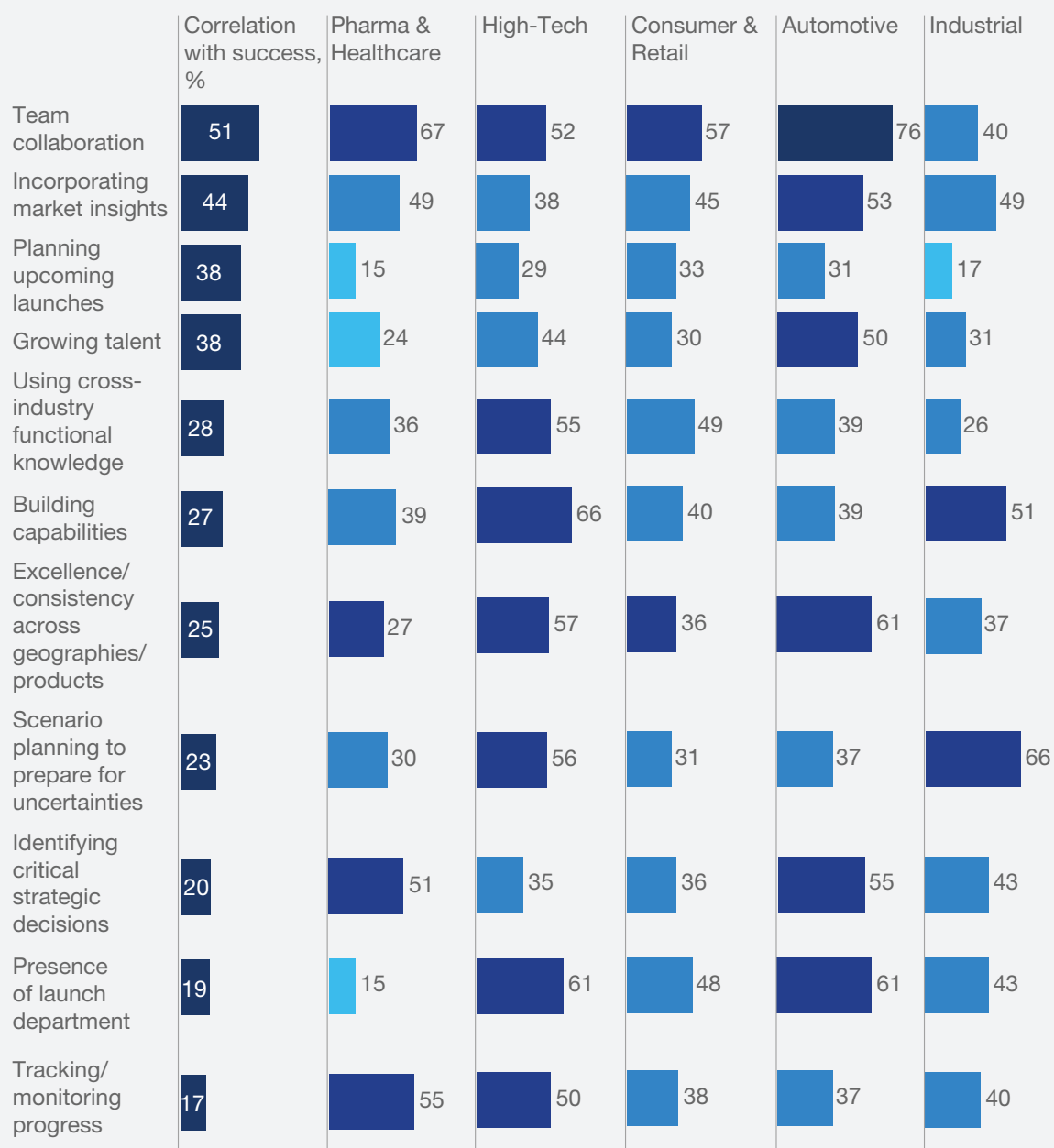
To counter this issue, the best performers establish a cross-functional launch department to orchestrate

and integrate activities across functions and geographies. This department operates like a center of excellence overseeing the full portfolio of launches and is the mechanism for bringing the right people together—marketers, social-media experts, developers, customer-service people, designers, etc.

For example, a German packaging company pulls together a launch team that combines technical, commercial, and regional stakeholders under a strong launch manager at the beginning of the product-development process. This greatly accelerates the process because the people who can make decisions are working together. This sort of collaboration and cross-pollination of ideas and expertise also often leads to better launch ideas.

## Exhibit 2 Specific launch capabilities correlate with success.

### Market performance, % Top 2 box



Source: McKinsey cross-industry launch survey, 2015



The launch department allocates budgets, usually with the direct approval of the CMO or sometimes even the CEO, and assigns managers to each launch who have end-to-end responsibility and are empowered to make decisions.

This group is also the keeper of all lessons learned about best practices in launching products and provides guidance, for example, on how to do a large launch as opposed to a smaller one. They develop comprehensive playbooks to standardize the best approaches, which then guide product-launch teams.

#### Demonstrate excellence in strategy and planning

Product launches are often complicated and expensive, with costs spiraling out of control. A sound strategy and clear plan are indispensable. A strategy should articulate exactly what the business wants to achieve with the product or service, including which customers to target, what key message to communicate, and which three to five critical decisions will best drive those outcomes.

These strategic decisions have to be made early enough in the development process for the launch team to think through what they mean for the launch itself. When Fiat launched its Fiat 500, for example, it wanted to shift perceptions away from Fiat cars as merely “functional” and increase awareness of the car’s style. The product-launch team decided to ask customers for their opinions about how to design the interior. The idea wasn’t so much to get input on design—there was limited flexibility in what could be done—but to get people talking about style and associating it with Fiat. To do this, the launch team needed to be involved early on in the car’s development process.

A firm strategy is the basis for a detailed launch plan, which identifies critical paths, resources, and decisions needed for success. In developing the launch plan, the best companies have a laser focus

on launch ROI (gross margin/launch investment) to determine if launch activities actually deliver value. Launch ROI shifts the emphasis to metrics that track outcomes, such as preorders, instead of inputs, such as number of launch events or number of walk-ins.

A good launch plan also provides transparency between headquarters and the responsible teams at the country level, who are responsible for both building on and implementing it. High levels of transparency and clarity are particularly important for large global launches, which often have 600 or 700 items associated with a launch, such as collateral, messaging, brochures, coupons, and web campaigns. A good plan should identify what activities need to happen when, and who has responsibility for each one.

The plan should also identify potential risk scenarios—what happens, for example, if a competitor launches a campaign for a competing product just before launch?—and develop risk-mitigation actions that enable rapid course correction.

The German packaging company cited above brings together strategy and planning by instituting a stringent launch tracking process, which measures commercial and technical progress. Commercial progress is tracked across big-idea generation, target-customer definition, use-case development, and go-to-market strategy. This process allows leadership to intervene quickly when issues or opportunities surface.

#### Invest in insights to tailor programs

A differentiated launch strategy relies on a solid understanding of the market, consumer, and competitive situation. Without that, companies often revert to just pushing out generic slogans and media messages that do little to convert customers. Basic demographic and online analysis is a good

start, but the best companies go beyond that to uncover insights into behaviors of (meaningfully) narrow segments of target customers.

One large auto manufacturer, for example, was preparing to launch a new car in China and wanted to reach young families. The original launch plan allocated the vast majority of advertising spend to TV and newspapers, with little focused on the web. However, analysis revealed that young families were going to a set of websites more often than watching TV. The company then scaled back their TV and newspaper advertising and poured more spend into family-oriented websites. They also focused on tailoring in-person events to young families where their foot traffic was high. That meant, for example, putting child seats in cars they put on display in malls and developing programs to entertain kids while parents checked out the car.

#### Build up launch talent

Often hundreds of people are involved in delivering the commercial launch of a product. One mistake in the process can jeopardize the entire launch. Successful companies understand that to deliver on the strategy, they need to invest in training and developing their people. This starts with not just attracting good talent, but also making launch-team roles important and valued, not a career dead end. The best companies develop specific career paths for their launch leaders, with clear milestones for promotion and significant rewards for strong performance.

CEOs can raise the prestige of the launch of a product or service by being actively involved, from announcing launches to reviewing launch plans with the board. They also have a pivotal role in celebrating launch success by communicating it to the business and championing winning launch teams. In this way, they can even create role models for others.

One approach that leading companies are using is to create a launch department that pulls together all commercial launch managers into a center of excellence, which helps identify and reward top talent. This organization also becomes the place where up-and-coming leaders are trained in product-launch excellence and fostering a culture of continuous improvement.

#### Getting started

Building up top launch capability is a significant effort. It requires leadership commitment and investing in supporting capabilities. In our experience, developing a strong launch capability requires executives to answer three sets of questions:

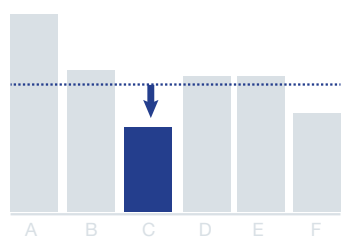
- What role does the new product/service development play in my corporate strategy?
- What levers can I pull to capture more value from my launches?
- What is the return on investment of my product and service launches? Is it better or worse than my peers'? How does it vary by product group/region?

A crucial starting point is a clear and unbiased understanding of current launch capabilities. This analysis not only helps leadership understand where to focus its energies but also provides a source of common knowledge. This is particularly effective in providing a common focus and settling arguments at the leadership level based on different data sources (or, often, no data at all). A three-step launch diagnostic process is proven to provide senior marketers with useful benchmarking data (Exhibit 3).

Products are a source of significant growth for businesses. But unless companies can master

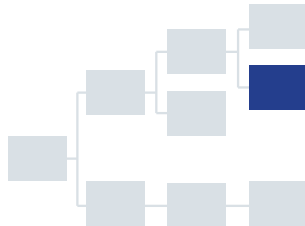
## Exhibit 3 Launch Diagnostic

### 1. Launch ROI: Benchmark



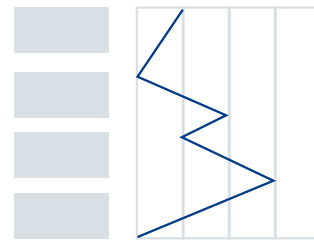
Compare and understand launch ROI across products, geographies, and business units in order to identify optimization areas.

### 2. Launch ROI: Drill-down



Drill down into operational launch ROI drivers (eg, distribution coverage, price erosion) to identify granular improvement areas.

### 3. Launch capability: Survey



Gather qualitative feedback from cross-functional teams on launch capabilities to identify pain points and uncover root causes.

product launches, the full value of products will remain out of reach. ■

<sup>1</sup> McKinsey cross-industry launch survey with 50+ senior executives.

<sup>2</sup> "Invest, Create, Perform: Mastering the three dimensions of growth in the digital age," March 2017, McKinsey.com.

<sup>3</sup> "Why most product launches fail," Harvard Business Review, April 2011.

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# The eight essentials of innovation

Strategic and organizational factors are what separate successful big-company innovators from the rest of the field.

Marc de Jong, Nathan Marston, and Erik Roth



It's no secret: innovation is difficult for well-established companies. By and large, they are better executors than innovators, and most succeed less through game-changing creativity than by optimizing their existing businesses.

Yet hard as it is for such organizations to innovate, large ones as diverse as Alcoa, the Discovery Group, and NASA's Ames Research Center are actually doing so. What can other companies learn from their approaches and attributes? That question formed the core of a multiyear study comprising

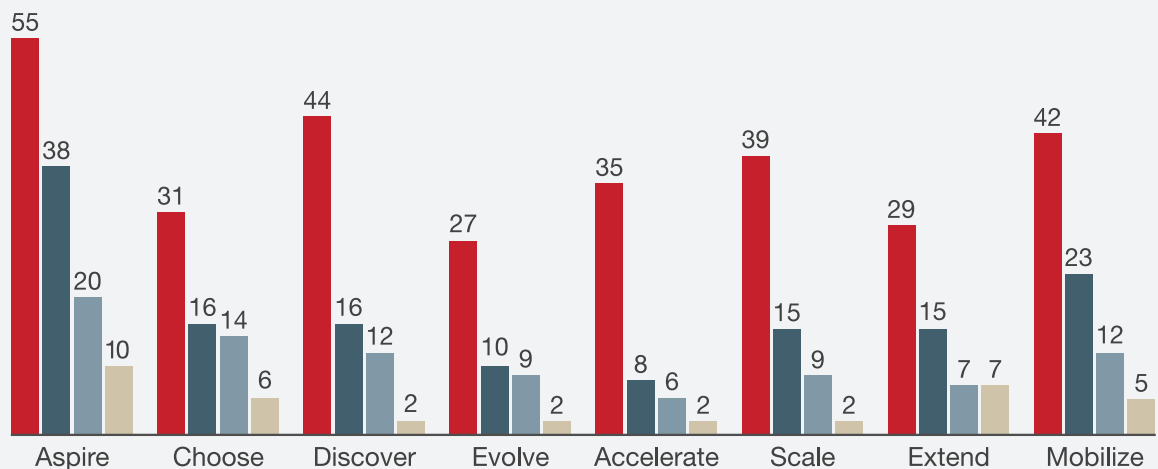
in-depth interviews, workshops, and surveys of more than 2,500 executives in over 300 companies, including both performance leaders and laggards, in a broad set of industries and countries (Exhibit 1). What we found were a set of eight essential attributes that are present, either in part or in full, at every big company that's a high performer in product, process, or business-model innovation.

Since innovation is a complex, company-wide endeavor, it requires a set of crosscutting practices and processes to structure, organize,

## Exhibit 1 What innovation leaders say they do right

% of respondents by performance quartile<sup>1</sup>

■ Top quartile ■ 2nd ■ 3rd ■ 4th



*The survey tested for 27 innovation practices spread across eight essentials*

<sup>1</sup>N = 623. Performance defined as a weighted index of measures for organic growth (% of growth from new products or services developed in-house) and innovation performance (% of sales from new products and self-assessment of innovation performance). Respondents who answered "yes to some degree," "no," or "don't know/not applicable" are not shown.

Source: McKinsey survey of 2,500 global executives, Nov 2012



## Exhibit 2    **Testing for innovation**

Do you really innovate?	
<b>Aspire</b>	Do you regard innovation-led growth as critical, and do you have cascaded targets that reflect this?
<b>Choose</b>	Do you invest in a coherent, time- and risk-balanced portfolio of initiatives with sufficient resources to win?
<b>Discover</b>	Do you have differentiated business, market, and technology insights that translate into winning value propositions?
<b>Evolve</b>	Do you create new business models that provide defensible and scalable profit sources?
<b>Accelerate</b>	Do you beat the competition by developing and launching innovations quickly and effectively?
<b>Scale</b>	Do you launch innovations at the right scale in the relevant markets and segments?
<b>Extend</b>	Do you win by creating and capitalizing on external networks?
<b>Mobilize</b>	Are your people motivated, rewarded, and organized to innovate repeatedly?

Source: McKinsey analysis

and encourage it. Taken together, the essentials described in this article constitute just such an operating system, as seen in Exhibit 2. These often overlapping, iterative, and nonsequential practices resist systematic categorization but can nonetheless be thought of in two groups. The first four, which are strategic and creative in nature, help set and prioritize the terms and conditions under which

innovation is more likely to thrive. The next four essentials deal with how to deliver and organize for innovation repeatedly over time and with enough value to contribute meaningfully to overall performance.

To be sure, there's no proven formula for success, particularly when it comes to innovation. While our

years of client-service experience provide strong indicators for the existence of a causal relationship between the attributes that survey respondents reported and the innovations of the companies we studied, the statistics described here can only *prove* correlation. Yet we firmly believe that if companies assimilate and apply these essentials—in their own way, in accordance with their particular context, capabilities, organizational culture, and appetite for risk—they will improve the likelihood that they, too, can rekindle the lost spark of innovation. In the digital age, the pace of change has gone into hyperspeed, so companies must get these strategic, creative, executional, and organizational factors right to innovate successfully.

### Aspire

President John F. Kennedy’s bold aspiration, in 1962, to “go to the moon in this decade” motivated a nation to unprecedented levels of innovation. A far-reaching vision can be a compelling catalyst, provided it’s realistic enough to stimulate action today.

But in a corporate setting, as many CEOs have discovered, even the most inspiring words often are insufficient, no matter how many times they are repeated. It helps to combine high-level aspirations with estimates of the value that innovation should generate to meet financial-growth objectives. Quantifying an “innovation target for growth,” and making it an explicit part of future strategic plans, helps solidify the importance of and accountability for innovation. The target itself must be large enough to force managers to include innovation investments in their business plans. If they can make their numbers using other, less risky tactics, our experience suggests that they (quite rationally) will.

Establishing a quantitative innovation aspiration is not enough, however. The target value needs to be apportioned to relevant business “owners” and

cascaded down to their organizations in the form of performance targets and timelines. Anything less risks encouraging inaction or the belief that innovation is someone else’s job.

For example, Lantmännen, a big Nordic agricultural cooperative, was challenged by flat organic growth and directionless innovation. Top executives created an aspirational vision and strategic plan linked to financial targets: 6 percent growth in the core business and 2 percent growth in new organic ventures. To encourage innovation projects, these quantitative targets were cascaded down to business units and, ultimately, to product groups. During the development of each innovation project, it had to show how it was helping to achieve the growth targets for its category and markets. As a result, Lantmännen went from 4 percent to 13 percent annual growth, underpinned by the successful launch of several new brands. Indeed, it became the market leader in premade food only four years after entry and created a new premium segment in this market.

Such performance parameters can seem painful to managers more accustomed to the traditional approach. In our experience, though, CEOs are likely just going through the motions if they don’t use evaluations and remuneration to assess and recognize the contribution that all top managers make to innovation.

### Choose

Fresh, creative insights are invaluable, but in our experience many companies run into difficulty less from a scarcity of new ideas than from the struggle to determine *which* ideas to support and scale. At bigger companies, this can be particularly problematic during market discontinuities, when supporting the next wave of growth may seem too risky, at least until competitive dynamics force painful changes.

Innovation is inherently risky, to be sure, and getting the most from a portfolio of innovation initiatives is more about managing risk than eliminating it. Since no one knows exactly where valuable innovations will emerge, and searching everywhere is impractical, executives must create some boundary conditions for the opportunity spaces they want to explore. The process of identifying and bounding these spaces can run the gamut from intuitive visions of the future to carefully scrutinized strategic analyses. Thoughtfully prioritizing these spaces also allows companies to assess whether they have enough investment behind their most valuable opportunities.

During this process, companies should set in motion more projects than they will ultimately be able to finance, which makes it easier to kill those that prove less promising. RELX Group, for example, runs 10 to 15 experiments per major customer segment, each funded with a preliminary budget of around \$200,000, through its innovation pipeline every year, choosing subsequently to invest more significant funds in one or two of them, and dropping the rest. “One of the hardest things to figure out is when to kill something,” says Kumsal Bayazit, RELX Group’s chief strategy officer. “It’s a heck of a lot easier if you have a portfolio of ideas.”

Once the opportunities are defined, companies need transparency into what people are working on and a governance process that constantly assesses not only the expected value, timing, and risk of the initiatives in the portfolio but also its overall composition. There’s no single mix that’s universally right. Most established companies err on the side of overloading their innovation pipelines with relatively safe, short-term, and incremental projects that have little chance of realizing their growth targets or staying within their risk parameters. Some spread themselves thinly across too many projects instead of focusing

on those with the highest potential for success and resourcing them to win.

These tendencies get reinforced by a sluggish resource-reallocation process. Our research shows that a company typically reallocates only a tiny fraction of its resources from year to year, thereby sentencing innovation to a stagnating march of incrementalism.<sup>1</sup>

### Discover

Innovation also requires actionable and differentiated insights—the kind that excite customers and bring new categories and markets into being. How do companies develop them? Genius is always an appealing approach, if you have or can get it. Fortunately, innovation yields to other approaches besides exceptional creativity.

The rest of us can look for insights by methodically and systematically scrutinizing three areas: a valuable problem to solve, a technology that enables a solution, and a business model that generates money from it. You could argue that nearly every successful innovation occurs at the intersection of these three elements. Companies that effectively collect, synthesize, and “collide” them stand the highest probability of success. “If you get the sweet spot of what the customer is struggling with, and at the same time get a deeper knowledge of the new technologies coming along and find a mechanism for how these two things can come together, then you are going to get good returns,” says Alcoa chairman and chief executive Klaus Kleinfeld.

The insight-discovery process, which extends beyond a company’s boundaries to include insight-generating partnerships, is the lifeblood of innovation. We won’t belabor the matter here, though, because it’s already the subject of countless articles and books.<sup>2</sup> One thing we can add is that discovery is iterative, and the active use of prototypes can help companies continue

to learn as they develop, test, validate, and refine their innovations. Moreover, we firmly believe that without a fully developed innovation *system* encompassing the other elements described in this article, large organizations probably won't innovate successfully, no matter how effective their insight-generation process is.

### Evolve

Business-model innovations—which change the economics of the value chain, diversify profit streams, and/or modify delivery models—have always been a vital part of a strong innovation portfolio. As smartphones and mobile apps threaten to upend oldline industries, business-model innovation has become all the more urgent: established companies must reinvent their businesses before technology-driven upstarts do. Why, then, do most innovation systems so squarely emphasize new products? The reason, of course, is that most big companies are reluctant to risk tampering with their core business model until it's visibly under threat. At that point, they can only hope it's not too late.

Leading companies combat this troubling tendency in a number of ways. They up their game in market intelligence, the better to separate signal from noise. They establish funding vehicles for new businesses that don't fit into the current structure. They constantly reevaluate their position in the value chain, carefully considering business models that might deliver value to priority groups of new customers. They sponsor pilot projects and experiments away from the core business to help combat narrow conceptions of what they are and do. And they stress-test newly emerging value propositions and operating models against countermoves by competitors.

Amazon does a particularly strong job extending itself into new business models by addressing the emerging needs of its customers and suppliers. In

fact, it has included many of its suppliers in its customer base by offering them an increasingly wide range of services, from hosted computing to warehouse management. Another strong performer, the *Financial Times*, was already experimenting with its business model in response to the increasing digitalization of media when, in 2007, it launched an innovative subscription model, upending its relationship with advertisers and readers. “We went against the received wisdom of popular strategies at the time,” says Caspar de Bono, *FT* board member and managing director of B2B. “We were very deliberate in getting ahead of the emerging structural change, and the decisions turned out to be very successful.” In print's heyday, 80 percent of the *FT*'s revenue came from print advertising. Now, more than half of it comes from content, and two-thirds of circulation comes from digital subscriptions.

### Accelerate

Virulent antibodies undermine innovation at many large companies. Cautious governance processes make it easy for stifling bureaucracies in marketing, legal, IT, and other functions to find reasons to halt or slow approvals. Too often, companies simply get in the way of their own attempts to innovate. A surprising number of impressive innovations from companies were actually the fruit of their mavericks, who succeeded in bypassing their early-approval processes. Clearly, there's a balance to be maintained: bureaucracy must be held in check, yet the rush to market should not undermine the cross-functional collaboration, continuous learning cycles, and clear decision pathways that help enable innovation. Are managers with the right knowledge, skills, and experience making the crucial decisions in a timely manner, so that innovation continually moves through an organization in a way that creates and maintains competitive advantage, without exposing a company to unnecessary risk?

Companies also thrive by testing their promising ideas with customers early in the process, before internal forces impose modifications that blur the original value proposition. To end up with the innovation initially envisioned, it's necessary to knock down the barriers that stand between a great idea and the end user. Companies need a well-connected manager to take charge of a project and be responsible for the budget, time to market, and key specifications—a person who can say yes rather than no. In addition, the project team needs to be cross-functional in reality, not just on paper. This means locating its members in a single place and ensuring that they give the project a significant amount of their time (at least half) to support a culture that puts the innovation project's success above the success of each function.

Cross-functional collaboration can help ensure end-user involvement throughout the development process. At many companies, marketing's role is to champion the interests of end users as development teams evolve products and to help ensure that the final result is what everyone first envisioned. But this responsibility is honored more often in the breach than in the observance. Other companies, meanwhile, rationalize that consumers don't necessarily know what they want until it becomes available. This may be true, but customers can certainly say what they *don't* like. And the more quickly and frequently a project team gets—and uses—feedback, the more quickly it gets a great end result.

### Scale

Some ideas, such as luxury goods and many smartphone apps, are destined for niche markets. Others, like social networks, work at global scale. Explicitly considering the appropriate magnitude and reach of a given idea is important to ensuring that the right resources and risks are involved in pursuing it. The seemingly safer option of scaling up over time can be a death sentence. Resources and

capabilities must be marshaled to make sure a new product or service can be delivered quickly at the desired volume and quality. Manufacturing facilities, suppliers, distributors, and others must be prepared to execute a rapid and full rollout.

For example, when TomTom launched its first touch-screen navigational device, in 2004, the product flew off the shelves. By 2006, TomTom's line of portable navigation devices reached sales of about 5 million units a year, and by 2008, yearly volume had jumped to more than 12 million. "That's faster market penetration than mobile phones" had, says Harold Goddijn, TomTom's CEO and cofounder. While TomTom's initial accomplishment lay in combining a well-defined consumer problem with widely available technology components, rapid scaling was vital to the product's continuing success. "We doubled down on managing our cash, our operations, maintaining quality, all the parts of the iceberg no one sees," Goddijn adds. "We were hugely well organized."

### Extend

In the space of only a few years, companies in nearly every sector have conceded that innovation requires external collaborators. Flows of talent and knowledge increasingly transcend company and geographic boundaries. Successful innovators achieve significant multiples for every dollar invested in innovation by accessing the skills and talents of others. In this way, they speed up innovation and uncover new ways to create value for their customers and ecosystem partners.

Smart collaboration with external partners, though, goes beyond merely sourcing new ideas and insights; it can involve sharing costs and finding faster routes to market. Famously, the components of Apple's first iPod were developed almost entirely outside the company; by efficiently managing these external partnerships, Apple was able to move from initial concept to marketable product in only nine



months. NASA's Ames Research Center teams up not just with international partners—launching joint satellites with nations as diverse as Lithuania, Saudi Arabia, and Sweden—but also with emerging companies, such as SpaceX.

High-performing innovators work hard to develop the ecosystems that help deliver these benefits. Indeed, they strive to become partners of choice, increasing the likelihood that the best ideas and people will come their way. That requires a systematic approach. First, these companies find out which partners they are already working with; surprisingly few companies know this. Then they decide which networks—say, four or five of them—they ideally need to support their innovation strategies. This step helps them to narrow and focus their collaboration efforts and to manage the flow of possibilities from outside the company. Strong innovators also regularly review their networks, extending and pruning them as appropriate and using sophisticated incentives and contractual structures to motivate high-performing business partners. Becoming a true partner of choice is, among other things, about clarifying what a partnership can offer the junior member: brand, reach, or access, perhaps. It is also about behavior. Partners of choice are fair and transparent in their dealings.

Moreover, companies that make the most of external networks have a good idea of what's most useful at which stages of the innovation process. In general, they cast a relatively wide net in the early going. But as they come closer to commercializing a new product or service, they become narrower and more specific in their sourcing, since by then the new offering's design is relatively set.

### Mobilize

How do leading companies stimulate, encourage, support, and reward innovative behavior and thinking among the right groups of people? The best

companies find ways to embed innovation into the fibers of their culture, from the core to the periphery.

They start back where we began: with aspirations that forge tight connections among innovation, strategy, and performance. When a company sets financial targets for innovation and defines market spaces, minds become far more focused. As those aspirations come to life through individual projects across the company, innovation leaders clarify responsibilities using the appropriate incentives and rewards.

The Discovery Group, for example, is upending the medical and life-insurance industries in its native South Africa and also has operations in the United Kingdom, the United States, and China, among other locations. Innovation is a standard measure in the company's semiannual divisional scorecards—a process that helps mobilize the organization and affects roughly 1,000 of the company's business leaders. "They are all required to innovate every year," Discovery founder and CEO Adrian Gore says of the company's business leaders. "They have no choice."

Organizational changes may be necessary, not because structural silver bullets exist—we've looked hard for them and don't think they do—but rather to promote collaboration, learning, and experimentation. Companies must help people to share ideas and knowledge freely, perhaps by locating teams working on different types of innovation in the same place, reviewing the structure of project teams to make sure they always have new blood, ensuring that lessons learned from success and failure are captured and assimilated, and recognizing innovation efforts even when they fall short of success.

Internal collaboration and experimentation can take years to establish, particularly in large, mature companies with strong cultures and ways of working

that, in other respects, may have served them well. Some companies set up “innovation garages” where small groups can work on important projects unconstrained by the normal working environment while building new ways of working that can be scaled up and absorbed into the larger organization. NASA, for example, has ten field centers. But the space agency relies on the Ames Research Center, in Silicon Valley, to maintain what its former director, Dr. Pete Worden, calls “the character of rebels” to function as “a laboratory that’s part of a much larger organization.”



Big companies do not easily reinvent themselves as leading innovators. Too many fixed routines and cultural factors can get in the way. For those that do make the attempt, innovation excellence is often built in a multiyear effort that touches most, if not all, parts of the organization. Our experience and research suggest that any company looking to make this journey will maximize its probability of success by closely studying and appropriately assimilating the leading practices of high-performing innovators. Taken together, these form an essential operating system for innovation within a company’s organizational structure and culture. ■

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<sup>1</sup> See Stephen Hall, Dan Lovullo, and Reinier Musters, “How to put your money where your strategy is,” *McKinsey Quarterly*, March 2012; and Vanessa Chan, Marc de Jong, and Vidyadhar Ranade, “Finding the sweet spot for allocating innovation resources,” *McKinsey Quarterly*, May 2014, both available on [mckinsey.com](http://mckinsey.com).

<sup>2</sup> See, for example, Marla M. Capozzi, Reneé Dye, and Amy Howe, “Sparkling creativity in teams: An executive’s guide,” *McKinsey Quarterly*, April 2011; and Marla M. Capozzi, John Horn, and Ari Kellen, “Battle-test your innovation strategy,” *McKinsey Quarterly*, December 2012, both available on [mckinsey.com](http://mckinsey.com).

# 4. Build your growth engine

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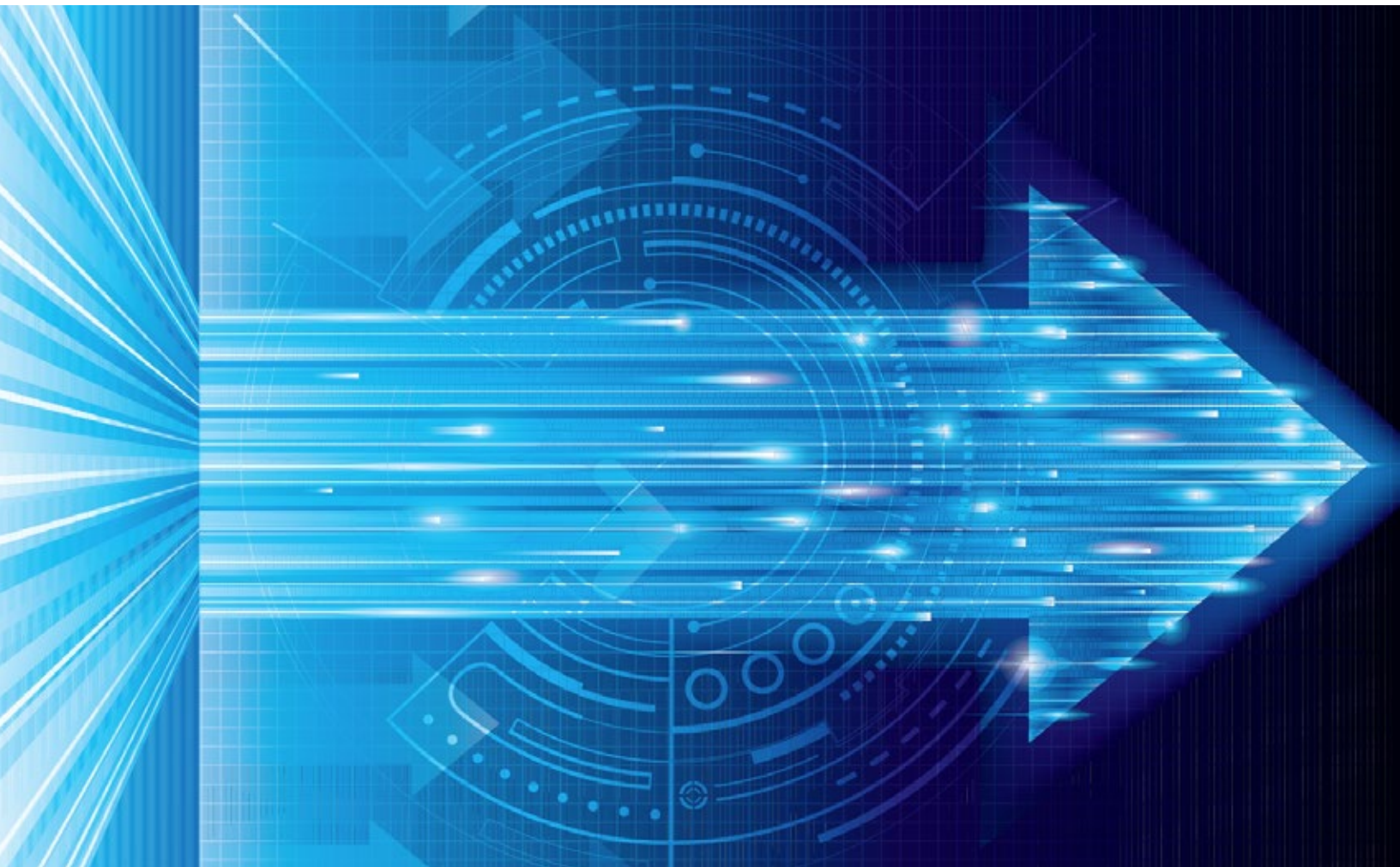




# Building a marketing organization that drives growth today

Technologies and customer expectations have changed faster than marketing organizations. Here's how to fix that.

Raphael Buck, Biljana Cvetanovski, Alex Harper, and Björn Timelin



From the rise of online shopping channels to ad campaigns created for an audience of one, consumer marketing has changed more in the past ten years than it did in the previous 30. Despite that level of change and disruption, if you had put a few typical marketers from the 1980s into a time machine and sent them into the marketing departments of today, they would probably feel right at home. There might be a new IT department and a few other changes, but the job titles, structures, approach to performance management—even the vocabulary—would be remarkably familiar.

That’s not a good thing. The truth is, while the proliferation of new channels and technologies has dramatically changed the environment in which marketers operate, the way they organize and approach their tasks has stayed more or less the same. Most marketing functions still develop and roll out large and infrequent campaigns, rely on agencies to make the same old media purchases, and are organized by geography or product.

As a result, few marketing organizations are able to take full advantage of new digital and advanced analytics tools that would enable them to be more agile, engaging, and effective. They are also missing out on growth. A recent McKinsey survey of executives found that 81 percent of high-growth companies outperformed in data and analytics.<sup>1</sup>

But capturing that advantage requires a new way of working. Some 71 percent of high-growth companies in that same survey have adopted agile processes such as scrum, cross-functional collaboration, and colocated teams. Another report found that top-performing marketers were more likely than their peers to be part of a networked organization (51 percent vs. 18 percent) and met more frequently with other parts of the business to create and deliver customer experience journeys.<sup>2</sup>

Extensive experience working with dozens of companies to improve their organizational models has shown that marketing organizations need to change in three ways. First, they need to shift their organizational model away from “boxes and lines” to a fluid ecosystem of internal and external partners. Second, they must scale agile ways of working. And third, they need to build out a set of supporting capabilities that can deliver great customer experiences (Exhibit 1).

### **Orchestrating the marketing ecosystem**

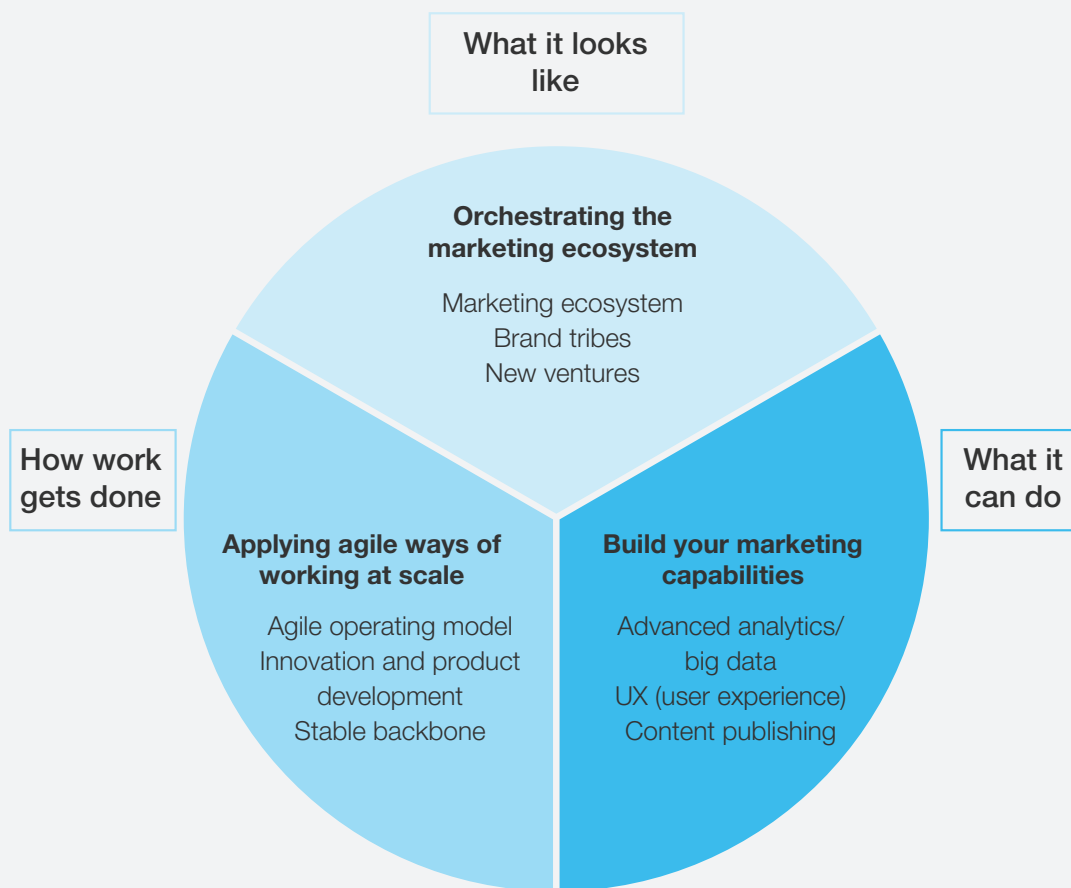
The digital age has made the old agency model redundant with the emergence of an array of narrower, more specialized services. Making effective use of these capabilities requires new management approaches and ways of working:

*Managing partnerships—inside and outside the organization* (see Exhibit 2): The traditional notion of managing a roster of a single media agency and one or two creative agencies of record seems like a relic from ancient marketing history. Today’s world features multiple channels and capabilities, such as search, social, programmatic, and content management, all of which need to be closely coordinated to be effective.

The teams that deliver these services—whether internal or external—need to function as an interconnected ‘ecosystem.’ An early decision is figuring out what to handle internally and what to outsource to an external partner. Core competencies such as strategy are best handled by the brand, while execution functions and experimenting with new media or channels can be handled by external partners. Over time, as the brand has a clearer sense of the value of the new capabilities, many activities will shift to internal teams.



**Exhibit 1 Making the marketing organization fit for the future.**



The real complexity comes in orchestrating all the teams. For this model to work, agencies can no longer be simple inputs in a linear process.<sup>3</sup>

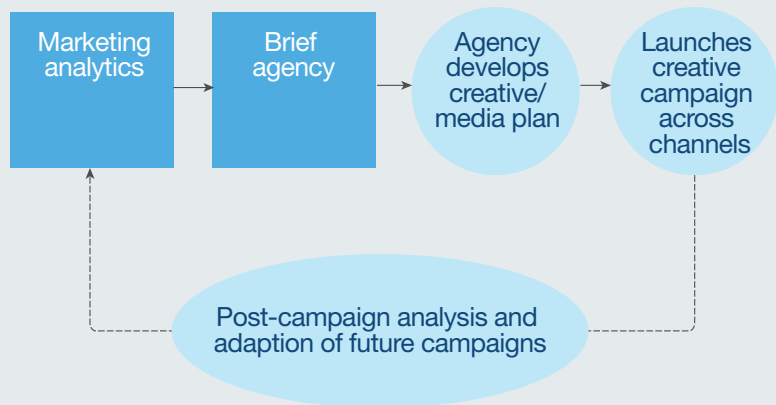
Instead, they need to be partners collaborating with brands and each other to create campaigns and assets. Brand managers need to set clearly aligned targets and establish clear deliverables and metrics. Some companies are already creating incentives that reward teams for their ability to work together, not just for their individual contributions. Marketers are investing in tools that coordinate internal teams

and external agencies, creating greater transparency in tracking progress.

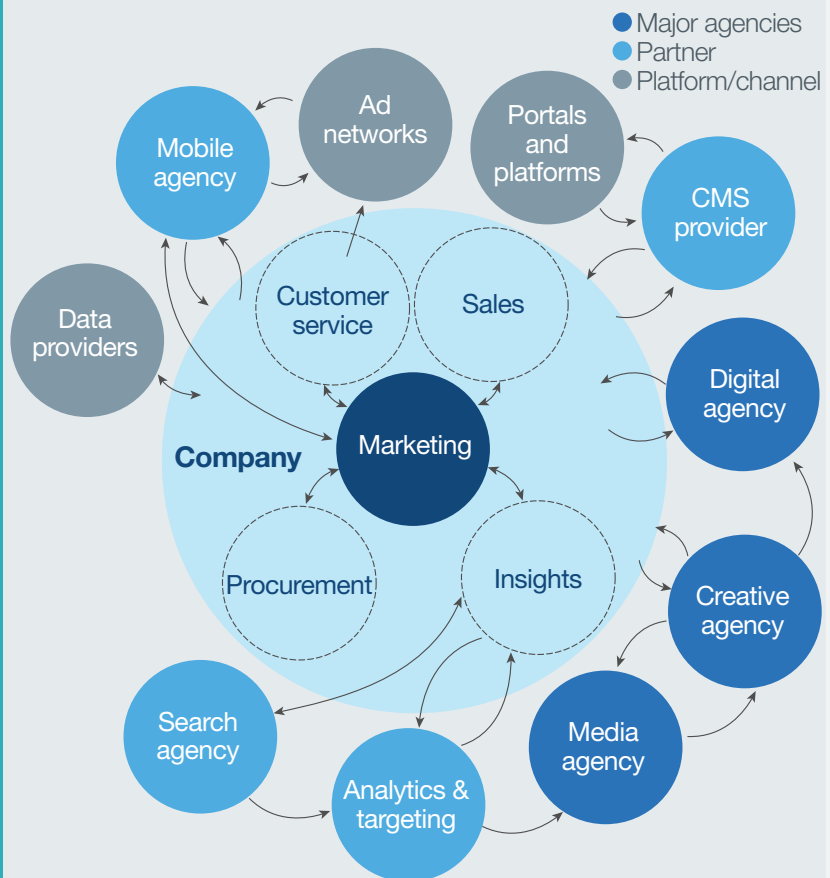
Supporting this model requires the role of the traditional brand manager to shift from leader to orchestrator. Brand managers need to understand enough of each specialist's area to work with all of them effectively. Most of all, they need to be adept at working within a networked organization in which they sit in the middle of a web of internal teams, agencies, customers, and suppliers. To do this effectively, brand managers need to put in place

## Exhibit 2 Managing the ecosystem

From a linear campaign process with few partners...



... to an inter-connected ecosystem



shared KPIs, communicate clear accountability to each partner, develop a “rapid reaction” governance structure, and create flexible guidelines so that partners can make decisions on the front lines quickly.

**Build brand tribes:** Brands have long been managed by global teams that design global campaigns and local teams that execute those campaigns as well as manage local ones. This often results in frustration in both directions: Local teams think global doesn’t understand their market, and global thinks that local isn’t using collective assets. To combat this issue, we have seen marketers start to build “brand tribes”—informal, globally dispersed networks of marketers, who collectively identify and share their best assets.

Instead of top-down direction, the tribes have community managers who foster global collaboration, post insights, promote assets for particular markets, and discourage off-brand execution. They put in place internal social platforms such as Slack to make it easy for people to share and find relevant content. This gives local managers access to assets that have been recommended by peers and approved by global managers and also provides recognition for those responsible for successful campaigns. Once adopted and embedded into the culture, brand tribes also become a way to reinforce brand standards. One global CPG is instituting a brand-tribes strategy as part of an overall marketing transformation. Led by the CMO, the effort was piloted in brands with strong leadership before being cascaded more broadly across the organization by the global brand heads. The global heads still decide on the major global campaigns and set the guidelines for local campaigns, but the local managers have more freedom to innovate—and to share those innovations with other brand managers on the tribe’s social platform. Marketing assets can

be voted up or down by peers, so that the most popular and successful campaigns rise to the most prominent positions on the platform.

Assets are also promoted by the community managers, making the platform a source of proven, high-quality assets for use anywhere. To encourage participation, a compensation system rewards brand managers for sharing and participating in the community. Recognition by peers and executives has also become an effective participation incentive.

**Nurture new ventures:** Companies are under continuous pressure to find new sources of growth, both inside and outside the core business. Recent research has shown, in fact, that companies that are able to create new products or services while maintaining a baseline of other capabilities are the fastest growers. For many companies, however, developing potentially disruptive businesses and business models that threaten the core business is understandably a challenge. Change takes time, and many people are invested in established products and ways of working. For this reason, we have found that companies can be successful nurturing digital ventures by creating new entities for that purpose.

One way to do this is to create a dedicated new-ventures unit inside the organization to develop new products and business models. This group not only gets the resources they need to prove themselves but are also freed from slow and inefficient processes that often weigh down larger companies. The second way is to partner with start-ups or incubators, which can give companies access to a larger pool of emerging innovations and technologies.

Recently, L’Oréal took the latter route by investing in Founders Factory, a global digital accelerator and incubator based in London. As part of the agreement, L’Oréal and Founders Factory will invest in and scale five early-stage beauty-related start-ups and

## The five shifts that have redefined the modern marketing landscape:

1. From targeted campaigns to personalized consumer interactions, leveraging advanced analytics
2. From sales primarily through bricks-and-mortar stores to a mix of online, offline, multichannel, and owned channels
3. From mass advertising campaigns to always-on content publishing
4. From a long-term innovation funnel to rapid test-and-learn, with an emphasis on speed to market
5. From marketing as a cost to marketing as an investment, with measurable ROI

cocreate two new companies from scratch every year. The in-house team of experts at Founders Factory, many of whom are successful entrepreneurs themselves, will provide hands-on support and advice to participating start-ups. The strategy provides an early look at innovative technologies and business models that relate to L'Oréal's core business.

### Applying agile ways of working at scale

The capability to test new ideas fast, refine them, and bring them rapidly to market has become essential. Creating new products and experiences in real time, however, requires new ways of working. Old, hierarchical reporting structures and approval-driven corporate cultures run counter to the speed and test-and-learn logic that underlie fast growth. Build an agile operating model: The concepts of agile and scrum—a specific form of agile that relies on small, self-organizing, cross-functional teams that work toward specific goals or “sprints” by breaking down tasks into smaller parts, assigning responsibility to team members, and reviewing progress frequently—originated in software

development but have begun to reshape the way consumer companies innovate and operate. With agile, companies use data and analytics to continuously identify promising opportunities or solutions in real time, deploying tests quickly, evaluating the results, and rapidly iterating.

Scaling agile across the business requires building credibility.<sup>4</sup> For each test that generates promising results, for example, the team can forecast the impact at scale and provide guidelines and rules to the marketing organization to apply the finding more broadly. As companies add new teams, it's important that each one be tightly focused on a specific goal, product, service, customer segment, or juncture in the customer journey. We recommend adding agile teams one at a time, waiting until they begin to operate effectively before adding the next. At scale, a high-functioning agile marketing organization can run hundreds of campaigns simultaneously and test multiple new ideas every week. These new ways of working enable continuous, data-driven improvements

to campaigns and assets, while also providing increased transparency and accountability (Exhibit 3.)

One online travel agency moved from a quarterly pace for development priorities to a rapid cadence of weekly—sometimes daily—improvements, live tests, and code releases. Up to five variants of each design improvement are now live-tested, first for impact on conversion and then against financial and marketing metrics, and improved. The weekly cadence means faster release, quicker reprioritization of tasks, and better performance. In one simple but telling example, the agency was able to move its search position to the top of the results page through a series of rapid cycles of learning how to best optimize its landing pages over six months. The company also reaped a cultural benefit, becoming

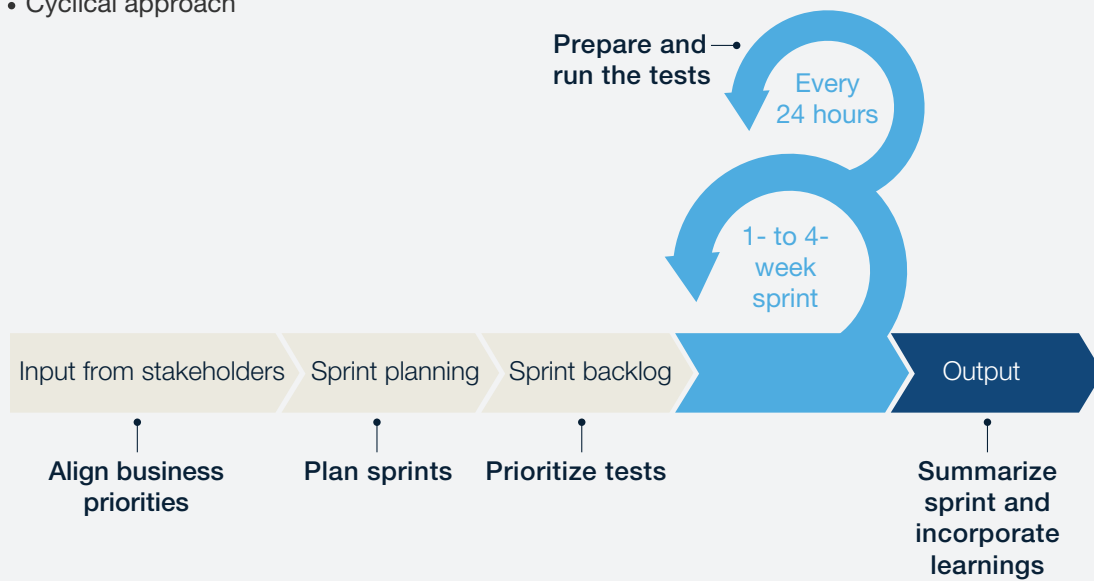
more open to change and quicker to respond to customers.

This agile mind-set has a bias for action and favors testing ideas quickly in a real market environment. For example, rather than testing a new snack with a focus group, an agile marketer quickly develops the snack, stocks it in a few retail outlets, and measures how it does with real customers. This approach relies on small, dedicated teams with the right mix of design and logistics skills, technical capabilities that include advanced marketing ROI tools to measure performance in real time rather than every six months, and advanced testing architectures to test multiple versions of websites or offers at once.

Netflix has built testing into the core of its culture, continuously A/B testing hundreds of variants of

### Exhibit 3 Agile process overview

- Quick decision-making process
- Colocated teams
- Cyclical approach





its website and apps, and measuring their impact on viewing hours. To support this, each product team has its own embedded analytics team.

Maintain a stable backbone for routine processes: Agile test-and-learn approaches are critical for dynamic processes in which the outcome is unknown, such as product development or user experience. Other more static processes, such as budgeting, procurement, performance management, customer analytics, and data management, are critical to have in place when scaling new processes. For that reason, they need to be stable and repeatable. Yes, they can be improved over time, but they do not require experimentation or wholesale reinvention. This stable backbone provides a competitive advantage for established companies over start-ups.

#### Adapting your marketing capabilities for the new world

Describing the agile workplace is one thing; making it happen is another. Marketers need to build or acquire specific new capabilities:

**Advanced analytics / big data:** To make sense of all the data marketers can now amass, marketing functions need to acquire or build significant new analytics capability. Analytics is what powers a test-and-learn culture in which results can be rapidly scanned, analyzed, and acted on. Advanced analytics systems can help manage the tremendous complexity involved in delivering tailored offers—and even more, in personalizing those offers and predicting what customers will want next. Getting personalization right and scaling it across the organization can reduce acquisition costs by as much as 50 percent, lift revenues by 5 to 15 percent, and increase the efficiency of marketing spend by 10 to 30 percent.<sup>5</sup>

Williams Sonoma leads in multibrand, multichannel CRM by maintaining a central repository for

customer information from both internal and external sources, amounting to 30 years of data for up to 60 million households. This gives the group, which includes Pottery Barn, West Elm, and others, an enormous resource for personalized marketing, including tailored emails and landing pages for new and existing customers. Indeed, 50 to 80 percent of new customers are acquired through personalized marketing messages that rely on this centralized database.

**User experience (UX):** While most companies understand the importance of a positive customer experience to the bottom line—done well, it can boost revenue 5 to 10 percent and reduce costs 15 to 20 percent—few excel at designing or delivering it. We have found that the starting point for delivering a great customer experience is an understanding of customer journeys, the series of interactions a customer has with a brand or peer to complete a task, such as opening an account or buying a product. Crucially, this isn't about just improving existing journeys but often reinventing them—with the help of digital technologies—to meet and beat customer expectations. Since these journeys touch so many parts of the organization (customer case, sales), marketers need to take the lead in building working relationships with other functions and in establishing agile, cross-functional teams that have accountability for a single journey.

**Content publishing:** For brands to maintain a tight relationship with consumers, they need to develop always-on capabilities that allow for continuous communication across many channels and formats. Getting the communications flow right requires an editorial team and a content supply chain that continuously creates and delivers high-quality and relevant information or entertainment that can be shared.



While many organizations have made progress in the dimensions highlighted in this piece, none, in our experience, has mastered all three. That's because it's difficult, and each situation is unique. But there is a path forward. It starts with looking outside your own walls for inspiration and forming a clear view of where you can excel. Then it requires combining full commitment and unity of purpose, from the executive suite to the teams empowered to create the change. ■

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<sup>1</sup> Kabir Ahuja, Jesko Perrey, and Liz Hilton Segel, "Invest, Create, Perform: Mastering the three dimensions of growth in the digital age," March 2017, McKinsey.com.

<sup>2</sup> David Edelman and Jason Heller, "The marketer strikes back," October 2015, McKinsey.com.

<sup>3</sup> Thomas Bauer, Jason Heller, Jeffrey Jacobs, and Rachael Schaffner, "How to get the most from your agency relationships in 2017," February 2017, McKinsey.com.

<sup>4</sup> David Edelman, Jason Heller, and Steven Spittaels, "Agile marketing: A step-by-step guide," November 2016, McKinsey.com.

<sup>5</sup> Matt Ariker, Alejandro Diaz, Jason Heller, and Jesko Perrey, "How marketers can personalize at scale," *Harvard Business Review*, November 2015, hbr.org.

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# Agile marketing: A step-by-step guide

Everyone wants to be “agile” these days. Here’s how successful companies put together the teams and the capabilities to actually make it happen at scale.

David Edelman, Jason Heller, and Steven Spittaels



An international bank recently decided it wanted to see how customers would respond to a new email offer. They pulled together a mailing list, cleaned it up, iterated on copy and design, and checked with legal several times to get the needed approvals. Eight weeks later, they were ready to go.

In a world where people decide whether to abandon a web page after three seconds and Quicken Loans gives an answer to online mortgage applicants in less than ten minutes, eight weeks for an email test pushes a company to the boundaries of irrelevance. For many large incumbents, however, such a glacial pace is the norm.

We've all heard how digital technology allows marketers to engage in innovative new ways to meet customers' needs far more effectively. But taking advantage of the new possibilities enabled by digital requires incumbents' marketing organizations to become much nimbler and have a bias for action. In other words, they have to become agile.

Agile, in the marketing context, means using data and analytics to continuously source promising opportunities or solutions to problems in real time, deploying tests quickly, evaluating the results, and rapidly iterating. At scale, a high-functioning agile marketing organization can run hundreds of campaigns simultaneously and multiple new ideas every week.

The truth is, many marketing organizations think they're working in an agile way because they've adopted some agility principles, such as test and learn or reliance on cross-functional teams. But when you look below the surface, you quickly find they're only partly agile, and they therefore only reap partial benefits. For example, marketing often doesn't have the support of the legal department, IT, or finance, so approvals, back-end dependencies, or spend allocations are slow. Or their agency and

technology partners aren't aligned on the need for speed and can't move quickly enough. Simply put: if you're not agile all the way, then you're not agile.

For companies competing in this era of disruption, this is a problem. In many companies, revenues in the segment offerings and product lines that use agile techniques have grown by as much as a factor of four. And even the most digitally savvy marketing organizations, where one typically sees limited room for improvement, have experienced revenue uplift of 20 to 40 percent. Agile also increases speed: marketing organizations that formerly took multiple weeks or even months to get a good idea translated into an offer fielded to customers find that after they adopt agile marketing practices, they can do it in less than two weeks.

Making your marketing organization agile isn't a simple matter, but we have found a practical and effective way to get there.

### Putting the team together

There are a number of prerequisites for agile marketing to work. A marketing organization must have a clear sense of what it wants to accomplish with its agile initiative (e.g., which customer segments it wants to acquire or which customer decision journeys it wants to improve) and have sufficient data, analytics, and the right kind of marketing-technology infrastructure in place. This technology component helps marketers capture, aggregate, and manage data from disparate systems; make decisions based on advanced propensity and next-best-action models; automate the delivery of campaigns and messages across channels; and feed customer tracking and message performance back into the system. (It should be noted that the tech tools don't have to be perfect. In fact, it can be a trap to focus on them too much. Most companies actually have a surfeit of tools.)

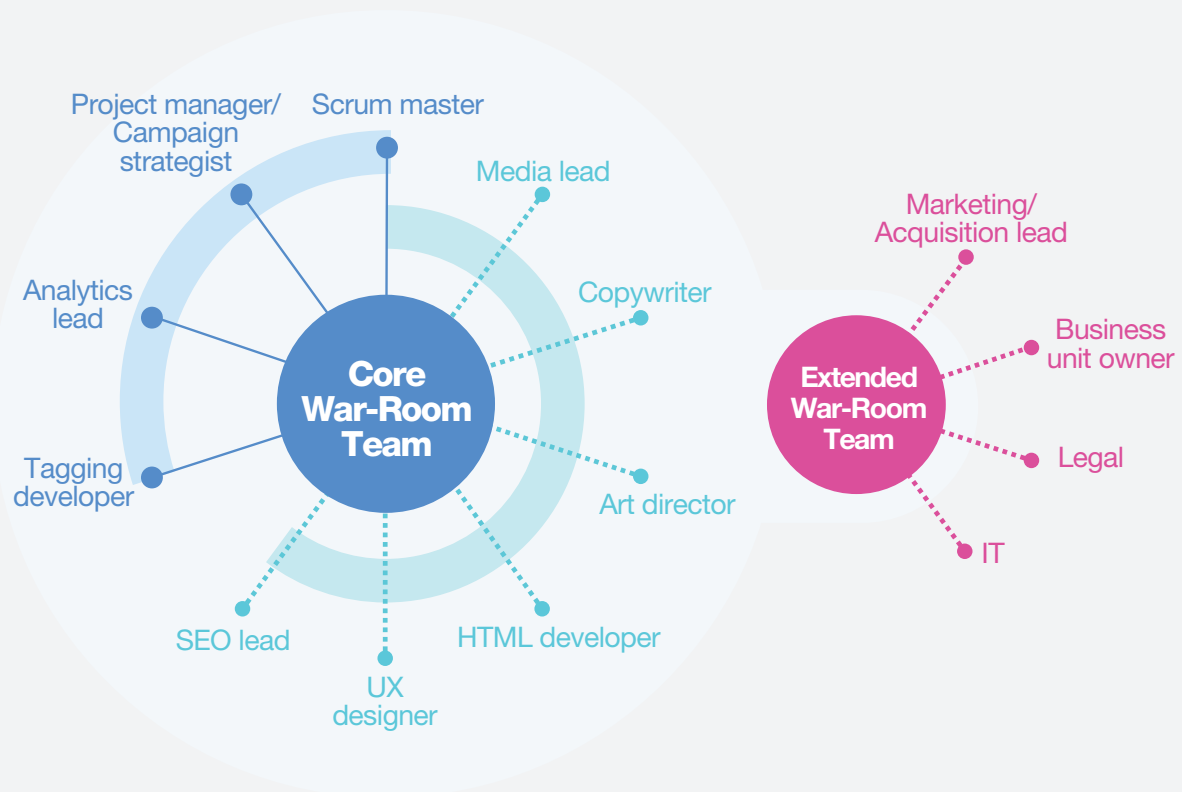
Another crucial prerequisite is sponsorship and stewardship of the shift to agile by senior marketing leaders. They provide key resources and crucial support when the new ways of working encounter inevitable resistance.

While these elements are crucial for success, the most important item is the people—bringing together a small team of talented people who can work together at speed. They should possess skills across multiple functions (both internal and external), be released from their “BAU” (business as usual) day jobs to work together full time, and be colocated in a “war room” (see exhibit). The mission of the war-

room team, as these groups are sometimes called (though companies also refer to them by other names, such as “pod” or “tribe”) is to execute a series of quick-turnaround experiments designed to create real bottom-line impact.

The exact composition of the war-room team depends on what tasks it plans to undertake. Tests that involve a lot of complex personalization will need a team weighted more heavily toward analytics. By contrast, if the agile initiative expects to run large numbers of smaller conversion-rate optimization tests, it would make more sense to load up on user-experience designers and project-management talent.

#### Exhibit The makeup of an agile war-room team



● These roles can be internal or outsourced to vendor.



Whatever the composition of the team, the war room needs to have clear lines of communication with other groups throughout the organization and speedy processes to access them. For example, buying marketing assets often requires procurement review and legal approval. So the war-room team must have access to key people in legal and procurement to negotiate any changes. At one bank trying to establish a war room, there was significant resistance to providing representatives from legal and the controller's office because of competing priorities. But marketing leadership knew their agile approach wouldn't work without them, so it pushed with all relevant leaders to make it happen. Those people need to be identified ahead of time, and "service-level agreements" put in place that outline how quickly they will respond. Similar models of interaction may be needed with IT, compliance/risk and finance groups.

The team itself needs to be small enough for everyone to remain clearly accountable to one another—8 to 12 is the maximum size. Jeff Bezos famously referred to "two-pizza teams," i.e., teams no bigger than can be fed by two pizzas.

A "scrum master," ideally with experience in agile and often working with an assistant, leads the team. The scrum master sets priorities, defines the hypotheses, manages the backlog, identifies necessary resources, and manages "sprints" (one-to-two-week cycles of work).

Building out an agile war room will require working in new ways with external agencies, adding depth in key resource areas such as media buying, creative, and UX design, or analytics as needed. Working at the pace of agile may challenge an agency's established workflows, but we have found that once they get into the rhythm, the performance boost justifies the change in procedures.

The marketing organization's senior leaders will understandably need to oversee the activities of the war-room team. But they ought to interact with the team in a lightweight manner—once every three or four weeks, for example. Automated dashboards with key metrics can help provide leadership with transparency.

Reading about what war-room teams do, one might think agile practices apply only to direct-response marketing activities. But agile methods can improve the performance of product development, marketing mix, and brand marketing as well, by providing more frequent feedback, allowing for testing and iterating of ideas and communications in market, and accelerating the process for delivering impact from brand efforts.

### Step by step overview of what an agile team does

Here is how an agile team works:

#### Aligns with leadership and sets team expectations

Once the war-room team is assembled, it works with the leaders of the marketing organization and other key stakeholders to align everyone on the initiative's goals. After that, the war-room team has a kickoff meeting to establish clearly that former ground rules and norms no longer apply and to articulate the agile culture and expectations: deep and continuous collaboration; speed; avoidance of "business as usual"; embracing the unexpected; striving for simplicity; data-trumping opinions; accountability—and above all, putting the customer at the center of all decisions.

#### Analyzes the data to identify the opportunities

By its second day, the team ought to be up and running and doing real work. That begins with developing insights based on targeted analytics. The insights should aim to identify anomalies, pain

points, issues, or opportunities in the decision journeys of key customer or prospect segments. Each morning there is a daily stand-up in which each team member gives a quick report on what they accomplished the day before and what they plan to do today. This is a powerful practice for imposing accountability, since everyone makes a daily promise to their peers and must report on it the very next day.

### Designs and prioritizes tests

For each identified opportunity or issue, the team develops both ideas about how to improve the experience and ways to test those ideas. For each hypothesis, the team designs a testing method and defines key performance indicators (KPIs). Once a list of potential tests has been generated, it is prioritized based on two criteria: potential business impact and ease of implementation. Prioritized ideas are bumped to the top of the queue to be tested immediately.

### Runs tests

The team runs tests in one-to-two-week “sprints” to validate whether the proposed approaches work (e.g., Does changing a call to action or an offer for a particular segment result in more customers completing a bank’s online loan application process?). The team needs to operate efficiently—few meetings, and those are short and to the point—to manage an effective level of throughput, with a streamlined production and approval process. One team at a European bank ran a series of systematic weekly media tests across all categories and reallocated spending based on the findings on an ongoing basis. This effort helped lead to more than a tenfold increase in conversion rates.

### Iterates the idea based on results

The team must have effective and flawless tracking mechanisms in place to quickly report on the performance of each test. The scrum master leads

review sessions to go over test findings and decide how to scale the tests that yield promising results, adapt to feedback, and kill off those that aren’t working—all within a compressed timeframe.

At the end of the each sprint, the war-room team debriefs to incorporate lessons learned and communicate results to key stakeholders. The scrum master resets priorities based on the results from the tests in the prior sprint and continues to work down the backlog of opportunities for the next sprint.

### Scale across the organization

Getting a single war-room team up and running is good, but the ultimate goal is to have the entire marketing organization operate in an agile way. Doing this requires a willingness to invest the time and resources to make agile stick.

The first step in scaling is building credibility. As the war-room team works its way through tests, the results of agile practices will begin to propagate across the marketing organization. For each test that generates promising results, for example, the team can forecast the impact at scale and provide a brief to the marketing organization, with guidelines for establishing a series of business rules to use for activities and initiatives based on operationalize the finding more broadly. With credibility, it’s easier to add more agile teams; one global retail company we know has scaled up its operations to include thirteen war rooms operating in parallel.

As companies add new war rooms, it’s important that each one be tightly focused on a specific goal, product, or service, based on the business goals of the company. Some companies, for example, have one team focused on customer acquisition and another on cross-/upselling to existing customers. Others have teams dedicated to different products, customers segments, or junctures in the customer journey.

We recommend adding agile teams one at a time and not adding new ones until the latest is operating effectively. As the number of teams grows and their capabilities increase, they can begin to expand their focus to assume responsibility for establishing business rules and executing against them. That systematic approach not only gives each new team intensive support as it comes online; it also allows business leaders to develop the kind of metrics dashboard it can use to track and manage performance for each team. This “control tower” helps to align resources as well, share best practices, and help break through bureaucratic issues. By scaling up in this way, the control-tower team has the opportunity to bring along all the supporting capabilities for marketing, everything from customer management to analytics to procurement, so that they operate at higher speeds as well.

A North American retailer established an agile marketing control tower and several war rooms to scale personalization across all key categories. The control tower ensured that the hundreds of tests run each year did not conflict and that the right technology was in place to collect appropriate data from the addressable audiences and to deliver a personalized experience across categories and channels. The war rooms each focused on systematically testing different media attributes and optimizing conversion on the company website across categories. After eighteen months, the retailer’s marketing-campaign throughput had grown four-fold, its customer satisfaction had increased by 30 percent, and digital sales had doubled.

As promising test findings become business rules, and as the number of war rooms grows, insights generated by agile practices will shape an ever-larger percentage of the organization’s marketing activities.



Marketing executives contemplating change often speak of the challenge associated with overcoming business as usual. By aggressively adopting agile practices, marketers can transform their organizations into fast-moving teams that continually drive growth for the business. ■

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# Reinventing the marketing function

Changes in customer behavior and technology are forcing many CMOs to rethink the function's role, the skills it requires, and the way it is organized, both internally and as part of a wider ecosystem of partnerships.

Eric Hazan



Of all the corporate functions, marketing is probably the one that has been the most radically transformed by digital technologies. All of them have, of course, been changed: some, such as IT—previously often seen as a “support function”—have risen to new prominence, and now play a driving role in digital transformation, as technology lies at its very heart. Others, such as HR and Finance, have been empowered by new tools, even if their vocation remains unchanged. **Marketing, however, has seen a drastic change in its landscape over the last ten years.**

At the same time, the way marketing departments are organized has hardly changed at all. It remains heavily inspired by the principles introduced by Procter & Gamble in 1931. As often as not, a small “digital” cell has been grafted onto the Media department or, for smaller groups, attached directly to the CMO (Chief Marketing Officer), while structures centered on brands or product lines continue to predominate.

But recent changes of paradigm in the Marketing function are bringing such models into question. Many CMOs are now having to rethink the function’s role, the skills it requires, and the way it is organized, both internally and as part of a wider ecosystem of partnerships.

### Paradigm shifts in consumer relations

Consider, to begin with, some of the major digital-driven changes that CMOs are now facing.

Firstly, the proliferation of channels and messages. The consumer is constantly bombarded with demands for attention, a phenomenon that is hard to measure (between 5,000 messages a day according to US market research firm Yankelovich; 15,000 according to KR Media) but nonetheless very real, as we all know from experience. The corollary is that the competition for a few precious seconds of the consumer’s attention is fierce.

Secondly, the reinforced power and scope of action of consumers, who are now center field—for better or for worse. For better: they can help create products (for example, Lego Ideas); they can act as an ad-hoc “digital labor force” (for example, tagging photos or performing geolocation); thanks to network effects, they can multiply the value of a service; and through positive word-of-mouth, they can become brand ambassadors. For worse: by generating “bad buzz” they can destroy, in a few hours, the result of years of marketing investments (as a number of recent high-profile cases have shown).

Then there is personalization. For a long time, this was an unattainable promise: what we called “personalization” was basically just finer segmentation. But the tools available today mean that the marketers’ ideal of the “segment of one” can now be made reality. Not only can we send messages tailored to fit the customer’s attributes (gender, age, centers of interest, etc.), we can even record their reactions (reading the e-mail, clicking the link, visiting a certain page, performing a certain action, etc.). From there, we can customize the approach to optimize its impact on a particular customer by adjusting the frequency of sending, the content, offers, etc. Artificial intelligence—with its capacity for “machine learning” and “deep learning”—will accelerate this trend still further.

Finally, we need to recognize that the distinction between the “real world” and the digital universe is now almost meaningless—at least from the customer viewpoint. The consumer decision journey has become more complex and, whether or not the final transaction is made online, digital platforms now exercise considerable influence over the consumer. As part of the purchasing cycle, consumers receive and send messages in both real and digital worlds: they will hear about a product for the first time on an influencer’s blog,



find out about it and assess its look and feel in a store, before comparing prices and ordering it online, picking it up from a store, and recommending it to their friends on a social network... Three years ago, McKinsey conducted a study—the iConsumer survey—of consumers in the digital age. It showed that 45% of French consumers checked the availability of products online before buying them at a store, 35% bought online and collected their purchases from the store, 30% contacted After-Sales via social media, and so on. “Real life” and “second life” have indeed begun to merge, and the movement will pick up speed as mixed reality technologies and the Internet of Things start to kick in.

#### A new profession...

These developments are bringing about radical change in the content of the CMO’s role, with a stronger technological component. It is no longer only about analyzing a “market” and designing the right marketing mix with which to target it. The CMO has a new, broader vocation: generating growth for the company by optimizing the “3Ds”: data, decision-making, and distribution of content.

The problem with growth—the primary objective of the CMO in most cases, implicitly coupled with an objective of profitability—is that it has become so very hard to attain in the majority of mature markets. Innovation in products and services is one key to achieving it. But beyond that, the only way, in these markets, is through an ever-finer understanding of customer segmentation—an understanding that is constantly updated and perfected in real time by means of the “3Ds”.

For data, first of all, the challenge is to go beyond traditional CRM tools: relational databases that only exploit a limited set of customer data, often separated into silos between the company’s different divisions or functions. The aim is to

leverage “CDPs”, customer data platforms, which are far more flexible, capable of collecting activity traces as well as data, both structured and unstructured, and above all, open to the outside. This means that third-party or public data can also be used. Here, the CMO’s mission is to identify and source the most useful customer data.

For decision-making, the aim is to increase the ROI of marketing spend by approaching things, as we said, no longer segment by segment, but individual by individual. By leveraging the detailed profile of each customer, we can decide what message to send them or which product to offer them at each step in their decision journey. Advanced analytics not only identifies correlations (“the customer looked at this product, so is likely to be interested in this other product”), it also predicts consumer behavior and tests out different approaches to identify the most effective one. Here, the role of the CMO is to optimize the quality of decision-making, drawing on analytical tools to model the customer journey and define the rules.

As for the distribution of content, finally, this involves “programmatic platforms” which help decide, in real time, which advertising spaces should be bought and which messages will be sent to the web user. This is, therefore, a form of automation, but one that needs to be constantly calibrated—and that is where the CMO steps in; as well, of course, as in the initial choice of platform.

#### ... requiring new skills and a new operating model

To fulfill their new role, CMOs will—in many cases—need to renew their skill set, and that of their teams.

First of all, they will have to be “literate” in a large number of technical fields (not necessarily specialists as such, but certainly capable of conversing with specialists): information systems, statistics, data, artificial intelligence and machine

learning, design and UX, online media platforms, etc. This culture will be a pre-requisite for effective dialogue with the IT department and with external technical service providers.

They will also need to master agile methods. The time when marketing was exclusively a long-term affair—with weeks for budget rounds, months for ad campaigns, and years for product cycles—is behind us. Strategic marketing has not gone away, but it is now supplemented by “agile” marketing. We have entered an age of iterative marketing, where ideas must be able to be tested out within weeks, if not days. A number of advertisers are now seeking to apply agile methods to their operating models. They have set up “war rooms” where small multi-disciplinary teams (data analysts, developers, media specialists, product managers) experiment with approaches and roll them out rapidly.

### ... and a new partner ecosystem

CMOs used to rely chiefly on three types of partner: a creative agency, a media agency, and in some cases a “lead” agency tasked with selecting providers to execute specific marketing operations such as product launch events and “street marketing”. Though they often opt to keep the same partners, CMOs are increasingly calibrating their use of these agencies in terms of impact—once again drawing on technology and data, which are constantly getting better at measuring the precise value created by each marketing operation. The choice of one channel rather than another is determined by criteria of impact and effectiveness.

CMOs may well also need to call upon other sources of cutting-edge expertise to help them manage technological complexity and the rapid pace of innovation. The fastest-growing players in the world of marketing technologies and advertising are those that combine creativity, data and technology. This

new ecosystem may simply be too much for any CMO to handle; they will probably need to bring in outside support to master its various dimensions.

Finally, CMOs more than ever need advice on strategic marketing—but this advice must be “holistic”, grounded in a very detailed analytical understanding of the end customer. In this case, the CMO’s partners will increasingly position themselves as “growth providers”, with an appropriate form of remuneration.



Ultimately, brands exist today through a continuous uninterrupted customer experience, both “connected” and “disconnected”, online and off. Managing this multitude of touch points while leveraging data to sustain the customer relationship over the long haul is—in this “connected” economy—the new mission of the Chief Marketing Officer. ■

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# The 90% success recipe: How digital and analytics can help commercial transformations beat the odds and the market

Pressure is mounting on CEOs and business leaders to deliver above-market growth. Consistently beating the market over time, however, requires a top-performing commercial engine underpinned by a new wave of digital and analytics capabilities.

Homayoun Hatami, Candace Lun Plotkin, Kevin McLellan, and Patrick Schulze



While hiring new talent is a crucial component of building necessary capabilities, our experience has shown that developing a market-beating company requires change that comes within the organization itself. Business executives today need to focus on building capabilities with the same level of commitment they showed when transforming their businesses through lean operations in the 1980s.

That prospect, however, is daunting considering that, traditionally, less than a third of transformations have succeeded as expected. A staggering 70 percent of the failures are due to an organization's inability to adopt required new behaviors quickly and completely. At the same time, leaders often doom any transformation effort by being overly tentative about changing their commercial structures for fear of disrupting sales activities. This level of change requires significant courage and leadership.

A new approach to commercial transformation (embedding digital, analytical, and agile skills into marketing, sales, and pricing capabilities to drive revenues and/or margin improvements) is turning that failure rate on its head. We have found an astonishing 90 percent of companies that embrace this new approach to overhauling their commercial drivers are not only delivering above-market growth but also sustaining it over time. Furthermore, two-thirds of all companies pushing these transformations are achieving this in either profitability or revenue growth, and a quarter are achieving it in both (see exhibit).

### The case for change

While most major companies understand the need to adapt to the marketplace, we find that they often don't have the level of commitment

needed for a commercial transformation to succeed over time. Increasingly, however, the decision for change is one that leadership can't put off. Better commercial capabilities are necessary to respond to something that we observe more and more often in the marketplace: Competitive advantage just doesn't last very long anymore. Competitors spot and adapt to innovations and new products quickly, and that reality is just going to accelerate as companies build out more digital and analytical capabilities.

"Sometimes we'll spend a lot of time bringing a product to market, and we need to plan for the fact that that gives us only a six-month head start," says Gary Booker, CMO for Dixons Retail. "We need to then figure out, whilst our competitors are catching up with what we've just done, what we're doing to make sure that when they get there we're already on to the next thing."

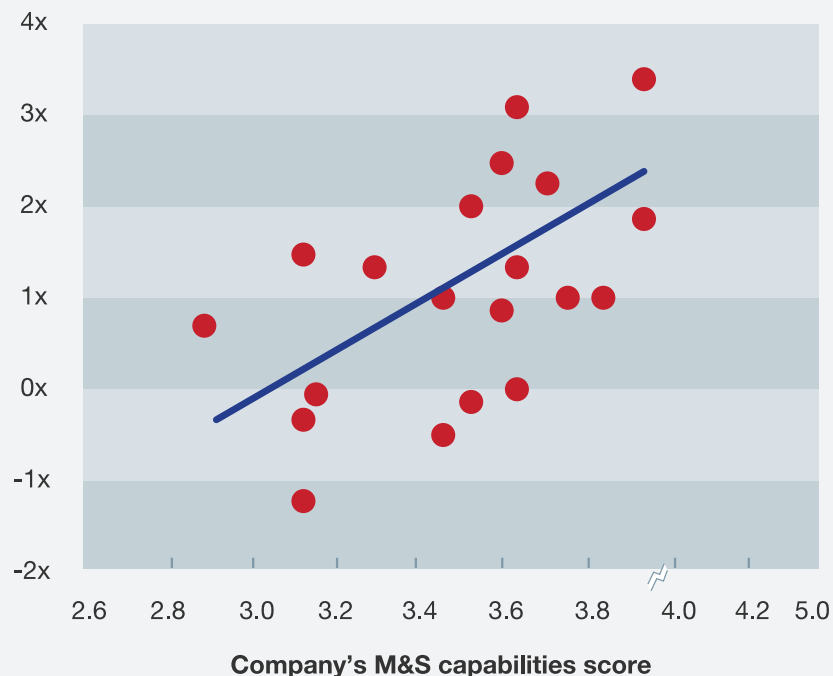
What that means in practice is having an agile organization that is constantly innovating, constantly spotting and reacting to new opportunities. It is a business that is constantly improving its understanding of how, what, and when the customer wants to interact and buy. Erwin van Laethem, CEO for Dutch energy company Essent, puts it succinctly: "Every success we've had in the market has been copied by our competitors. What you can't copy is how people work together in an organization."

Our research demonstrates that companies with more advanced marketing and sales capabilities tend to grow their revenue 30 percent more than the average company within their sector. (See exhibit). What's more, those companies with leading digital capabilities, are growing 5x faster than their peers.

**Exhibit**    **Companies that invest in marketing & sales drive above-market growth.**

**Growth above market**

**Company's performance relative to market**  
(revenue growth multiplier)



Source: McKinsey CCAT Database

Furthermore, successful commercial transformations have delivered consistently impressive results: A chemicals company grew revenue 7 percent annually while cutting marketing and sales costs by 8 percent; a manufacturer saw a 3-5 percent uptick in revenue based on revised marketing plans; a paper and packaging company is on track to increase ROIC from 6 percent to 10 percent in three years, thanks to its program to build a continuous-improvement mindset in marketing and sales.

The case for change is clear; how to do it is less so. How have these commercial

transformations succeeded where others before have faltered? Our experience leading 100 commercial transformations in the past five years, together with the results from a survey of 2,300 executives and our Digital Quotient™ database, distilled the recipe for success into the following six components:

**1. Know where you are and where you're going**

“You need to create the compelling case for change. Define what problem the organization is trying to solve and why the current status is not good enough.” That’s the advice of one European chief commercial officer, and it



crystallizes where any transformation should start. A clear vision is essential and should be based on insights from data rather than on hunches.

Typically, companies don't have a strong sense of their commercial capabilities. High-performing companies, however, systematically assess their capabilities at a granular enough level to allow executives to take meaningful action. The best companies are deliberate about identifying their strengths and weaknesses against all capabilities and then mapping them against their goals so they understand which capabilities to prioritize. Everyone in the C-suite must be able to articulate what two to three commercial capabilities their organization is focused on building, how they are building them, and how well the capability-building effort is translating into impact. High performing companies have been focusing particularly on their digital capabilities across marketing, sales, and IT strategy, culture, and organization.

Leading companies use intense multiday workshops to distill this initial vision into concrete targets and timelines that can be filtered down from the leadership team. Connecting a visionary goal with a clear and pragmatic timeline creates tremendous energy to start the transformation.

## 2. Create a transformation team built on trust

With the aspirations and fact base in place, the next stage is to create a resilient commercial-transformation team. While it is typically led by either the CEO, head of sales, CMO, or sometimes even the COO, it should include marketing, sales, operations, data analytics/scientists, and business-unit leaders. Team members need to be respected—their day-to-

day colleagues should feel they can't afford to lose them. It is also important to include HR and communications professionals alongside a project manager who keeps everyone focused on the next step of the journey and tracks the relevant metrics.

Since commercial transformations are long processes and involve taking risks, the team must invest time in building deep levels of trust to keep morale high over time. We've found that 63 percent of successful commercial transformations balance team health with performance. Activities to build that trust should focus on learning what really makes each person tick, understanding motivations, and identifying attitudes towards change and risk.

To kick start team building at a healthcare company, for instance, executives went on an offsite that included an extreme ropes course and an outdoor orienteering exercise where some team members were blindfolded. Trust builds quickly when you're dangling 50 feet above the ground or relying on someone else to see. The second half of the offsite focused on sharing stories, often personal ones related to issues that employees might not otherwise bring up in the workplace but that can explain behaviors with a major impact on a transformation.

What matters is that the team members understand their own motivations and those of their colleagues as they embark on a transformational journey that definitely involves new experiences and risks.

## 3. Score quick wins

Transformations will not succeed unless they deliver substantive short-term wins within six to twelve months. Typically, therefore, the best

companies build momentum by focusing first on initiatives that have early impact—and help fund the transformation—then on building a case for further change efforts.

A heavy-equipment manufacturer discovered there was a large consumer market of people who liked the brand but couldn't easily buy the products because they were sold only through B2B sales channels. As a result, the company quickly moved its mid-priced product line into big-box retailers, thus gaining access to the consumer segment. Revenues grew by 10 percent within just eight months.

Aside from the additional revenue, this success proved that the company could get its products into new segments through both targeted marketing and building relationships with retailers, without upsetting its traditional sellers. In the longer term, this quick win moved customer insights to the heart of everything the company did and proved to any skeptics that the transformation into a customer-solutions organization was both worth pursuing and achievable.

To help accelerate the process, many companies are also embracing, at least in parts of their organization, the notion of agile. This capability boils down to having a dedicated approach to constantly testing, learning, and evolving ideas and solutions based on getting quick results and clear data-driven insights.

#### 4. Activate the organization

Working with leadership, the transformation team has to structure a plan for pushing change throughout the organization. That requires a clear vision for building new habits at every level of the organization. For the C-suite, it's about mindset change and developing new

leadership and change-management skills. For managers, the focus needs to be on coaching, product knowledge, and problem solving. Frontline reps need specific selling skills like consultative selling and using pricing analytics. You can't do everything at once, of course, so the team needs to carefully sequence the effort, from rolling out training sessions to doing field work to reinforcing habits through e-learning, for example.

Activating an entire organization also requires finding the right people to make the change happen throughout the business. More than 60 percent of our survey respondents said that having committed change leaders across the organization was "extremely important" to the transformation effort. At a packaging company, senior managers used network-analysis and organizational-health-index tools to discover who would be "up for the battle," in the words of one marketing director. The company ran a survey to identify to whom staff turned when they had questions, and who was trusted. The results revealed the most influential people at key points across the organization, and they were invited to become "change champions." These are the people who have to reinforce the messages relentlessly and deliver the change on the ground.

Imaginative communications are also necessary so that everyone continues to sit up, take notice, and act. These may involve internal or even external advertising campaigns, social media, town hall meetings, and a raft of other communication efforts.

#### 5. Commit to coaching

Coaching is so critical for success that we want to highlight it specifically. Good coaching is much more than going on a ride-along with your

buddies or doing a sales pitch while someone watches. It's about a real commitment to improving your people by providing constructive feedback, empathizing, helping them work through issues, and reinforcing their strengths ... at the right cadence. It's also about role modeling new behaviors, something that rarely happens in practice.

The CEO of a business division said that "personal development through manager coaching is now a hallmark of how we run our business." It's clear that success doesn't just come from shiny new tools; it comes from breaking old habits. But turning sales managers into coaches requires a change in behavior. One company provided managers with training in traditional skills such as handling difficult conversations and assigned a "supercoach" to each sales manager. These coaches, drawn from its central sales-training team, observed real-life coaching interactions between managers and sales reps and gave specific feedback on the managers' coaching skills. The company credits the enhanced coaching role of the sales managers with a resulting 25 percent improvement in close rates.

In sales, companies have found that a structured coaching program with at least weekly contact between coach and sales rep is vital to changing how people work. For example, a consumer-services company mandates that sales managers conduct daily 15-minute check-in calls with all reps who fail to hit their monthly targets. Reps who make their targets get weekly one-on-one sessions, and reps who exceed their targets get a 10-minute praise call every week. The company also requires managers to join each rep for a day every month.

Such regular and frequent team touchpoints can be vital to the success of pilot projects. One company held weekly meetings at which the team could plot strategy for the week ahead. The results of the first pilots exceeded all aspirations. Sales calls per rep rose by 40 percent, offers closed per sales team rocketed by 75 percent, and the average contract value per week rose by 80 percent—and by as much as 150 percent for new deals. These results were achieved with the same sales reps and managers who had previously been underperforming. It was the company's approach to performance management rather than the specific tools that made the difference.

## 6. Hardwire a performance culture

The reality of today's economy is that change is constant. Hard-wiring a high-performance culture into a company's DNA is the only way to assure growth above the market year after year.

As Tom O'Brien, group vice president and general manager, marketing & sales, at Sasol, says of the pricing transformation he led: "The real success of this is not if we deliver two to three billion, but if we deliver that and then identify another two to three billion, and deliver on that, again and again."

Building this culture requires putting in place specific processes and tools to redirect the organization, reinforce behavior, and build new habits. But the really critical component is putting in place the right metrics to track and adjust performance. Without them, it's virtually impossible to understand what is and isn't working.

## Listen and lead—what leaders say about taking responsibility

Ultimately, a commercial transformation lives or dies on the hunger and determination to make it succeed. Just as companies set corporate visions, they can also set “people visions.” During a transformation, people are invited to do things they haven’t done before and perhaps they didn’t think they could do. None of this is possible without leadership. In conversations with senior marketing and sales executives who have gone through successful transformations, leadership emerged as paramount. Here are some of their insights:

- Be consistent, be accessible, be passionate. Show that you care.
- Translate the change story within the organization, but keep it simple, celebrate successes, and give tough feedback when things are going wrong.
- Be transparent, and trust people. One CEO shares KPIs with 35,000 people through weekly webcasts to help people understand where the company is in the change journey.
- Have honest conversations. There is huge value and respect to be gained from saying “I don’t know!”
- Find great people, have the courage of your convictions, but recognize that you don’t have a monopoly on insight.
- Be fair, be clear, respect people, and be a true part of the team—never miss meetings or fail to respond to e-mails, etc.).
- Celebrate initiative, learnings, and failure, when it is following by learning; experimenting and testing, tweaking and improving are now, more than ever a reality in the digital world.

The best-performing companies develop dashboards to track progress. They include basic financial-performance metrics, of course, but importantly they also track indicators of changes in behavior, such as understanding how marketing is helping the salesforce sell, which tools helped close

sales, and how often collaboration meetings occurred.

These companies also actively track capability metrics, such as training courses their people have taken, whether they passed or failed, and how that correlates with

performance in the field. They then use those calculations to adjust their capability-building efforts and zero in on weak performers who need more or different training.

The companies that effect a successful transformation go one step further by adding surveys and in-person interviews with their people to provide an even more comprehensive picture of commercial performance. They also develop customer-satisfaction measures—using sales, business units, and pricing as the “customers” of marketing. To be most effective, measurement must start before a transformation kicks in, in order to create a baseline. Then at regular intervals, companies measure again to understand what progress has been made at both the organizational and capability levels.

One multinational industrial company took this comprehensive commercial view of metrics and discovered a big gap between what sales reps were doing in the field and what their distributors actually wanted from them. Although the product and pricing were good, their distributors wanted to visualize the product and calculate the cost and payoff of various product options. They found further that the things marketing was creating, such as brochures, weren’t helping with the sales process. Sales decided to ask marketing to create a calculator that would help tabulate the answers to distributor questions in real time.

As a European marketing director put it, “The organization needs to be—and stay—hungry. Focus on what needs to be done, and then ensure you sustain it.”

While metrics are important to track performance (e.g. traffic, conversion, transaction size, etc), they also need to

support a performance culture. Commercial leaders put in place metrics to measure test and learn progress and agile A/B testing approaches, for example. These metrics can help avoid paralysis by analysis by helping employees track their performance in a way that encourages learning as you go to drive progress, incremental improvements, and quick feedback loops with your customers.



A new breed of commercial transformation is rewriting the playbook on how to deliver successful, sustained, above-market growth. At least as much investment is needed in organizational culture and health as in the intricacies of what will change on the ground. This makes transformation challenging, yes, but it also means the rewards are substantial.

Not only do all the pieces of the transformational jigsaw have to fit, but the picture they create has to be clear and easily understood by everyone. A strong leader needs to ensure that the enthusiasm, energy and momentum is sustained throughout the process. It’s likely to be one of the most challenging things a company undertakes—but it has the potential to be the most rewarding both for your people and for achieving above-market growth. ■

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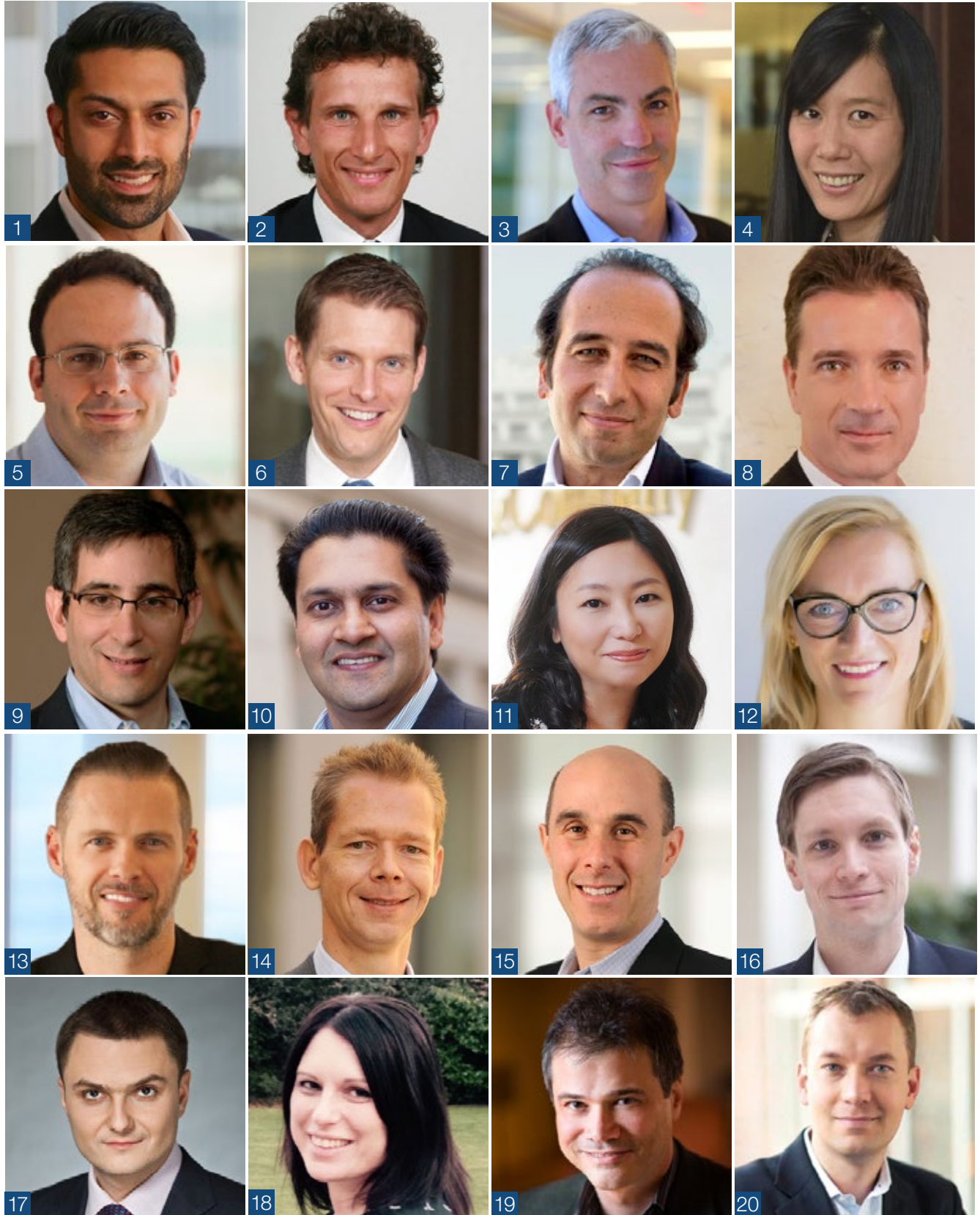
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