Going from **global trends** to corporate strategy

Will your business catch them before they catch it?

Wendy M. Becker
and Vanessa M. Freeman

An executive's ability to read trends accurately in a rapidly changing business environment can make all the difference between riding the currents of opportunity and paddling upstream against them. But even when you have a good feel for broad emerging macroeconomic, social, environmental, and business developments, how do you assess their impact on the profitability of your own company? And what should you do about them?

The need to evaluate these developments should not be underestimated. In a recent McKinsey survey, executives around the world weighed in on the forces shaping the global business environment. Asked which three trends will be the most important ones for global business during the next five years, these executives chose two macroeconomic trends (the growing number of consumers in emerging economies and the shift of economic activity between and within regions) and a business trend (the greater ease of obtaining information and developing knowledge).[z] But it is worth noting that executives think most of the ten trends we asked them to

[1] *The McKinsey Quarterly* conducted the survey in March 2006 and received 3,470 responses from a worldwide representative sample of business executives, 44 percent of whom are CEOs or other C-level executives. For the full survey results, see "An executive take on the top business trends: A McKinsey Global Survey," *The McKinsey Quarterly,* Web exclusive, April 2006 (www.mckinseyquarterly.com/links/22697).
Ian Davis and Elizabeth Stephenson, "Ten trends to watch in 2006," *The McKinsey Quarterly,* Web exclusive, January 2006 (www.mckinseyquarterly.com/links/22698).

Article at a glance

Macroeconomic, social, and business trends shape the global landscape. Anticipating their impact can help companies succeed by riding the current rather than swimming against it.

Executives must understand the full range of subtrends behind each trend and how they interact to affect many industries—and not just the obvious ones.

According to new research, companies that shift their portfolios to align them with favorable trends are much more likely to achieve strong growth and profits.

Large companies must innovate to take advantage of global trends without jeopardizing the core business. They can succeed by combining their scale assets to create and amplify the value of their innovations.

assess will be substantially more important for global business overall than for the profitability of their own companies.

That distinction calls for deeper analysis and reflection. For starters, executives shouldn't view even the most powerful trends in isolation. Beneath each lies a multitude of subtrends that interact to affect not only the obvious industries but also many others, to varying degrees and in different ways. In our experience, a scan of global trends too often proves superficial or simplifies the complexity of interacting subtrends, thus putting strategies and operations at risk.

Trends to watch

In this article, our survey findings are accompanied by a series of reflections exploring some of the steps that top managers can take to understand trends and use them in a company's strategy. How should executives go about the difficult task of analyzing the impact of a complex global trend (Exhibit i, on the next spread)? Why do growth and profits depend on a company's ability to shift the corporate portfolio continually so that it is aligned with favorable trends? What role can the strategic-planning process play in identifying growth opportunities and assessing the portfolio mix? And how can large companies use their scale to drive the innovations that could put them in front of a trend before it passes them by? (See sidebar "Analyzing a global trend.")

Competing with portfolios

As global trends shape the business landscape, they will inevitably affect competition among companies. And just as companies often fail to analyze global trends in detail, they can also fall short in their analysis of the competitive factors those trends create.

Analyzing a global trend

The complex nature of long-term global trends and the way they interact make it challenging for executives to analyze their impact on a company's profitability over the long term. But that complexity makes it all the more important for companies to get to grips with their business environment.

Take, for instance, one of our ten trends: increasingly tight constraints on the supply and use of natural resources, or as your morning newspaper might put it for a particular resource, "Oil price hits new all-time high." Not surprisingly, fully 88 percent of the executives at energy companies and 69 percent of those at manufacturing ones expect this trend to be important or very important for the profitability of their businesses. But across industries, only 40 percent of our respondents agree, though 71 percent view this trend as important to global business overall. Fewer still—30 percent—say that their companies are preparing for shortages or steep increases in the price of raw materials.

We believe that many companies have yet to consider the full range of this trend's subtrends: for instance, water is increasingly scarce, global fisheries are reaching a crisis point, and deforestation threatens to cause more than just economic harm. Moreover, as these ripples spread, even companies that don't seem to be affected in the near term must analyze each development's real impact on their industries, geographies, and business units. The analysis should include the effect on products, processes, customers, competitors, and employees.

Executives should consider the opportunities and risks these subtrends pose. Can companies that know all about the demand for and supply of minerals use these insights in the trading markets? Will the large-scale shipping of water become economically viable for the cargo industry? Will biotechnology companies change the game with craps that require less water or trees that grow much faster than today's?

Corporate leaders must understand how trends interact as well. Auto manufacturers, for instance, should view the trend of booming markets in developing economies through the lens of another: constrained energy resources and increasing concern about pollution. What are the likely implications when hundreds of millions of Indian and Chinese consumers buy cars for the first time? Automakers face a series of challenges: designing energy-efficient cars that are cheap to buy and drive and don't put intolerable pressure on the environment.

To ride the coming waves of global forces, a company must prepare by undertaking a comprehensive longer-range analysis of the external environment. The analysis should go well beyond a superficial scan of global issues not only to build a detailed understanding of the trends and how they will affect the company but also to facilitate open dialogue within the top team about what the future will bring. In addition, the company should regularly review and update this aligned view of the future; only then can it identify growth opportunities, plan for economic discontinuities and risks, and make the big bets necessary to capture the most rewarding opportunities.

Wendy M. Becker and Vanessa M. Freeman

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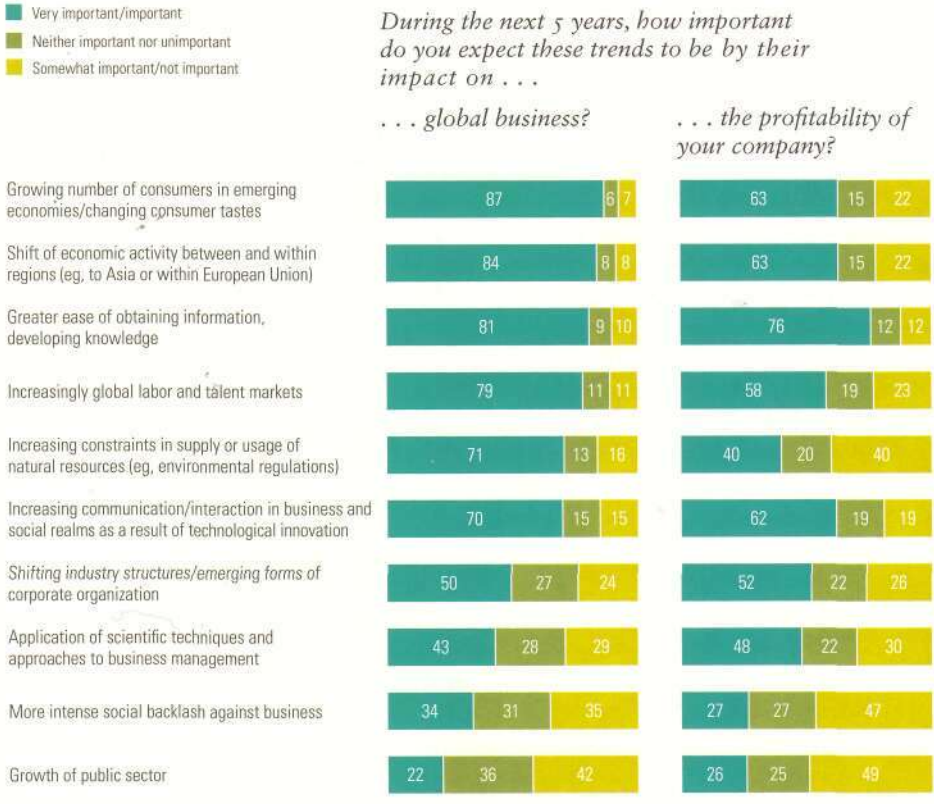
EXHIBIT 1

The impact of 10 trends

% of respondents[1]



[1]All data weighted by GDP of constituent countries to adjust for differences in response rates from various regions; figures do not sum to 100%, because of rounding.

Source: Mar 2006 *McKinsey Quarterly* Global Survey of Business Executives

The executives polled in our survey agree that competition is becoming more intense: 85 percent of them describe the business environment of their companies as more competitive (45 percent) or much more competitive (40 percent) than it was five years ago. Opinions about specific competitive challenges—low-cost competitors, the improved capabilities of competitors in general, regulatory changes—vary by industry, appropriately enough. More than a third of the representatives of heavy industry, for example, single out low-cost rivals as the most important competitive factor, as opposed to just one in ten in financial services. And telecom executives are

EXHIBIT 2

Competitive intensity by industry

% of respondents who describe the business environment of their companies as 'more' or 'much more' competitive than 5 years ago (n = 2,963)[1]

What single factor contributes most to the increasing competitive intensity in your industry today?

Industry[2] of respondent's company

	Business services	Consumer	Banking, finance	Health care	Heavy industry	IT	Telecom	Other
Improved capabilities of competitors (eg, better knowledge or better talent)	27	21	27	18	25	30	18	20
More low-cost competitors	25	25	11	18	36	24	27	14
More competitors	18	13	15	10	9	11	9	18
Growing size of competitors	7	13	14	10	8	10	9	8
Growing number of innovative market entrants	10	9	9	9	3	10	17	10
Regulatory changes (eg, market or industry deregulation, trade agreements)	4	4	12	22	8	3	17	10
Rising consumer awareness and activism	3	5	5	9	3	4	1	14
Growing number of attractive, accessible markets	3	4	5	1	6	5	2	2

[1] All data weighted by GDP of constituent countries to adjust for differences in response rates from various regions; figures do not sum to 100%, because respondents who answered "other factor" are not shown.

[2] **Banking, finance**: accounting, asset management, banking, insurance, personal financial services, private equity, stock brokerage/exchange; **business services**: advertising, conglomerates and holding companies, construction, consultancy, engineering, legal, marketing, real-estate management, research and development, transportation and logistics, wholesale services; **consumer**: agriculture, cable and satellite, consumer packaged goods, e-commerce and portals, gaming, media and entertainment, retail, travel and tourism; **health care**: hospitals, pharmaceutical and medical products; **heavy industry**: automotive, chemicals, electric power, electronics, energy (petroleum, natural gas, other), manufacturing, metals and mining, pulp and paper; **IT**: computer hardware and software, IT services; **telecom**: telecommunications; **other**: academia, government, nonprofit organizations, among others.

Source: Mar 2006 *McKinsey Quarterly* Global Survey of Business Executives

almost twice as likely as those from other industries to be concerned about innovative market entrants (Exhibit 2).

In our view, companies should push the analysis even further, the better to shift the business mix of their portfolios in response to the competitive dynamics of their industries. According to new research, companies that tweak portfolios to align them with favorable competitive factors are quite likely to grow faster and offer higher returns to shareholders than companies that don't (see sidebar "Keep shifting portfolios," on the next page).

Keep shifting portfolios

To determine the financial impact of broad global trends, a company must sift through their second- and third-order effects even as unanticipated new business models and other hybrid species sprout up and change the competitive landscape. Our research on growth in large companies highlights the importance of analyzing changing competitive factors at the most detailed level (industry, subindustry, geography) and in their most elemental form (the specific trends and subtrends that not only create opportunities and risks but also drive competition at each level). Only in this way can companies obtain insights into the way these factors will affect their future growth and profitability. By unearthing the follow-on effects of trends such as consolidation, regulatory change, the rise of attacker business models, and specific shifts in the needs or power of customers, executives can better move the portfolios of their companies toward segments and markets with favorable prospects.

Our research bears out this point. We analyzed the top-line growth of more than 150 large companies from 1999 to 2004 and tested how closely their organic growth correlated with their mix of businesses. The broadest classifications of portfolios, such as "consumer discretionary," weren't at all useful in explaining the different growth rates of companies. Classifying business portfolios more tightly into 140 subsectors (such as beverages and packaged foods) made it possible to explain about 35 percent of the variance in organic growth across companies. Finally, when we went as far as the reported data allowed—analyzing business segments by geography (for example, ice cream and frozen desserts in Asia)—we explained 60 percent of the variance. Similar results hold for differences in profitability.

What can companies do if they aren't lucky enough to hold legacy portfolios aligned with favorable trends? Quite a lot, it turns out. Our research suggests that strong growth and profits often result from intensive changes in the portfolio mix through M&A, the creation of new businesses, or the radical reallocation of budgets. In fact, significant changes to the portfolio occurred in two out of three companies that, over five years, increased their revenues at a pace faster than the growth of GDP and gave their shareholders total returns that outperformed global stock indexes. (We define a significant change as one of at least 15 percent in the distribution of total revenues over a company's business segments and geographies.) In contrast, almost two out of three companies that failed to expand at a pace faster than the growth of GDP hadn't shifted their portfolios in this way.

So it seems that many profitable growth companies not only know about the trends in their markets but also act on the way those trends play out at the microlevel.

Martijn Allessie and Carrie Thompson

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EXHIBIT 3

A disconnect

% of respondents whose company has a strategic-planning process at company/business unit level (n = 2,976)[1]

[1] Excludes respondents who answered "don't know."

Source: Mar 2006 *McKinsey Quarterly* Global Survey of Business Executives

The role of strategic planning

Strategic-planning processes can play a vital role in identifying new growth areas and assessing corporate portfolios to determine the optimal mix of businesses. Indeed, in this respect the top executives in our survey emphasize the effectiveness of their companies' strategic planning. Interestingly, however, lower-echelon executives instead underline its role in the annual budgeting process (Exhibit 3). This seeming disconnect in perceptions about what strategic planning should and does achieve suggests that ancillary processes, removed from the plans of the core business, might better serve companies looking to grow and to develop their portfolios (see sidebar "Planning for change," on the next page).

Innovation and the pace of change

Innovation is high on the minds of executives around the world. In fact, they see it as the main reason the pace of change in the global business environment is accelerating so greatly (Exhibit 4, on the next spread).

Unfortunately, a quickly changing business environment driven by a constant flow of new ideas can be daunting for executives of large companies. These executives know that speed, good execution, and incremental innovation are essential to keep a core business competitive

Planning for change

Few executives would deny that good strategic planning can help companies find new growth opportunities and evaluate what they should add to or subtract from the corporate portfolio of businesses. Yet when we talked with managers at a score of major companies, most of these people ruefully admitted that the formal strategic-planning process was optimized to maintain and develop the core business through activities such as budgeting, driving incremental growth, and aligning management with short-term financial targets. Other strategic objectives received haphazard treatment, if any.

This kind of strategic-planning process usually drives the performance of the core business effectively. Yet it isn't very efficient. Often, a nine-month planning cycle involving a huge amount of work merely generates a budget that more or less reflects the size of each business unit, with incremental growth expectations layered on top.

We believe that companies can shorten and streamline this formal planning process and thereby allow executives to focus on developing strategies. Companies should reach for these goals through tailored ancillary processes removed from the annual planning exercise and its immersion in the financial and operational details of current businesses. To design such processes, a company should determine which strategic objectives are the most important ones for its own purposes, given the composition of its portfolio and the specific attributes of its industry. One important goal should be to develop and review corporate strategies in a regular rhythm—the better to combat the tendency, revealed by our research, to make most decisions involving major mergers, acquisitions, and divestures in an ad hoc or opportunistic way.

Companies can make a good start by studying what some of them already do. One pharmaceutical company, for instance, established a new function for strategic initiatives to pursue growth beyond the core business. Planners generated a portfolio of ideas in a series of off-site meetings and vetted them with the company's top 100 managers. A strategic-initiative team then explored in detail the business viability of each idea in the queue—typically looking at two or three in parallel—and gave the appropriate business units the best ones to commercialize.

A large multibusiness company implemented a biannual corporate-portfolio review process to ascertain which businesses had an upside for growth and which should be divested to free capital for investment in new growth areas. To help liberate corporate managers from the business-as-usual mind-set of financial and operational planning, the company decoupled this portfolio review from the annual planning process.

Renee Dye and Olivier Sibony

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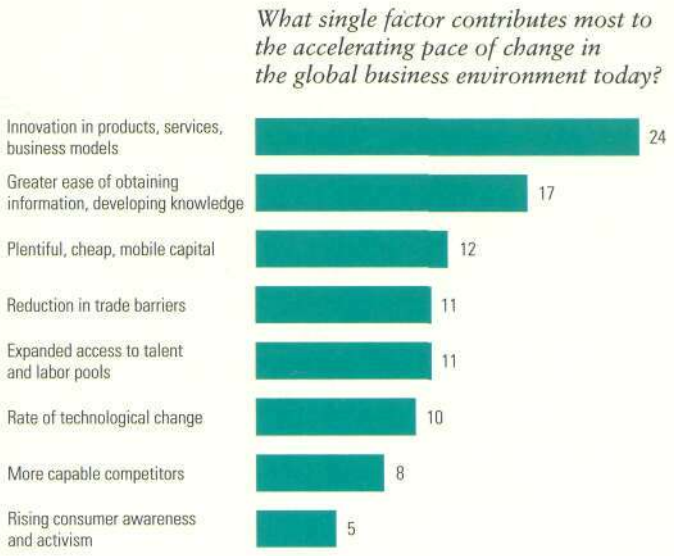
Why so fast?

% of respondents who say pace of change in global business environment is accelerating (n = 3,453)[1]



[1] All data weighted by GDP of constituent countries to adjust for differences in response rates from various regions; figures do not sum to 100%, because respondents who answered "other" are not shown.

Source: Mar 2006 *McKinsey Quarterly* Global Survey of Business Executives

with its peers. Furthermore, large corporations must innovate to build new businesses for themselves so that their portfolios stay in line with changing consumer preferences, budding demand in emerging markets, and other global trends.

In the mobile-phone business, for example, leading manufacturers dance a constant minuet of brinkmanship: each must prepare near-term responses to the moves of the others while building a long-term competitive advantage through the next design or feature breakthrough in handsets. Doing all these things takes a huge amount of innovation. Although scale can be a problem for big companies undertaking this kind of effort, they can turn it to their advantage as well (see sidebar "Innovating at scale," on the next page).

Innovating at scale

For a $20 billion company the required scale of any innovation and the impact it must achieve are staggering. Top managers know that unlike the leaders of a start-up, they can't bet the company on a single breakthrough. What's more, a large company's need to produce near-term results in its core business often seems to be in conflict with its need to innovate for tomorrow.

Yet there is also an upside. Many big corporations haven't yet fully used scale to transform promising ideas into innovations whose value can be amplified by their diffusion among a number of customer and product segments. To seize this opportunity, large companies must overcome two prevalent beliefs: that innovation takes resources away from the core business and that it requires an entrepreneurial culture, which flourishes only in smaller and younger companies. In fact, we would argue that far from being in conflict with innovation, a large company's core business and assets can be used as stepping-stones to innovate with an impact that smaller companies can only dream of.

Innovating at this level begins with an understanding of a large organization's scale advantages. Substantial tangible assets such as technology and human and financial capital can serve as powerful complements to the diversity and reach of brands, knowledge, and other intangibles. Large companies can also bear and manage risk as well as place a number of different bets. Companies should evaluate such assets and identify those that can collectively amplify the value of innovation and, at times, both serve the core business and provide new growth opportunities.

Scale assets can, for example, extend the reach of an innovation beyond immediately addressable core segments. Consider Motorola's successful RAZR mobile phone, which set a new standard in ultrathin handsets. This breakthrough parlays corporate engineering and design assets that can be reapplied under the Motorola brand in other market segments (such as smartphones, which handle a number of applications) where design is a key competitive factor.

Large companies can also use their assets to broaden their sources of innovation. P&G, for example, realized that it couldn't meet its growth objectives solely through internal product development. The company therefore decided to draw on resources (such as global brands, patents, and relationships with suppliers, retailers, consumers, and regulators) in order to set up and widely publicize "open-innovation" networks, where scientists share intellectual-property agreements. Along the same lines, it has also encouraged start-ups with ideas for new products to bring them to P&G. It then uses its brand, marketing skills, supplier networks, and other relationships to diffuse these innovations through various market segments and new products. Each participant benefits as the network grows.

Identifying scale advantages and applying them to innovation isn't easy. But for companies that overcome the obstacles, innovation can be worth more than just the sum of its parts.

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Global trends form tangled webs that can catch a company's strategy unawares. Companies that refine their understanding of the way trends will filter down into their own industries, subindustries, and geographical markets can shift their portfolios and gracefully ride future trends as they emerge.

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Fonte: The McKinsey Quaterly, n. 3, p. 17-27, 2006.