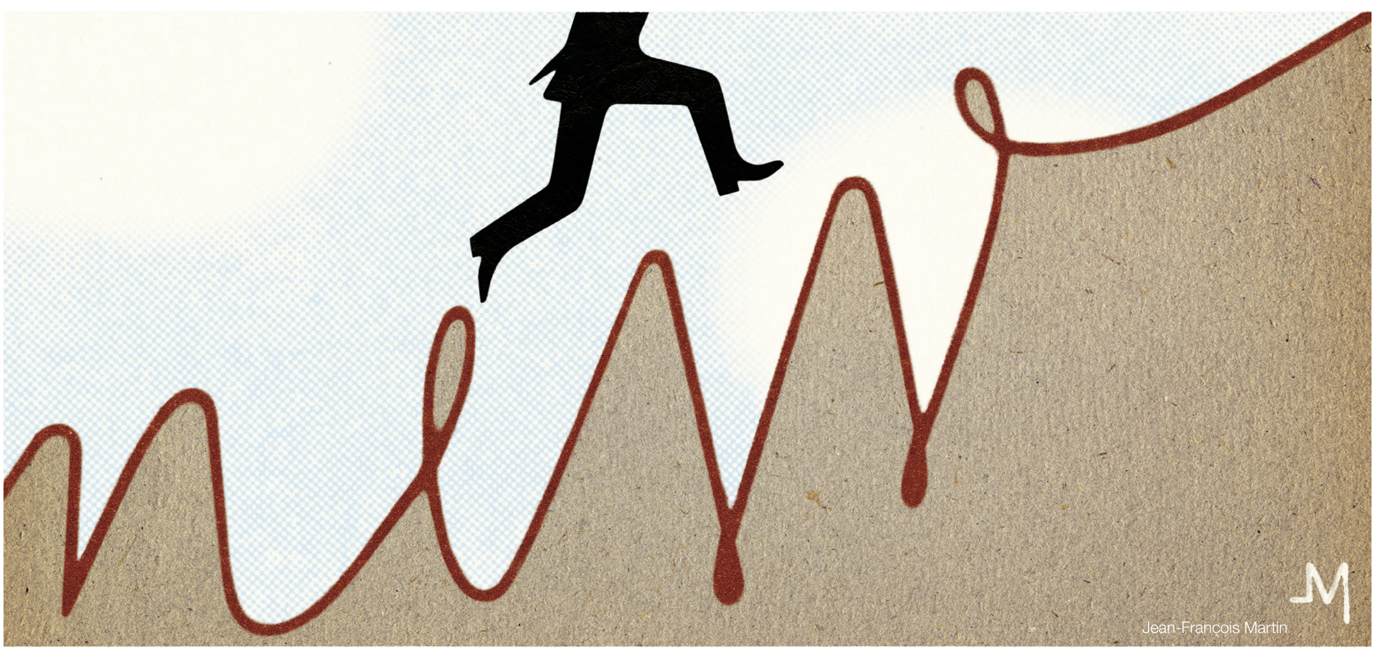
McKinsey&Company

Growing beyond the core business

Most companies are seeking growth outside their core business, according to a new survey. But few have made revenue gains as a result—or have the right capabilities to support it.

A clear majority of executives say their companies are pursuing growth in categories outside their core business—and report a strong belief that doing so has created company value. But a McKinsey Global Survey suggests that over time, companies' aspirations to grow through these activities have produced only modest results and that few companies have the right practices in place to support such growth.[1]

These are the key findings from a survey on how companies expand into product or service categories beyond their core business. Nearly nine in ten respondents say that in the past five years, their companies have either pursued at least one activity in a new category, have considered it, or plan to do so in the next five years. Companies are most likely to pursue new activities through investments in organic growth and with long-term interests in mind. Executives at emerging-economy companies report greater paybacks than their peers at developed-economy firms—but few respondents overall say that over time, the activities have added much to company revenues. This could be because, according to the results, there's much room for improvement in the ways that many companies identify and evaluate new opportunities.



Significant value at stake—and modest results

At most companies, pursuing growth in new product or service categories outside the core is already on the agenda. Three-quarters of respondents say that over the past five years, their companies have pursued at least one business activity in a new category. Another 14 percent say their companies have either considered pursuing this growth or plan to do so in the next five years.

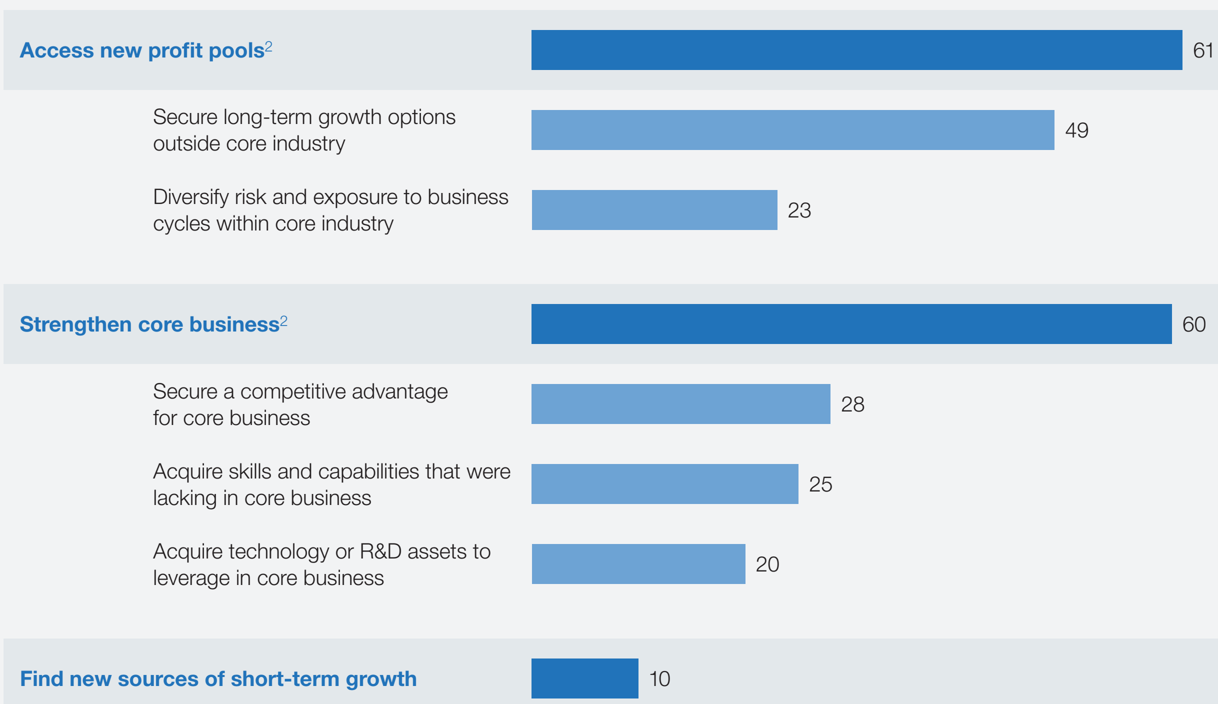
For many of these companies, growth beyond their core business is a long-term play. Among C-suite executives (who respondents most often say are responsible for evaluating these opportunities), only one in ten say their companies consider new activities for short-term returns. C-level respondents also say their companies are equally likely to consider such a move to access new profit pools as to strengthen their core business (Exhibit 1).

Exhibit 1

Companies pursue new activities both to access new profit pools and to strengthen their core business.

% of C-level respondents,[1] n = 273

Most important factors to justify expansion into activities outside companies' core business



[1]Respondents who answered "other" or "don't know" are not shown.
[2]These figures reflect the aggregation and recalculation of responses on the individual factors that follow.

No matter the reason, though, few executives report significant top-line results over time from diversifying activities. Only one-third of all respondents say their companies' moves beyond the core generate more than 10 percent of their revenues today. The share of revenues increases with the number of activities that companies pursue. But even at firms that are active in more than ten product or service categories, 35 percent of executives say these activities make up more than 10 percent of revenue. What's more, when asked about the biggest revenue-generating activity of the past five years, respondents most often say this move has created just some financial value for their companies.[2]

The emerging-economy advantage

At the same time, executives also report notable differences in the value that developed-economy and emerging-economy companies see from these growth activities beyond the core. At companies based in emerging economies, respondents are about 1.4 times more likely than their developed-economy peers to say their biggest move in a new category has created significant value for their companies—likely due to structural advantages in their home markets (Exhibit 2).

Exhibit 2 **At diversified companies in emerging markets, executives report that structural advantages help them create value.**

% of respondents at emerging-economy companies, n = 149

If your company were to pursue a new activity beyond its core business, in what ways would your home market give you an advantage over companies based in developed markets that are also pursuing new activities?[1]

[1]Respondents who answered "don't know" are not shown. This question was asked only of respondents who work at companies that are headquartered in emerging economies.

When asked what gives their companies a distinctive advantage over those based in developed economies, emerging-economy respondents most often cite greater opportunities to reinvest retained earnings in new businesses—easier to do than in developed economies, where relative growth is much slower—and a greater ability to leverage their local knowledge and relationships.

Best practices for expanding beyond the core business

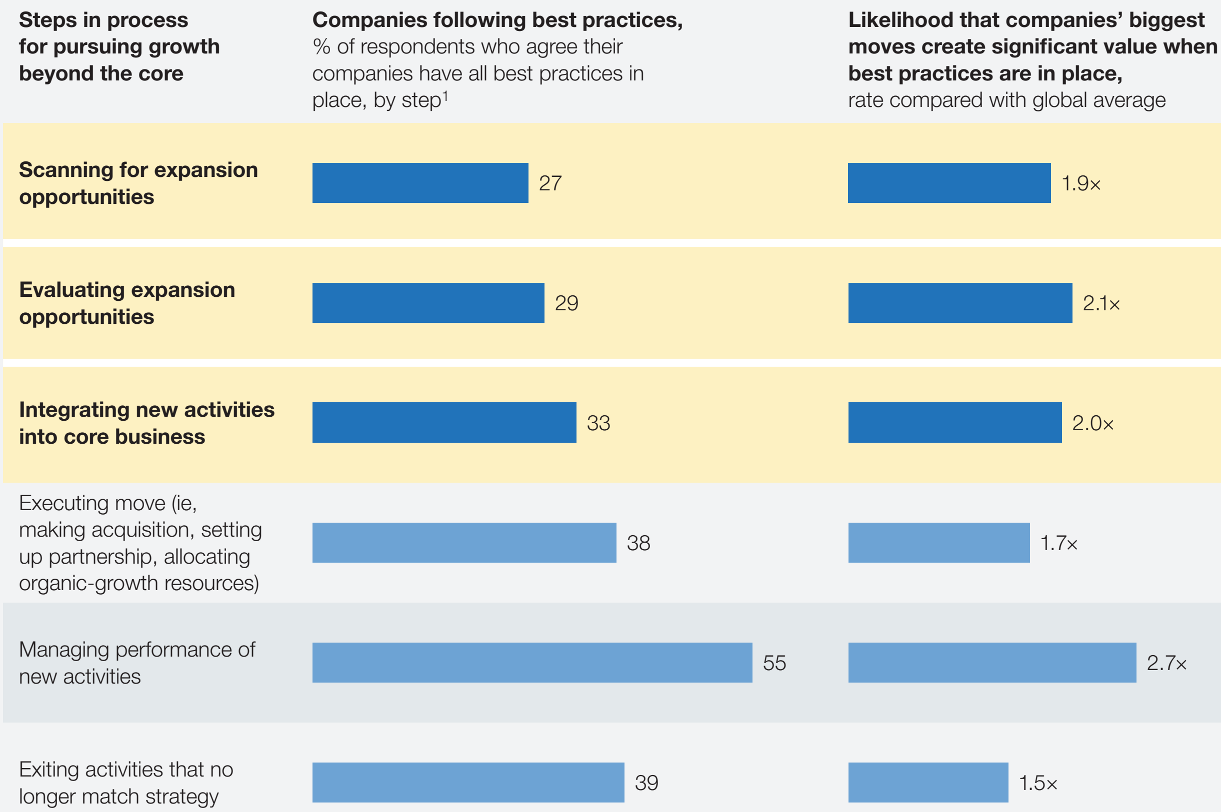
Across regions, respondents at emerging-economy and developed-economy firms agree on the approaches their companies use to grow in new areas: investments in organic growth are cited most often by both groups, followed by mergers and acquisitions.[3] Both groups are likeliest to identify their executive teams and boards as the ones responsible for evaluating opportunities in new categories. There is also consensus among both groups that new activities shouldn't stray too far from the core business. When assessing a move's value potential, nearly two-thirds of all respondents say unique links between the activity and the existing business are the most important criteria their companies consider.

When asked about different steps in the process of pursuing growth in new categories,[4] few executives say their companies follow the best practices that make this growth successful. According to executives, firms most often struggle to scan for new opportunities, evaluate those opportunities, and integrate new activities into the core business (Exhibit 3). But respondents at companies that get the practices right are much likelier than others—about twice as likely for each of these three steps—to report that their biggest move in the past five years has created significant company value.

Respondents whose companies follow best practices for scanning, evaluating, or integrating new activities into the core business are twice as likely as others to report significant value creation from diversifying.

Exhibit 3 **Most companies lack best practices to expand beyond their core business, especially when scanning, evaluating, and integrating new opportunities.**

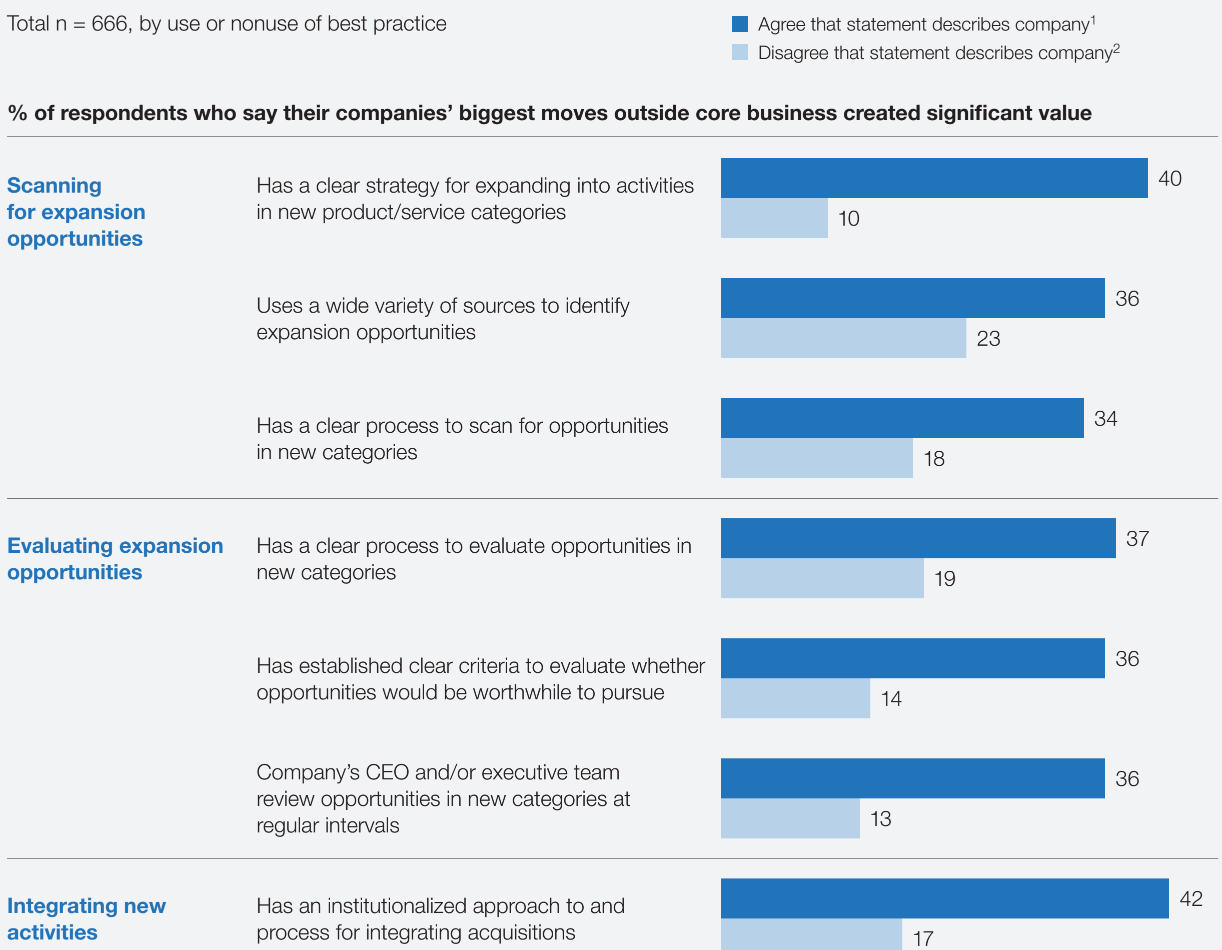
n = 695



[1]Includes respondents who "agree" or "strongly agree" that the practices describe their companies. Those who answered "somewhat agree," "somewhat disagree," "disagree," "strongly disagree," or "don't know/not applicable" are not included.

More specifically, the responses in these three areas (scanning, evaluation, and integration) suggest which individual practices link most closely to value creation. When executives say their companies have a clear strategy for expanding into new activities, for example, they are four times more likely than those whose companies have no such strategy to report significant value creation (Exhibit 4). With respect to managing new activities, respondents are also four times more likely to report value creation when their companies actively and regularly review the performance of these activities.

Exhibit 4 **Best practices for scanning, evaluating, and integrating growth opportunities beyond the core can drive significant value.**



[1] Includes respondents who "agree" or "strongly agree." Those who answered "somewhat agree" or "don't know/not applicable" are not included.
[2] Includes respondents who "disagree" or "strongly disagree." Those who answered "somewhat disagree" or "don't know/not applicable" are not included.

Looking ahead

- *Understand the market context.* The results indicate that a company's opportunity to grow successfully beyond its core business differs across regions, with respondents reporting that growth in new categories pays off more in emerging economies than in developed economies. We have also seen that diversifying activities can benefit companies in some industries more than others. For companies looking to expand into new activities, it's important to understand first the extent to which growth beyond the core in their region and industry is either an opportunity or a risk.

- *Find growth close to home.* When asked about the criteria their companies use to assess a new activity's potential value, the largest share of executives say unique links between the activity and the core business are most important. Companies would do well to follow suit and start identifying growth opportunities that are close to home—in other words, ideas or opportunities where they can leverage existing capabilities and skills in their core business.

- *Build the right capabilities.* Most respondents report that their companies lack the capabilities (or even a clear strategy) to grow beyond the core, so it's no wonder that most companies see only modest contributions to revenue as a result of such activities. However, companies with the capabilities to scan, evaluate, and integrate opportunities have a much higher chance to create value with these moves. When planning to pursue new opportunities outside of their core business, leaders should assess their companies' capabilities to make sure the right processes and practices are in place to maximize the value that new activities can add. ■

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[1] The online survey was in the field from November 4 to November 14, 2014 and garnered responses from 1,143 executives at companies with annual revenues of $500 million or more, representing the full range of regions, industries, functional specialties, and tenures. Of them, 904 executives say their companies have either pursued or considered pursuing growth in a new product or service category, beyond their companies' core business, in the past five years. To adjust for differences in response rates, the data are weighted by the contribution of each respondent's nation to global GDP.

[2] The largest share (49 percent) of respondents say the biggest revenue-generating move has created some financial value; 28 percent say the move has created significant financial value, 9 percent say it had no effect, 8 percent say it destroyed some value, and 2 percent say it destroyed significant value.

[3] We also asked about joint ventures, which 37 percent of respondents cite as an approach their companies have taken to grow beyond their core business.

[4] The steps are: scanning for new opportunities, evaluating opportunities, executing the growth move, integrating new activities into the business, managing the performance of new activities, and exiting activities when they no longer match the strategy.

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