Business strategy articles

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January 2014
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The strategic yardstick you can’t afford to ignore

A systematic scan of the economic-profit performance of nearly 3,000 global companies yields fresh insight about where and how to compete.

At first blush, “beating the market” might sound like an expression better suited to investing or financial management than to business strategy. When you think about it, though, overcoming the profit-depleting effects of market forces is the essence of good strategy—what separates winners from losers, headline makers from also-rans. A focus on the presence, absence, or possibility of market-beating value creation should therefore help transform any discussion of strategy from something vague and conceptual into something specific and concrete.

While there are many indicators of market-beating strategies, in our experience economic profit (EP)—what’s left over after subtracting the cost of capital from net operating profit—is highly revealing. Using this lens, individual companies can take a hard-boiled look at the effectiveness of their strategies. Recently, we undertook a large-scale analysis of economic profit for nearly 3,000 large nonfinancial companies in McKinsey’s proprietary corporate-performance database. That effort enabled us to test some deeply held truths and distill generalizable lessons about what it takes to win consistently.

For example, we saw that the corporate world, like the world beyond it, has a relatively small number of elites and that, just as society grapples with the contemporary challenge of limited social mobility, many companies seem stuck in their strategic
“class.” Escaping the gravity of the corporate middle class, indeed, requires businesses to expand or reinvent themselves unusually rapidly, often in the context of an industry whose overall performance is improving. Below, we review some of the analyses emerging from our economic-profit exercise.

**Strategy is rife with inequality**

Economic profit is distributed in a far from democratic way (Exhibit 1). The 60 percent of companies in the middle three quintiles generate a little over $29 billion in economic profit, or around $17 million each—only 10 percent of the total pie. This share is dwarfed by the $677 billion generated in the top quintile, where each company creates almost 70 times more economic profit than do companies in the middle three, and by the nearly $411 billion destroyed in the bottom quintile.

For companies in the majority group, at least, market forces appear to be a very powerful constraint to creating value.

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**Exhibit 1**

The distribution of economic profit is highly imbalanced.

**Average economic profit** for top 3,000 companies by FY2011 revenues, (excluding outliers),¹ 2007–11, $ million

<table>
<thead>
<tr>
<th>Quintiles²</th>
<th>I</th>
<th>II</th>
<th>III</th>
<th>IV</th>
<th>V</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average</td>
<td>1,180</td>
<td>121</td>
<td>10</td>
<td>-80</td>
<td>-709</td>
</tr>
</tbody>
</table>

Total of 3 middle quintiles = $29,437 million

¹Actual sample = 2,875; excludes outliers and companies with insufficient data to calculate average economic profit for given period. Outliers are companies with economic profit >$10 billion (ie, Apple, BHP Billiton, China Mobile, Exxon Mobil, Gazprom, and Microsoft) and those with less than −$5 billion.

²Defined as: I = average economic profit >$262 million; II = $262 million to $49 million; III = $49 million to −$24 million; IV = −$24 million to −$60 million; V = below −$160 million.
What separates the corporate classes?
Economic profit has four components: revenues, margins, asset turns, and the tangible-capital ratio (TCR). Revenues and margins are familiar enough. Asset turns, sometimes described as asset leverage, measure the capacity to extract revenue from a given quantity of assets. TCR is the ratio of physical to total capital, including goodwill (the more M&A a company does, and the higher the premium it pays over book value, the lower its TCR). Every company has a “fingerprint,” hinting at its value formula, across these drivers. A detailed decomposition of the four determinants of value by quintile reveals several things.

Size clearly matters: both the biggest creators and the biggest destroyers of economic profit are large. Low turns are the hallmark of the bottom quintile, which includes capital-intensive industries, such as airlines, electric utilities, and railroads. High margins clearly differentiate the top class of EP outperformers. Somewhat counterintuitively, however, the weakest EP performers have the best TCR and the strongest the worst. For top companies routinely engaged in M&A, the added cost of goodwill is apparently more than recouped in profitable scale.

Finally, it’s worth noting that the average company in the first four quintiles grows by double-digit rates a year—a compelling fact in its own right. Bottom-quintile companies grow one-third more slowly. This compounds their asset-intensity problem, as higher revenues don’t offset fixed investment.

Exhibit 2
There are three speeds of reversion to the mean.
Cohort average based on companies’ quintile in 1997–2001, n = 2,160

1 Top 3,000 companies by FY2011 revenues, minus companies with insufficient data to consistently calculate the 3 metrics for given period.
2 Net enterprise value (NEV) divided by net operating profit less adjusted taxes (NOPLAT).
Wealth stays at the top
Markets are typically strong agents of mean reversion—but not when it comes to economic profit. We created cohorts based on the performance of companies from 1997 to 2001 and “followed” them to see how long the performance differential lasted (Exhibit 2).

The valuation multiple (enterprise value divided by earnings) converges rapidly and completely. Returns on invested capital (ROIC) partially converge, but the gap never fully closes. Both results reflect the impact of market forces: the strongest EP performers attract imitation, eroding their advantages, while the weakest reform. In the case of EP, though, a portion of the advantage persists: the rich stay rich and the poor stay poor.

Why? Because top-quintile companies offset the impact of declining ROIC by attracting a disproportionate share of investment. Two opposing forces are at work here. ROIC convergence reduces the gap between the top and bottom quintiles by $409 million, while diverging capital flows increase the gap by $593 million. In fact, companies in the top quintile in 1997–2001 invested 2.6 times more fresh capital than bottom-quintile businesses did over the subsequent decade. So at least on average, companies in the elite class stay ahead, mostly because they get bigger.

That doesn’t mean elite companies can rest on their laurels. Nearly half dropped out of the top quintile over a ten-year period, and one in eight slid all the way to the bottom (Exhibit 3). The force

Exhibit 3

A look at class mobility shows the likelihood that companies will change class over a decade.


<table>
<thead>
<tr>
<th>Quintile I</th>
<th>Quintiles II, III, IV</th>
<th>Quintile V</th>
</tr>
</thead>
<tbody>
<tr>
<td>Moved down from top quintile</td>
<td>Stayed within the middle quintiles</td>
<td>Moved up from bottom quintile</td>
</tr>
<tr>
<td>% of companies that...</td>
<td>46</td>
<td>55</td>
</tr>
<tr>
<td>Stayed in the top quintile</td>
<td>54</td>
<td>1,344</td>
</tr>
<tr>
<td>Moved up to Quintile I</td>
<td>Moved down to Quintile V</td>
<td>Moved up from bottom quintile</td>
</tr>
<tr>
<td>11</td>
<td>10</td>
<td>45</td>
</tr>
</tbody>
</table>

1 Actual sample = 2,240; based on top 3,000 companies by FY2011 revenues, minus companies with insufficient data for mobility analysis over given period. Quintiles based on rankings for economic-profit generation for 1997–2001, averaged and held as a fixed cohort.
Much of a company’s economic profit depends upon the industry in which it operates.

Share of contribution to company performance, 2007–11, n = 2,888

<table>
<thead>
<tr>
<th>Economic-profit quintiles</th>
<th>Company effect (^2)</th>
<th>Industry effect (^3)</th>
<th>Average across all quintiles (^4)</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>67</td>
<td>33</td>
<td>40</td>
</tr>
<tr>
<td>II</td>
<td>50</td>
<td>50</td>
<td>50</td>
</tr>
<tr>
<td>III</td>
<td>46</td>
<td>54</td>
<td>54</td>
</tr>
<tr>
<td>IV</td>
<td>49</td>
<td>51</td>
<td>51</td>
</tr>
<tr>
<td>V</td>
<td>62</td>
<td>38</td>
<td>40</td>
</tr>
</tbody>
</table>

1Top 3,000 companies by revenues in FY2011, minus companies with insufficient data to calculate average economic profit for given period; 128 industries analyzed; those with fewer than 3 companies default to next level of industry classification.

2Defined as difference between company’s economic profit and its industry’s average economic profit.

3Defined as difference between an industry’s average economic profit and the market average.

4Weighted by absolute contribution to economic profit.

of gravity is even stronger in the three middle quintiles: 79 percent of the companies that started there remained a decade later. In the top and bottom classes, a small majority of companies stay at their station. Most strikingly, only 11 percent of companies in the middle make the leap to the top league.

**Riding the megatrends**

To find out more about upward mobility, we looked closely at the 37 companies that started in the middle quintile in the 1997–2001 period but rose to the top over the subsequent one. This breakout group seems to have improved its performance miraculously, increasing revenues by 21 percent and adding 18 percentage points to ROIC. Something very special is needed to achieve results like these and escape the middle. So what’s the secret? Are these “social climbers” hauling themselves up the ladder primarily through their own efforts, or are wider industry forces at work?

Of those 37 companies, 33 compete in industries that have improved their economic-profit ranking. A rising tide helped lift these boats: the wireless-telecommunications-services industry, for example, pulled middling players to a conspicuously higher rank. The industry’s average EP was 112th out of the 128 in our sample in 1997–2001, but by 2007–11 it had jumped up 102 spots, to 10th place; 2 of our 37 big movers were wireless players.

On average, the 37 breakout companies were in industries that jumped up 39 places on the economic-profit league table. Only four came from
The strategic yardstick you can’t afford to ignore

industries with a flat or declining economic-profit rank. Overall, 75 percent of the increased economic profit of the 37 companies came from improvements in their markets or industries. The lesson is clear: riding on the coattails of an industry-moving trend is almost essential to escaping the middle class.

Of course, no coattails can guarantee strong performance. While on average, companies in good industries are three times more likely than others to generate a market-beating economic profit, a below-average company in a good industry appears no more likely to win than an above-average company in a bad one. Warren Buffett once famously remarked, “With few exceptions, when a manager with a reputation for brilliance tackles a business with a reputation for poor fundamental economics, it is the reputation of the business that remains intact.” But our research suggests that he is only partly right.

Why do you make money?
So how do we untangle the forces of market selection versus company effects in explaining performance? How much does the neighborhood determine a company’s economic fate? The question is fundamental because of the widespread confusion between performance and capability.4

Among 128 global industries, we can explain 40 percent of a company’s economic profit by the industry in which it competes (Exhibit 4). We make this calculation from simple but powerful math by adding the three layers of the company’s EP: the market’s average EP, plus the difference between the average EP of the company’s industry peers and the market average (the industry effect), plus the difference between the company’s EP and the industry-average EP (the company effect). The industry’s contribution is smaller in the top and bottom quintiles—idiosyncratic factors explain more of the performance differences here.

The remaining 60 percent (the company effect) represents other drivers of value. These could be attributable, first, to a company’s more granular choices about market selection—not just broad industries, but subsegments and geographies too. After those are accounted for, there will be a gap representing a company’s unique proprietary advantage, encapsulated in privileged assets and special capabilities. It takes real work to isolate these factors, but the payoff can be worthwhile: first, because market selection is in many ways a more practical lever of strategy than broad attempts to lift market share and, second, because it can clear up misconceptions about the (noisy) link between performance and capabilities.

The lesson is clear: riding on the coattails of an industry-moving trend is almost essential to escaping the middle class.
So, what are the implications for CEOs and strategists?

- If you’re in the elite, “use it or lose it.” You have a privileged ability to mobilize capital. Really know the formula that got you there and vigilantly watch for signs of change. You can’t rest on your laurels, as the odds are almost 50–50 that you will slide down into the middle class—or lower.

- If you’re in the middle, you mostly face a battle of inches. A fortunate few companies will ride a favorable industry trend. But for the most part, it will take substantial strategic or operational shifts to escape the gravity of market forces. The odds are against you, which elevates the importance of looking at strategy with a high degree of rigor.

- If you’re at the bottom, growth without better performance will be the equivalent of throwing good money after bad. You will probably need a new trend to get out of the basement, but in the meantime focus on improving ROIC, which often requires improving asset turns.

Our research offers a yardstick on the empirical reality of strategy and can help create better rules of thumb for considering and assessing it. Individual companies should start by measuring whether they beat the market and by digging into the timeless strategic question of why they make money.

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1 For more, see Chris Bradley, Martin Hirt, and Sven Smit, “Have you tested your strategy lately?,” mckinsey.com, January 2011.
2 For technical details on the calculation of economic profit, including its relationship with the key drivers of corporate value (return on invested capital and growth), see chapter six and appendix A of Marc Goedhart, Tim Koller, and David Wessels, Valuation: Measuring and Managing the Value of Companies, fifth edition, Hoboken, NJ: John Wiley & Sons, 2010.
3 There is, mathematically, a fifth dimension of economic value: funding. But the weight of evidence suggests that companies cannot directly influence it. For the purposes of this analysis, we use a global average cost of capital of 9 percent.

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Mastering the building blocks of strategy

Chris Bradley, Angus Dawson, and Antoine Montard

Increase your likelihood of developing effective strategies through an approach that’s thorough, action-oriented, and comfortable with debate and ambiguity.

Left unchecked, market forces continually conspire to deplete profits. Powerful business strategies can counteract those tendencies, but good strategy is difficult to formulate. Indeed, the latest McKinsey research (see “The strategic yardstick you can’t afford to ignore,” on mckinsey.com) finds that a very small number of companies create most economic profit. The research also shows that a significant number of good companies outperform even in so-called bad industries, where the average economic profit is less than the market average.

How do they do it? In other words, where do powerful strategies come from? Sometimes it’s luck, or good timing, or a stroke of inspiration. In our experience, it’s also possible to load the dice in favor of developing good strategies by focusing on the core building blocks that often get overlooked. One is the need to gain agreement—before creating strategy—on the essential decisions and the criteria for making them. Another is to ensure that the company is prepared and willing to act on a strategy once it is adopted. Too much of what passes for strategy development, we find, consists of hurried efforts...

1 A 2011 McKinsey survey asked executives to evaluate their strategies against ten objective tests of business strategy. It found that 65 percent of companies passed just three or fewer tests. For more, see Chris Bradley, Martin Hirt, and Sven Smit, “Have you tested your strategy lately?,” McKinsey Quarterly, January 2011, mckinsey.com.

2 What’s left over after subtracting the cost of capital from net operating profit.
that skip one or more of the essentials. The resulting strategies are often flawed from the start.

It’s also easy, though, to go too far in the other direction and make the creation of strategy a rigid, box-checking exercise. Appealing as a formula-driven approach might be, it ignores the truth that strategy creation is a journey—and an inherently messy one at that. Proprietary insights are hard to come by. Shaping keen insights into good strategies requires deep interpersonal engagement and debate from senior executives, as well as the ability to deal with ambiguity in charged and often stressful circumstances. When would-be strategists overlook these dynamics, they cover the essentials in name only. Consequently, they miss opportunities and threats, or create great paper strategies that remain unfinished in practice.

In this article, we’ll outline a middle path—an end-to-end way of thinking that views the creation of strategy as a journey, not a project. This method, developed through our work with some 900 global companies over the past five years, can help senior executives approach strategy in a rigorous and complete way. We’ll also describe some principles that strategists should keep in mind as they use the method to ensure that their strategic-planning processes embody the spirit of debate and engagement, which, in turn, yields inspiration. By better understanding both the method and how to get the most out of it, companies can boost the odds that the strategies they create will beat the market.

Do justice to strategy’s building blocks

Most companies we’re familiar with demonstrate a variety of good habits when they create strategies, and they get many things right. But what they miss can be critical. Consider these examples:

• a technology company that prided itself on analytical rigor but never accurately diagnosed how difficult it would be for a targeted customer group to provide reasonable returns

• a beer company that rightly focused on industry structure in its core business but made a losing bet on a related business—wine—after failing to forecast declining returns stemming from structural shifts there
a telecommunications company’s strategy team, which recognized the importance of involving senior managers but ended up alienating them by holding a series of time-consuming workshops that focused on alignment around strategic choices, though the full set of choices hadn’t yet been identified.

These problems don’t have to happen. We find that companies do better when they ground all their strategy-development efforts and processes in an understanding of the building blocks of strategy. These straightforward modes of activity (exhibit) track the progression of a strategy from its roots as an idea through its emergence as an operational reality.

One central building block is deep insight into the starting position of the company: where and why it creates—or destroys—value (diagnose). Executives also need a point of view on how the future may unfold (forecast). By combining insights into a company’s starting position with a perspective on the future, the company can develop and explore alternative ways to win (search) and ultimately decide which alternative to pursue (choose). With the strategy selected, the company needs to create an action plan and reallocate resources to deliver it (commit).

Exhibit

The building blocks of strategy help companies make strategic choices and carry them through to operational reality.

<table>
<thead>
<tr>
<th>Frame</th>
<th>What are the right questions?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Diagnose</td>
<td>Where and why do we make money?</td>
</tr>
<tr>
<td>Forecast</td>
<td>What futures do we need to plan for?</td>
</tr>
<tr>
<td>Search</td>
<td>What are the potential pathways to winning?</td>
</tr>
<tr>
<td>Choose</td>
<td>What is our integrated strategy?</td>
</tr>
<tr>
<td>Commit</td>
<td>How do we drive changes?</td>
</tr>
<tr>
<td>Evolve</td>
<td>How do we adapt and learn?</td>
</tr>
</tbody>
</table>
These five core building blocks are book-ended by two others. One is an initial block (frame) to ensure that the team properly identifies and agrees to both the questions asked and the decisions made as the strategy is developed. The final block (evolve) is dedicated to the constant monitoring and refreshing of the strategy as conditions change and new information becomes available.

To some extent, the building blocks simply represent a thorough list of activities that all good strategists perform. And while all are important and should be included in the creation of strategy, slavishly following this or any other framework won't bring success. Depending on the situation, some blocks will be more critical than others and therefore require more attention (see sidebar, “Re-create, recommit, and refresh”).

That’s why taking some time to frame issues at the outset is so important. When strategists do so, they are better able to identify the real choices and constraints facing their organizations and to see which building blocks are likely to matter most given the situation at hand. Unfortunately, many executives feel that taking the time to frame strategy choices thoughtfully and to decide where to focus strategy-development efforts is a luxury they don’t have.

We’ve seen evidence of this pressure firsthand and in the responses to an executive survey we’ve been conducting as part of an ongoing research project. Fully two-thirds of the 200 executives we’ve surveyed so far report that they feel rushed to provide outputs in their strategic-planning processes. This pressure is understandable in today’s always-on, fast-changing environment, but it can be hazardous to a company’s strategic health. That’s especially true in the all-too-common situations when it’s not immediately obvious what factors will determine the success or failure of a change to strategy.

A financial-services institution in the Asia–Pacific region, for example, was investigating a growth opportunity involving the creation of an online business. Changing the company’s focus in this way would be a big undertaking, but the upside potential was large. Moreover, the members of the strategy team could already see that demonstrating the channel’s significant potential to the top team would be straightforward. Before doing that, however, they stepped back to spend some
time thinking through the idea’s broader strategic context—framing, in other words.

When they did, they saw a serious risk of cannibalization for one of the company’s existing businesses. The new venture would also require substantial funding over the next three to five years before it contributed financially. This had important implications, and the team’s members needed to convince themselves that the risk was worth taking. Moreover, if the company made the move, would it

Re-create, recommit, and refresh

For a number of years, we, our colleagues, and many others who are engaged in the practice of strategy have been pointing out how ill-suited traditional strategic-planning processes are to the dynamism and pace of 21st-century business life. Less clear is what should happen to many organizations’ well-oiled approaches. Shut them down? Morph them into budgeting and operational-planning processes? Use them to synthesize the valuable insights emerging from more frequent strategic dialogues involving larger numbers of executives?

The building blocks of strategy shed fresh light on what strategic planning should and shouldn’t try to do. For starters, we’d emphasize that periodically—perhaps as often as every three to five years, if new competitors arrive or markets unexpectedly shift—companies must re-create their strategies. This cannot be accomplished through typical planning processes, as it requires broader skills, wider engagement, and more flexibility to make big strategic choices than they allow. So forget about strategic planning when you need to revamp your strategy; instead, take a more immersive strategy-development approach using all of the seven building blocks described in this article.

At the other end of the spectrum is what we would describe as the need to recommit organizations to established strategies. Traditional strategic planning is tailor-made for this purpose, and thinking about the task in these terms helps elevate it above the glorified budgeting exercise into which some processes lapse. Two of the building blocks we have described in this article—
commit and evolve—are useful reminders of what any such strategic-planning process should accomplish: the constant monitoring of strategy, the reallocation of resources, the alignment of management on strategic priorities, and the creation of targets, budgets, and operational plans.

Between these two extremes lies the strategic refresh, which is particularly relevant for organizations where a lot of valuable, ongoing strategy dialogue takes place among members of the top team. Such engagement can highlight nagging issues that might one day necessitate a strategic redo but certainly merit attention now. For example, if signs suggesting that one or more key assumptions have become less valid emerge from strategic dialogues at the business-unit level, it might be time to update the company’s perspective on long-term trends. This exercise could be elevated in importance by making it a core theme of the upcoming strategic-planning process. In such situations, it’s a good idea to check all seven building blocks quickly, with an emphasis on understanding the strategic implications of underlying changes. If they are big enough, that could be a red flag signaling the need to re-create the strategy and thus to elevate the discussion beyond strategic-planning parameters.

For a closer look at how to improve strategic planning, see “Managing the strategy journey” and “Dynamic management: Better decisions in uncertain times,” on mckinsey.com.
team’s focus on gaining commitment was prescient; the prototype and the communication around it helped convince the leaders that the concept was so compelling for consumers that if the company didn’t cannibalize its existing business, a competitor would probably come up with the idea. The effort also helped motivate the leaders of the finance and IT functions to support the new offer. The company launched it in record time, to promising early results in both customer acquisition and levels of customer engagement.

In retrospect, the team credits the conversations and debates held during this framing period as necessary to identify and resolve the potential stumbling blocks related to the organization’s strategic direction. Although messy at times, this activity helped build an organizational commitment to the strategy and its importance to the company.

**Myth-bust your story**

A focus on strategic building blocks also can help companies develop penetrating insights. While “insight” conjures up visions of research, data crunching, and “aha” moments, real strategic insight also rests on a seemingly mundane and easy-to-overlook factor: a thorough understanding of how and why a company, its competitors, and others in the industry value chain make money. Absent dumb luck, a strategy that doesn’t tap directly into such an understanding will underperform.

The difficulty, as professor Phil Rosenzweig of the International Institute for Management Development has explained so well, is that a company’s performance—good or bad—creates strong impressions that powerfully shape the way people perceive strategies, leaders, cultures, and organizational effectiveness. A commodity company, for instance, might falsely attribute its strong performance to the efficiency of its operations. Yet despite its efficiency, the economics of those operations could be swamped by market-structure changes that have significant pricing implications or by unexpectedly volatile demand.

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One way senior executives can address the challenge, we find, is explicitly questioning received corporate wisdom—much as the popular US television show *MythBusters* does when it takes apparent axioms, urban legends, and popular assumptions and (in entertaining fashion) tries to prove or disprove them. In the creation of strategy, this approach means dispassionately identifying the elements that contribute to performance, while discounting any factor contaminated by perceptions of the company’s supposed greatness. It also requires a curiosity that’s woefully lacking in some strategic-planning processes. Nearly eight in ten executives we surveyed, for example, say that the processes of their companies are more geared to confirming existing hypotheses than to testing new ones.

To see how these dynamics play out in practice, consider the experience of a global retailer that was revisiting its strategy after the previous one had delivered five years of strong earnings. The positive results, most in the company believed, reflected good execution and the success of a recent initiative to refresh the store format. Still, the leader of the business felt there could be more to the story and worried that continuing along the same path might not produce the same results in the future. To determine what was actually driving performance, the leader met with the company’s strategy team, as well as other executives.

This was time well spent. The resulting discussions sparked important insights—revealing, for example, that while overall performance was good, there were problems under the surface. On the positive side, the company was steadily improving its margins and winning customers from a higher-cost competitor. Nonetheless, the solid network growth at the top-line level appeared to be masking a

Nearly eight in ten executives say that the processes of their companies are more geared to confirming existing hypotheses than to testing new ones.
worrisome decline in the productivity of older stores. The big drag on performance, the team discovered, was the loss of mainstream customers to a cheaper competitor, which careful analysis showed to have an unassailable advantage on cost. Increasing promotional activity had so far seemed to stem the march of this aggressive rival, but the retailer was running out of steam and hitting practical limits. Significant changes would be necessary.

**Let them grapple**

This realization was the product of more than just number crunching. The thoughtful argument and debate surrounding the analysis from day one played a vital part in generating the insights. In our experience, many companies forget this truth when they create strategy. Instead, they put too much emphasis on preparing documents and completing analyses and not enough on stimulating the productive debates that lead to better decisions.

Getting executives to grapple with the issues can be a messy process, and the debates may be quite personal. After all, formulating good strategies typically involves revisiting fundamental and deeply held beliefs about a company’s past and future, and people tend not to shift their views without a fight. But without the necessary fights, and without the use of carefully designed decision-making techniques, companies may end up with rubber-stamped strategies whose flaws are exposed during implementation—or afterward, by competitors.

When companies find ways to get executives grappling—throughout the strategy-development process—with the choices that matter, they make better, less biased decisions. They also improve the likelihood that the relevant stakeholders will be on board when the time comes to make and act on choices.

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4 We also know that executives exhibit a number of biases that lead them to be overconfident about their beliefs and adept at finding facts to confirm them and reject challenges. To learn more about addressing this problem, see Dan Lovallo and Olivier Sibony, “The case for behavioral strategy,” *McKinsey Quarterly*, March 2010, mckinsey.com.

5 The importance of gaining social support for a strategy is often overlooked. Fully 62 percent of executives in our survey say that their strategy processes focus on the strategy itself, not on building a support base of influencers who will drive implementation.
To exemplify our point, let’s look again at the retailer’s strategy team as it engaged with the company’s broader leadership group to share its observations. Most strategy teams interact with decision makers by presenting management with a summary report and recommendations. But this team understood that senior managers needed time to debate the issues themselves and reach their own conclusions—and that such collective discussions would improve the resulting strategy.

Because the senior managers had a very hands-on attitude, the strategy team designed a series of weekly meetings called think tanks to let them work through a profit-deconstruction exercise illuminating the company’s past. In each session, the analysis was tabled after a certain point, and the management team’s members took turns drawing out conclusions or identifying further questions that needed answering. The strategy team was prohibited from bringing any conclusions of the analysis to these meetings, much to its discomfort. This ensured that company leaders were invested in the decision-making process and could challenge the strategy team with new ideas.

Through a series of small-group meetings, the leadership team (with analytical help from the strategy team) debated the reasons for the company’s past success and how to continue it. By unpacking these complex dynamics together, the leadership team arrived at an accurate, sharp diagnosis: the company needed to restore mainstream shoppers’ trust in its prices. The result was a simple, focused strategy for delivering “value” products and reinforcing that market position with customers. Furthermore, because the management team was deeply involved in the diagnosis, its members had a strong incentive to drive implementation.

**Don’t leave the strategy unfinished**

In conversations with senior executives, we occasionally hear some version of this saying: “I’d rather have a good strategy and great execution than vice versa.” We believe that this attitude reflects confusion about what great strategy is. Such a strategy creates a path for action and is inherently incomplete without it. Yet many companies fail to get the conditions for successful implementation right, and
fully two-thirds of the executives in our survey admit that their companies struggle with the issue.

It’s a crucial struggle. No strategy, however brilliant, can be implemented successfully unless the people who have the most important jobs know what they need to do differently, understand how and why they should do it, and have the necessary resources. An added challenge, of course, is that strategic choices often involve big changes over long, three- to five-year time frames.

Finishing a strategy, therefore, requires creating tangible, proximate goals that connect to the longer-term strategy. It’s easy to create a high-level list of next steps and things to do differently on Monday morning. It’s much harder to roll back the future and connect it to the present so that people understand what they need to do differently and actually do it.

When companies fail to set proximate goals, the results can be disappointing. An Asian telecommunications company, for example, had landed on an intriguing and counterintuitive strategy involving two big shifts: it wanted to move its target customer base from big business to the midmarket and to standardize its products rather than provide customized service to large clients. Making the changes work, however, would require salespeople to start saying no to new business from large and complex clients so that the company could redirect its efforts to midmarket customers. The short-term pain (lower revenues and higher costs) would ultimately lead the company to a market-beating position.

The management team understood and encouraged the shift and was ready to act. But the strategy team did not do enough to prepare the organization for the moves, instead spending its time on detailed initiative-planning exercises. Absent any effort to translate the company’s strategic desires into proximate goals for its employees, those employees balked at the changes.

Sales managers, for example, not only viewed saying no to larger customers as a short-term loss for the business but also were simply not as excited about pursuing midmarket customers with simpler needs. They understood the strategy intellectually and believed the analysis, but their skills, incentives, and ways of working and even
thinking had not changed. Without such changes, they couldn’t connect the necessary steps to a longer-term goal and naturally reverted to their old ways, creating a backlash that inevitably undermined the strategy. Only afterward did the team recognize the kinds of activities that might have helped—for example, changing the salespeople’s goals, resetting the overall budget to acknowledge the transition from one customer segment to another, and using the reallocated funding to generate a new product-development road map.

Creating strategy in today’s environment of complexity, ever-changing priorities, and conflicting agendas is a daunting task. Yet when senior executives invest the time and effort to develop a more thorough, thoughtful approach to strategy, they not only increase the odds of building a winning business but also often enjoy a positive spin-off: the gifts of simplicity and focus, as well as the conviction to get things done.

The authors wish to thank Matthew Chapman, Pia Mortensen, and Victoria Newman for their contributions to the development of this article.

Chris Bradley is a principal in McKinsey’s Sydney office, where Angus Dawson is a director and Antoine Montard is a senior expert.
Ten timeless tests can help you kick the tires on your strategy and kick up the level of strategic dialogue throughout your company.

‘What’s the next new thing in strategy?’, a senior executive recently asked Phil Rosenzweig, a professor at IMD, in Switzerland. His response was surprising for someone whose career is devoted to advancing the state of the art of strategy: “With all respect, I think that’s the wrong question. There’s always new stuff out there, and most of it’s not very good. Rather than looking for the next musing, it’s probably better to be thorough about what we know is true and make sure we do that well.”

Let’s face it: the basic principles that make for good strategy often get obscured. Sometimes the explanation is a quest for the next new thing—natural in a field that emerged through the steady accumulation of frameworks promising to unlock the secret of competitive advantage. In other cases, the culprit is torrents of data, reams of analysis, and piles of documents that can be more distracting than enlightening.

Ultimately, strategy is a way of thinking, not a procedural exercise or a set of frameworks. To stimulate that thinking and the dialogue that goes along with it, we developed a set of tests aimed at helping executives assess the strength of their strategies. We focused on testing the strategy itself (in other words, the output of the strategy-development process), rather than the frameworks, tools, and approaches that generate...
Have you tested your strategy lately?

Most companies’ strategies pass fewer than four of the ten tests.

Number of tests rated as fully consistent with company strategy, % of respondents

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<thead>
<tr>
<th>Number of Tests</th>
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<td>3 or fewer</td>
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Source: 2010 McKinsey survey of 2,135 global executives on testing business strategy

Strategies, for two reasons. First, companies develop strategy in many different ways, often idiosyncratic to their organizations, people, and markets. Second, many strategies emerge over time rather than from a process of deliberate formulation.³

There are ten tests on our list, and not all are created equal. The first—“will it beat the market?”—is comprehensive. The remaining nine dis-aggregate the picture of a market-beating strategy, though it’s certainly possible for a strategy to succeed without “passing” all nine of them. This list may sound more complicated than the three Cs or the five forces of strategy.⁴ But detailed pressure testing, in our experience, helps pinpoint more precisely where the strategy needs work, while generating a deeper and more fruitful strategic dialogue.

Those conversations matter, but they often are loose and disjointed. We heard that, loud and clear, over the past two years in workshops where we explored our tests with more than 700 senior strategists around the world. Furthermore, a recent McKinsey Quarterly survey of 2,135 executives indicates that few strategies pass more than three

³For a classic statement of the idea that strategies are more emergent than planned, see Henry Mintzberg, “Crafting strategy,” Harvard Business Review, 1987, July–August, Volume 65, Number 4, pp. 66–75.

⁴The three Cs and the five forces are seminal strategy frameworks. The three Cs (competitors, customers, and company) were articulated by retired McKinsey partner Kenichi Ohmae in The Mind of the Strategist (McGraw-Hill, 1982). The five forces (barriers to entry, buyer power, supplier power, the threat of substitutes, and the degree of rivalry) were set forth by Harvard Business School professor Michael Porter in Competitive Strategy (Free Press, 1998).
of the tests. In contrast, the reflections of a range of current and former strategy practitioners (see “How we do it: Strategic tests from four senior executives,” on mckinseyquarterly.com) suggest that the tests described here help formalize something that the best strategists do quite intuitively.

The tests of a good strategy are timeless in nature. But the ability to pressure-test a strategy is especially timely now. The financial crisis of 2008 and the recession that followed made some strategies obsolete, revealed weaknesses in others, and forced many companies to confront choices and trade-offs they put off in boom years. At the same time, a shift toward shorter planning cycles and decentralized strategic decision making are increasing the utility of a common set of tests. All this makes today an ideal time to kick the tires on your strategy.

**Will your strategy beat the market?**

All companies operate in markets surrounded by customers, suppliers, competitors, substitutes, and potential entrants, all seeking to advance their own positions. That process, unimpeded, inexorably drives economic surplus—the gap between the return a company earns and its cost of capital—toward zero.

For a company to beat the market by capturing and retaining an economic surplus, there must be an imperfection that stops or at least slows the working of the market. An imperfection controlled by a company is a competitive advantage. These are by definition scarce and fleeting because markets drive reversion to mean performance. The best companies are emulated by those in the middle of the pack, and the worst exit or undergo significant reform. As each player responds to and learns from the actions of others, best practice becomes commonplace rather than a market-beating strategy. Good strategies emphasize difference—versus your direct competitors, versus potential substitutes, and versus potential entrants.

Market participants play out the drama of competition on a stage beset by randomness. Because the evolution of markets is path dependent—that is, its current state at any one time is the sum product of all pre-

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Markets drive a reversion to mean performance.

Performance cohorts based on position in 2001 relative to mean, n = 743

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<th>Return on invested capital (ROIC), %</th>
<th>Ratio of enterprise value to invested capital (EV/IC)</th>
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1 Sample of largest 1,200 nonfinancial US-listed companies in 2009 was narrowed to 743 that were also listed in 2001.
Source: Standard & Poor’s Compustat; McKinsey analysis

previous events, including a great many random ones—the winners of today are often the accidents of history. Consider the development of the US tire industry. At its peak in the mid-1920s, a frenzy of entry had created almost 300 competitors. Yet by the 1940s, four producers controlled more than 70 percent of the market. Those winners happened to make retrospectively lucky choices about location and technology, but at the time it was difficult to tell which companies were truly fit for the evolving environment. The histories of many other industries, from aerospace to information technology, show remarkably similar patterns.

To beat the market, therefore, advantages have to be robust and responsive in the face of onrushing market forces. Few companies, in our experience, ask themselves if they are beating the market—the pressures of “just playing along” seem intense enough. But playing along can feel safer than it is. Weaker contenders win surprisingly often in war when they deploy a divergent strategy, and the same is true in business.6

Does your strategy tap a true source of advantage?

Know your competitive advantage, and you’ve answered the question of why you make money (and vice versa). Competitive advantage stems from two sources of scarcity: positional advantages and special capabilities.

Positional advantages are rooted in structurally attractive markets. By definition, such advantages favor incumbents: they create an asymmetry between those inside and those outside high walls. For example, in Australia, two beer makers control 95 percent of the market and enjoy triple the margins of US brewers. This situation has sustained itself for two decades, but it wasn’t always so. Beginning in the 1980s, the Australian industry experienced consolidation. That change in structure was associated with a change in industry conduct (price growth began outstripping general inflation) and a change in industry performance (higher profitability). Understanding the relationship among structure, conduct, and performance is a critical part of the quest for positional advantage.

Special capabilities, the second source of competitive advantage, are scarce resources whose possession confers unique benefits. The most obvious resources, such as drug patents or leases on mineral deposits, we call “privileged, tradable assets”: they can be bought and sold. A second category of special capabilities, “distinctive competencies,” consists of things a company does particularly well, such as innovating or managing stakeholders. These capabilities can be just as powerful in creating advantage but cannot be easily traded.

Too often, companies are cavalier about claiming special capabilities. Such a capability must be critical to a company’s profits and exist in abundance within it while being scarce outside. As such, special capabilities tend to be specific in nature and few in number. Companies often err here by mistaking size for scale advantage or overestimating their ability to leverage capabilities across markets. They infer special capabilities from observed performance, often without considering other explanations (such as luck or positional advantage). Companies should test any claimed capability advantage vigorously before pinning their hopes on it.

When companies bundle together activities that collectively create advantage, it becomes more difficult for competitors to identify and
replicate its exact source. Consider Aldi, the highly successful dis-
count grocery retailer. To deliver its value proposition of lower prices,
Aldi has completely redesigned the typical business system of a
supermarket: only 1,500 or so products rather than 30,000, the stock-
ing of one own-brand or private label rather than hundreds of
national brands, and superlean replenishment on pallets and trolleys,
thus avoiding the expensive task of hand stacking shelves. Given
the enormous changes necessary for any supermarket that wishes to
copy the total system, it is extremely difficult to mimic Aldi’s value
proposition.

Finally, don’t forget to take a dynamic view. What can erode positional
advantage? Which special capabilities are becoming vulnerable?
There is every reason to believe that competitors will exploit points of
vulnerability. Assume, like Lewis Carroll’s Red Queen, that you have
to run just to stay in the same place.

Is your strategy granular about where to
compete?

The need to beat the market begs the question of which market.
Research shows that the unit of analysis used in determining strategy
(essentially, the degree to which a market is segmented) signifi-
cantly influences resource allocation and thus the likelihood of success:
dividing the same businesses in different ways leads to strikingly
different capital allocations.

What is the right level of granularity? Push within reason for the finest
possible objective segmentation of the market: think 30 to 50 seg-
ments rather than the more typical 5 or so. Too often, by contrast, the
business unit as defined by the organizational chart becomes the
default for defining markets, reducing from the start the potential scope
of strategic thinking.

Defining and understanding these segments correctly is one of the
most practical things a company can do to improve its strategy. Manage-
ment at one large bank attributed fast growth and share gains to
measurably superior customer perceptions and satisfaction. Examining
the bank’s markets at a more granular level suggested that 90 percent
of its outperformance could be attributed to a relatively high exposure
to one fast-growing city and to a presence in a fast-growing product
segment. This insight helped the bank avoid building its strategy on
false assumptions about what was and wasn’t working for the operation as a whole.

In fact, 80 percent of the variance in revenue growth is explained by choices about where to compete, according to research summarized in *The Granularity of Growth*, leaving only 20 percent explained by choices about how to compete. Unfortunately, this is the exact opposite of the allocation of time and effort in a typical strategy-development process. Companies should be shifting their attention greatly toward the “where” and should strive to outposition competitors by regularly reallocating resources as opportunities shift within and between segments.

Does your strategy put you ahead of trends?

The emergence of new trends is the norm. But many strategies place too much weight on the continuation of the status quo because they extrapolate from the past three to five years, a time frame too brief to capture the true violence of market forces.

A major innovation or an external shock in regulation, demand, or technology, for example, can drive a rapid, full-scale industry transition. But most trends emerge fairly slowly—so slowly that companies generally fail to respond until a trend hits profits. At this point, it is too late to mount a strategically effective response, let alone shape the change to your advantage. Managers typically delay action, held back by sunk costs, an unwillingness to cannibalize a legacy business, or an attachment to yesterday’s formula for success. The cost of delay is steep: consider the plight of major travel agency chains slow to understand the power of online intermediaries. Conversely, for companies that get ahead of the curve, major market transitions are an opportunity to rethink their commitments in areas ranging from technology to distribution and to tailor their strategies to the new environment.

To do so, strategists must take trend analysis seriously. Always look to the edges. How are early adopters and that small cadre of consumers who seem to be ahead of the curve acting? What are small, innovative entrants doing? What technologies under development could change the game? To see which trends really matter, assess their potential
Have you tested your strategy lately?

Have you tested your strategy lately? impact on the financial position of your company and articulate the decisions you would make differently if that outcome were certain. For example, don’t just stop at an aging population as a trend—work it through to its conclusion. Which consumer behaviors would change? Which particular product lines would be affected? What would be the precise effect on the P&L? And how does that picture line up with today’s investment priorities?

Does your strategy rest on privileged insights?

Data today can be cheap, accessible, and easily assembled into detailed analyses that leave executives with the comfortable feeling of possessing an informed strategy. But much of this is noise and most of it is widely available to rivals. Furthermore, routinely analyzing readily available data diverts attention from where insight-creating advantage lies: in the weak signals buried in the noise.

In the 1990s, when the ability to burn music onto CDs emerged, no one knew how digitization would play out; MP3s, peer-to-peer file sharing, and streaming Web-based media were not on the horizon. But one corporation with a large record label recognized more rapidly than others that the practical advantage of copyright protection could quickly become diluted if consumers began copying material. Early recognition of that possibility allowed the CEO to sell the business at a multiple based on everyone else’s assumption that the status quo was unthreatened.

Developing proprietary insights isn’t easy. In fact, this is the element of good strategy where most companies stumble (see sidebar, “The insight deficit”). A search for problems can help you get started. Create a short list of questions whose answers would have major implications for the company’s strategy—for example, “What will we regret doing if the development of India hiccups or stalls, and what will we not regret?” In doing so, don’t forget to examine the assumptions, explicit and implicit, behind an established business model. Do they still fit the current environment?

Another key is to collect new data through field observations or research rather than to recycle the same industry reports everyone else uses. Similarly, seeking novel ways to analyze the data can generate
powerful new insights. For example, one supermarket chain we know recently rethought its store network strategy on the basis of surprising results from a new clustering algorithm.

Finally, many strategic breakthroughs have their root in a simple but profound customer insight (usually solving an old problem for the customer in a new way). In our experience, companies that go out of their way to experience the world from the customer’s perspective routinely develop better strategies.

**Does your strategy embrace uncertainty?**

A central challenge of strategy is that we have to make choices now, but the payoffs occur in a future environment we cannot fully know or control. A critical step in embracing uncertainty is to try to characterize exactly what variety of it you face—a surprisingly rare activity at many companies. Our work over the years has emphasized four levels of uncertainty. Level one offers a reasonably clear view of the future: a range of outcomes tight enough to support a firm decision. At level two, there are a number of identifiable outcomes for which a company should prepare. At level three, the possible outcomes are represented not by a set of points but by a range that can be understood as a probability distribution. Level four features total ambiguity, where even the distribution of outcomes is unknown.

In our experience, companies oscillate between assuming, simplistically, that they are operating at level one (and making bold but unjustified point forecasts) and succumbing to an unnecessarily pessimistic level-four paralysis. In each case, careful analysis of the situation usually redistributes the variables into the middle ground of levels two and three.

Rigorously understanding the uncertainty you face starts with listing the variables that would influence a strategic decision and prioritizing them according to their impact. Focus early analysis on removing as much uncertainty as you can—by, for example, ruling out impossible outcomes and using the underlying economics at work to highlight outcomes that are either mutually reinforcing or unlikely because they would undermine one another in the market. Then apply tools such as scenario analysis to the remaining, irreducible uncertainty, which should be at the heart of your strategy.
Have you tested your strategy lately?

Does your strategy balance commitment and flexibility?

Commitment and flexibility exist in inverse proportion to each other: the greater the commitment you make, the less flexibility remains. This tension is one of the core challenges of strategy. Indeed, strategy can be expressed as making the right trade-offs over time between commitment and flexibility.

Making such trade-offs effectively requires an understanding of which decisions involve commitment. Inside any large company, hundreds of people make thousands of decisions each year. Only a few are strategic: those that involve commitment through hard-to-reverse investments in long-lasting, company-specific assets. Commitment is the only path to sustainable competitive advantage.

In a world of uncertainty, strategy is about not just where and how to compete but also when. Committing too early can be a leap in the dark. Being too late is also dangerous, either because opportunities are perishable or rivals can seize advantage while your company stands on the sidelines. Flexibility is the essential ingredient that allows companies to make commitments when the risk/return trade-off seems most advantageous.

A market-beating strategy will focus on just a few crucial, high-commitment choices to be made now, while leaving flexibility for other such choices to be made over time. In practice, this approach means building your strategy as a portfolio comprising three things: big bets, or committed positions aimed at gaining significant competitive advantage; no-regrets moves, which will pay off whatever happens; and real options, or actions that involve relatively low costs now but can be elevated to a higher level of commitment as changing conditions warrant. You can build underpriced options into a strategy by, for example, modularizing major capital projects or maintaining the flexibility to switch between different inputs.
Is your strategy contaminated by bias?

It’s possible to believe honestly that you have a market-beating strategy when, in fact, you don’t. Sometimes, that’s because forces beyond your control change. But in other cases, the cause is unintentional fuzzy thinking.

Behavioral economists have identified many characteristics of the brain that are often strengths in our broader, personal environment but that can work against us in the world of business decision making. The worst offenders include overoptimism (our tendency to hope for the best and believe too much in our own forecasts and abilities), anchoring (tying our valuation of something to an arbitrary reference point), loss aversion (putting too much emphasis on avoiding downsides and so eschewing risks worth taking), the confirmation bias (overweighting information that validates our opinions), herding (taking comfort in following the crowd), and the champion bias (assigning to an idea merit that’s based on the person proposing it).

Strategy is especially prone to faulty logic because it relies on extrapolating ways to win in the future from a complex set of factors observed today. This is fertile ground for two big inference problems: attribution error (succumbing to the “halo effect”) and survivorship bias (ignoring the “graveyard of silent failures”). Attribution error is the false attribution of success to observed factors; it is strategy by hindsight and assumes that replicating the actions of another company will lead to similar results. Survivorship bias refers to an analysis based on a surviving population, without consideration of those who did not live to tell their tale: this approach skews our view of what caused success and presents no insights into what might cause failure—were the survivors just luckier? Case studies have their place, but hindsight is in reality not 20/20. There are too many unseen factors.

Developing multiple hypotheses and potential solutions to choose among is one way to “de-bias” decision making. Too often, the typical
drill is to develop a promising hypothesis and put a lot of effort into building a fact base to validate it. In contrast, it is critical to bring fresh eyes to the issues and to maintain a culture of challenge, in which the obligation to dissent is fostered.

The decision-making process can also be de-biased by, for example, specifying objective decision criteria in advance and examining the possibility of being wrong. Techniques such as the “premortem assessment” (imagining yourself in a future where your decision turns out to have been mistaken and identifying why that might have been so) can also be useful.

**Test 9: Is there conviction to act on your strategy?**

This test and the one that follows aren’t strictly about the strategy itself but about the investment you’ve made in implementing it—a distinction that in our experience quickly becomes meaningless because the two, inevitably, become intertwined. Many good strategies fall short in implementation because of an absence of conviction in the organization, particularly among the top team, where just one or two non-believers can strangle strategic change at birth.

Where a change of strategy is needed, that is usually because changes in the external environment have rendered obsolete the assumptions underlying a company’s earlier strategy. To move ahead with implementation, you need a process that openly questions the old assumptions and allows managers to develop a new set of beliefs in tune with the new situation. This goal is not likely to be achieved just via lengthy reports and presentations. Nor will the social processes required to absorb new beliefs—group formation, building shared meaning, exposing and reconciling differences, aligning and accepting accountability—occur in formal meetings.

CEOs and boards should not be fooled by the warm glow they feel after a nice presentation by management. They must make sure that the whole team actually shares the new beliefs that support the strategy. This requirement means taking decision makers on a journey of discovery by creating experiences that will help them viscerally grasp mismatches that may exist between what the new strategy requires and the actions and behavior that have brought them success for many
years. For example, visit plants and customers or tour a country your company plans to enter, so that the leadership team can personally meet crucial stakeholders. Mock-ups, video clips, and virtual experiences also can help.

The result of such an effort should be a support base of influencers who feel connected to the strategy and may even become evangelists for it. Because strategy often emanates from the top, and CEOs are accustomed to being heeded, this commonsense step often gets overlooked, to the great detriment of the strategy.

Test 10:

Have you translated your strategy into an action plan?

In implementing any new strategy, it’s imperative to define clearly what you are moving from and where you are moving to with respect to your company’s business model, organization, and capabilities. Develop a detailed view of the shifts required to make the move, and ensure that processes and mechanisms, for which individual executives must be accountable, are in place to effect the changes. Quite simply, this is an action plan. Everyone needs to know what to do. Be sure that each major “from–to shift” is matched with the energy to make it happen. And since the totality of the change often represents a major organizational transformation, make sure you and your senior team are drawing on the large body of research and experience offering solid advice on change management—a topic beyond the scope of this article!

Finally, don’t forget to make sure your ongoing resource allocation processes are aligned with your strategy. If you want to know what it actually is, look where the best people and the most generous budgets are—and be prepared to change these things significantly. Effort spent aligning the budget with the strategy will pay off many times over.

As we’ve discussed the tests with hundreds of senior executives at many of the world’s largest companies, we’ve come away convinced that a lot of these topics are part of the strategic dialogue in organizations. But we’ve also heard time and again that discussion of such issues is often, as one executive in Japan recently told us, “random, simultaneous, and extremely confusing.” Our hope is that the tests will prove a simple and effective antidote: a means of quickly identifying gaps in executives’
strategic thinking, opening their minds toward new ways of using strategy to create value, and improving the quality of the strategy-development process itself.

The authors wish to acknowledge the many contributions of McKinsey alumnus Nick Percy, now the head of strategy for BBC Worldwide, to the thinking behind this article.

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The insight deficit

A fresh strategic insight—something your company sees that no one else does—is one of the foundations of competitive advantage. It helps companies focus their resources on moves that separate them from the pack. That makes the following interesting: in a recent survey, only 35% of 2,135 global executives believed their strategies rested on unique and powerful insights. That figure was dramatically lower than the average—62 percent—for nine other tests we asked executives to measure their strategies against.

What's more, only 14 percent of surveyed executives placed novel insights among the top three strategic influencers of financial performance. One likely explanation: the widespread availability of information and adoption of sophisticated strategy frameworks creates an impression that “everyone knows what we know and is probably analyzing the data in the same ways that we are.” The danger is obvious: if strategists question their ability to generate novel insights, they are less likely to reach for the relative advantages that are most likely to differentiate them from competitors.

For the complete survey results, see “Putting strategies to the test: McKinsey Global Survey results,” on mckinseyquarterly.com.