McKinsey & Company

McKinsey on Finance

Perspectives for CFOs and other finance leaders

Forward, with focus

Inside: Sharpening forecasts, advancing FP&A, activating portfolio management, applying carbon insight, enhancing HR in M&A, preparing for the CFO role, and seeing your organization through to better decisions

Number 87,
January 2025

McKinsey on Finance is a quarterly publication offering perspectives drawn from across—and beyond—McKinsey for CFOs, those who aspire to be CFOs, and other finance professionals.

This and archived issues of *McKinsey on Finance* are available online at McKinsey.com, where selected articles are also available in audio format. A series of podcasts on corporate-finance and strategy topics is available for streaming or downloading on McKinsey.com, as well as on Apple Podcasts and Google Podcasts.

Editorial Contact:
McKinsey_on_Finance@McKinsey.com

To request permission to republish an article, send an email to McKinsey_on_Finance@McKinsey.com

McKinsey on Finance

Perspectives for CFOs and other finance leaders

Forward, with focus

Number 87, January 2025

Contents

Interested in reading *McKinsey on Finance* online? Email your name, your title, and the name of your company to McKinsey_on_Finance@McKinsey.com, and we'll notify you as soon as new articles become available.

Item 1:
Forward, with focus

“Prediction is very difficult,” physicist Neils Bohr reputedly observed, “especially if it’s about the future.” CFOs can’t know for certain what the future will bring. But they can make more informed decisions for their companies, their stakeholders, and themselves on the way to what’s ahead.

In a new survey, global CFOs report a growing focus on the long term. We explore the results in greater detail in “Toward the long term: CFO perspectives on the future of finance.” Among other findings, respondents point to strategic planning and long-term resource allocation as their leading priorities, as well as generative AI—to a much greater extent, in fact, than they did in our 2023 survey. It’s a daunting task for anyone who assumes the CFO mantle, perhaps for new CFOs most of all. Multiple finance leaders share their perspectives about transitioning to leading the finance function in “How to prepare for the CFO role.”

Fortunately, there are concrete steps that CFOs of all tenures can take to improve in the role. Consider forecasting. Best-in-class approaches help CFOs better understand their own complex businesses and chart a more informed course through uncertainty. In “Advanced FP&A practices for a volatile macroeconomic and business environment,” colleagues John Kelleher, Marla Capozzi, and Dean Di Giorgio describe six practical steps for more sophisticated and impactful forecasts. Current dynamics also suggest that many CFOs will need a more advanced, and more holistic, view of their organization’s carbon management. In “Managing carbon: A new role for the CFO,” Hemant Ahlawat, Peter Spiller, Tim Koller, and Erik Ringvold examine the actions that effective finance leaders are taking. A few companies are already using best-in-class emissions data and analysis not only to reduce emissions but also to make better decisions for value creation.

Beyond major changes in emissions regulations, broader competitive dynamics are very much on the move. Companies can’t expect to stay ahead of competitors by keeping their business portfolios stagnant. In “Active portfolio management: Five practical insights for value creation,” Andy West, Anna Mattsson, Jamie Koenig, and Santiago Garcia explain why a company’s portfolio works best as a strategically focused whole and show that active portfolio management is a powerful—though surprisingly underutilized—tool of value creation.

Strategy often extends to dealmaking; in those cases, capturing deal synergies is crucial, not least by integrating new talent. In this edition’s featured interview—with Lisa Blair Davis, the global head of HR for Johnson & Johnson MedTech—we present a closer look at the HR leader’s role in M&A.

Each individual is unique and profoundly *human*, which includes a full suite of decision-making biases. In many contexts, the ways that people process new information and make decisions can be irrational. Yet as Tim Koller explains in “What I learned from Daniel Kahneman,” organizations are uniquely positioned to foster better decision making.

Even the largest, most disparate mix of businesses can be well-performing organizations. In “Is your ‘conglomerate discount’ a performance discount or a communication problem?,” the authors look at the unique challenges that conglomerates face in understanding and communicating the value of their business portfolios. The most effective conglomerates figure out not only how their businesses cohere into a strategic whole but also how to clearly communicate the business case to a typically skeptical capital market audience.

Finally, perhaps no class of investors takes a more rigorous view of value creation potential than intrinsic investors. In the concluding “Looking back” section of this edition, our analysis finds an interesting divergence between the holdings of intrinsic investors (the category of investors that take and hold a position in a company over long periods, after careful scrutiny) in “Magnificent Seven” companies compared with their investments in a broader mix of large-cap stocks—and the investments made by retail investors. Of course, neither investors nor CFOs have a crystal ball to foresee future cash flow. But they should be prepared, now, to articulate their vision of how prospective performance could play out.

Andy West
Senior partner
Boston

Celia Huber
Senior partner
Bay Area

Michael Birshan
Senior partner
London

Toward the long term: CFO perspectives on the future of finance

In a new survey, CFOs report a growing focus on longer-term planning and high expectations for technology, including generative AI.

by Ankur Agrawal and Christian Grube
with Jorge Herranz Bayo

For finance leaders, the challenge of balancing a growing list of priorities, mandates, and reporting lines isn't getting any easier. CFOs play a range of critical roles in their organizations, including (but not limited to) crisis manager, functional leader, and thought partner to the CEO. In our newest CFO pulse survey,[1] finance leaders also cite emerging risks to their companies' growth—namely, supply chain disruptions and weak demand—that require attention and management.

At the same time, CFOs tend to say they are looking beyond short-term concerns in a way they haven't in previous years. Most finance leaders cite strategic planning and long-term resource allocation and planning as top finance priorities, and much more often than they did in our 2023 survey. And while few CFOs say their finance functions have digitized their processes at scale or have adopted generative AI (gen AI), nearly all of them believe that gen AI has the potential to create value in myriad ways, from helping finance employees move away from manual analysis to improving leadership and strategy support.

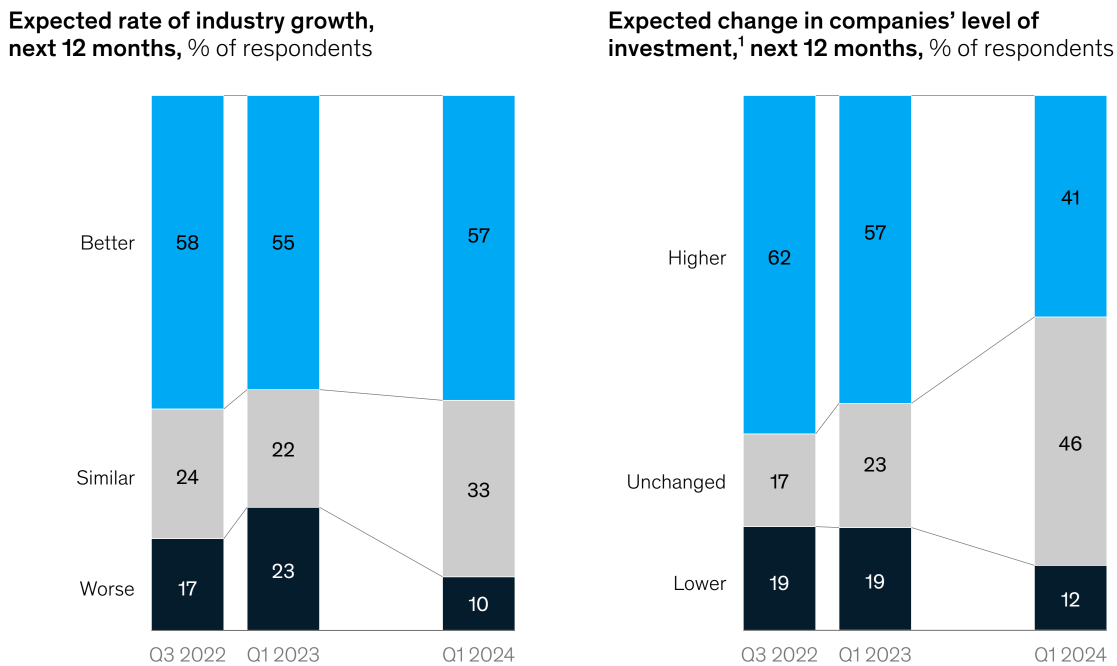
When asked about their overall business outlook, CFOs are increasingly likely to expect the status quo will hold in the next year. Compared with 2023, a larger percentage of finance leaders expect their industries' rate of growth will stay the same. They are also twice as likely to expect their companies' investment levels will hold steady—a departure from the past two surveys, when CFOs predicted an increase in investment (Exhibit 1). While concerns over inflation have ebbed since the 2023 survey, CFOs are 2.5 times more likely (49 percent, up from 20 percent) to say supply chain disruptions threaten their companies' growth. Similar to last year, a majority of respondents cite increased economic volatility as a risk.

CFOs tend to say they are looking beyond short-term concerns in a way they haven't in previous years.

[1] The online survey was in the field from March 14 to April 25, 2024, and garnered responses from 126 finance leaders of companies in 26 countries, with nearly half (61) working for companies headquartered in the United States. Of the 126 respondents, 47 are CFOs of companies and 79 are CFOs of business units or regions. To adjust for differences in response rates, the data are weighted by the contribution of each respondent's nation to global GDP.

Exhibit 1

Compared with past surveys, CFOs are more likely to expect their industries' growth rates and companies' investment levels to hold steady.



Note: Figures may not sum to 100%, as respondents who answered "don't know" are not shown.
[1]For example, capital expenditure, R&D, and marketing.
Source: McKinsey Global Surveys of CFOs, 2022–24

McKinsey & Company

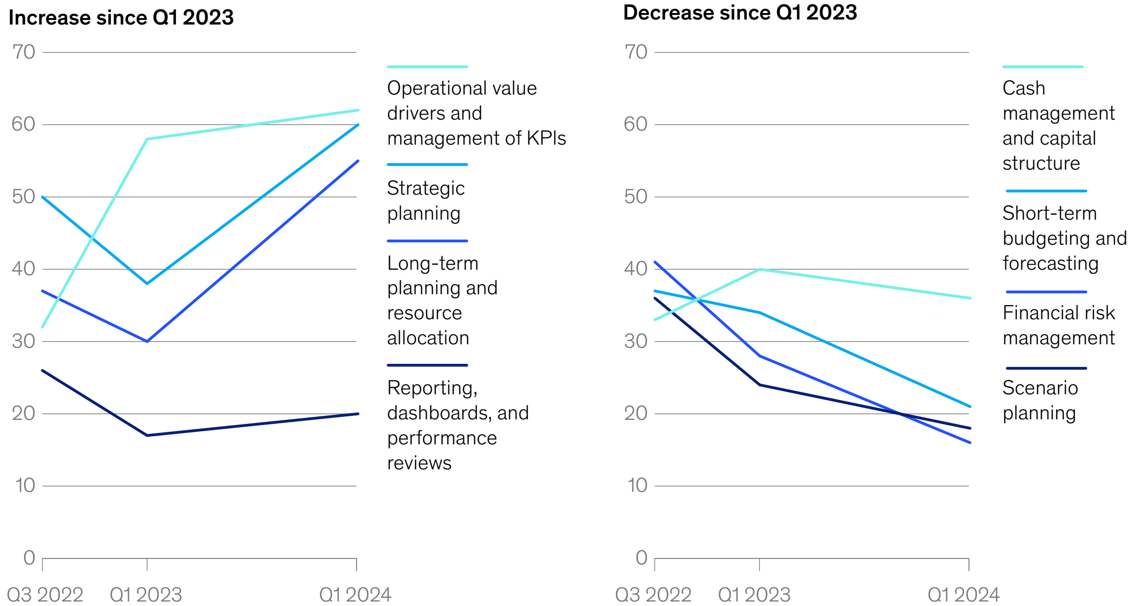
When asked about their own finance organizations, CFOs continue to cite operational value drivers and KPI management as a top priority—as they did one year ago. But other results suggest they are refocusing on the future. Fifty-five percent now say that long-term planning and resource allocation is also a top priority for finance, up from 30 percent in the past survey. Likewise, the percentage of CFOs citing strategic planning as a top priority has grown considerably since 2023: 60 percent now say so, versus 38 percent last year (Exhibit 2).

For all the benefits that digital technology—and gen AI, specifically—can bring to finance organizations, the survey suggests that many of them have room to improve their implementation and use of tech. On one hand, nearly all respondents (98 percent) say their finance functions have invested in digitization and automation, regardless of where they are on their digitization journeys. On the other, a plurality of CFOs report that just one-quarter or less of their processes are currently digitized or automated (Exhibit 3).

Exhibit 2

With respect to their priorities, finance functions seem to be refocusing on the long term.

Finance organizations' top priorities, next 12 months, % of respondents



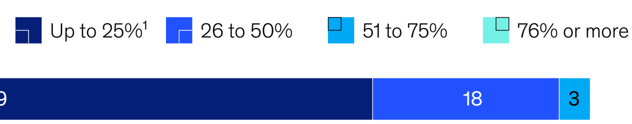
Source: McKinsey Global Surveys of CFOs, 2022–24

McKinsey & Company

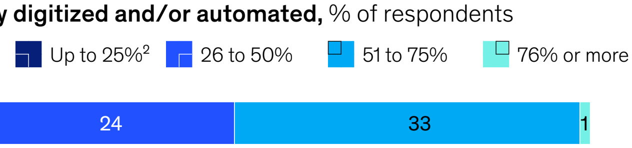
Exhibit 3

While nearly all CFOs say their finance functions have digitized processes in the past year, many are still early in their journeys.

Share of finance processes that have been digitized and/or automated, past 12 months, % of respondents



Share of finance processes that are currently digitized and/or automated, % of respondents



Note: Figures may not sum to 100%, as respondents who answered "don't know" are not shown.
[1] 4 CFO respondents said none of their finance processes have been digitized and/or automated in the past 12 months.
[2] 1 CFO respondent said none of their finance processes are currently digitized and/or automated.
Source: McKinsey Global Survey of CFOs in 32 countries, March 14–April 25, 2024 (n = 126)

McKinsey & Company

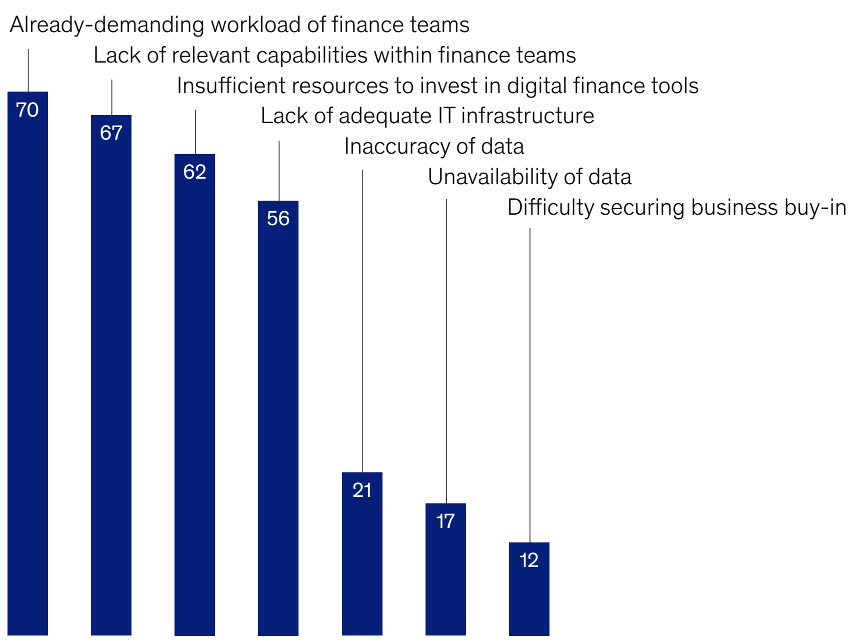
Part of the reason for low digitization rates may be the breadth of the tech-related challenges—many of which are organizational—that finance functions face. When asked about the roadblocks to creating value from data and technology, CFOs report that their finance functions face already-demanding workloads, a lack of relevant capabilities, and insufficient resources (Exhibit 4). All three of these challenges are more prevalent than the tech infrastructure or data-related issues we asked about.

Among CFOs, expectations for AI and gen AI are high. There's near-universal consensus that these technologies will create value for the finance function, even in areas where they're not yet in use (Exhibit 5). More than eight in ten CFO respondents believe that AI and gen AI will generate insights that enable employees to spend more time on value-adding (rather than manual) tasks and will improve employees' overall productivity. When asked about potential gen AI applications that would be most

Exhibit 4

The results suggest that organizational—rather than technical—issues pose the biggest barriers to capturing tech-related value in finance.

Finance functions' main challenges to creating value from data and technology,[1] % of respondents



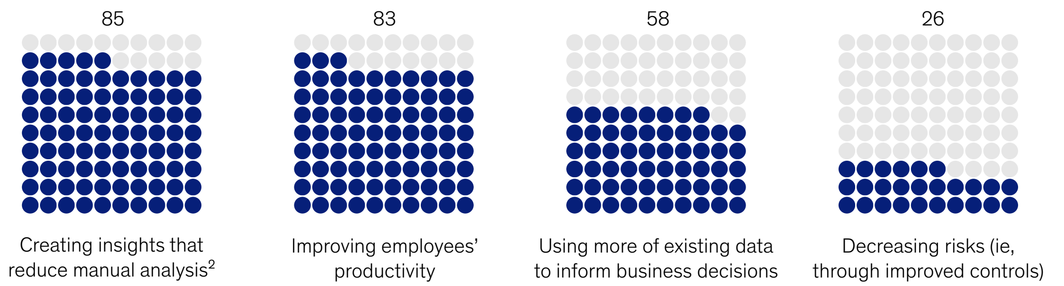
[1]Respondents who answered "other" or "don't know" are not shown.
Source: McKinsey Global Survey of CFOs in 32 countries, March 14–April 25, 2024 (n = 126)

McKinsey & Company

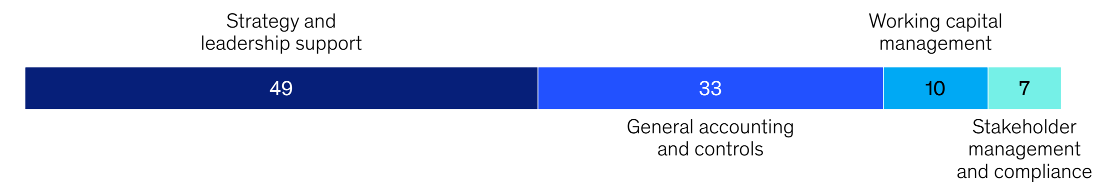
Exhibit 5

CFOs have high expectations for the benefits AI and generative AI can bring to finance.

Ways that AI and generative AI will create value for the finance function, next 5 years,[1] % of respondents



Generative AI application that will be most useful to the finance function, next 5 years,[3] % of respondents



[1]Respondents who answered "other" or "not applicable" are not shown. Only 2 respondents said "not applicable; I do not expect the finance function's use of AI and gen AI to create value."
[2]Ie, so employees can spend more time on value-adding tasks.
[3]Figures do not sum to 100%, as respondents who answered "other" or "don't know" are not shown.
Source: McKinsey Global Survey of CFOs in 32 countries, March 14–April 25, 2024 (n = 126)

McKinsey & Company

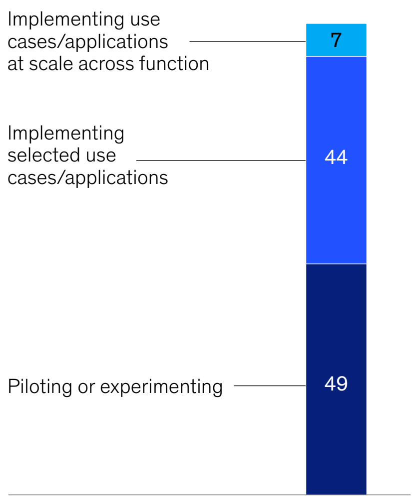
useful to finance, CFOs most often identify strategy and leadership support (49 percent), such as insight generation and competitor insights monitoring. This is followed by one-third of CFOs who cite controlling and general accounting use cases.

Just one in five CFOs reports the use of gen AI tools, and of them, nearly half are still in the pilot and experimentation phase. For those who are already putting gen AI to work, they report the same benefits that CFOs expect the tools will offer in the future. The largest share, 71 percent, say gen AI has created value by improving the productivity of finance employees (Exhibit 6). After that, 54 percent cite better use of data in business decisions and 48 percent cite insight generation that allows employees to focus on higher-order tasks.

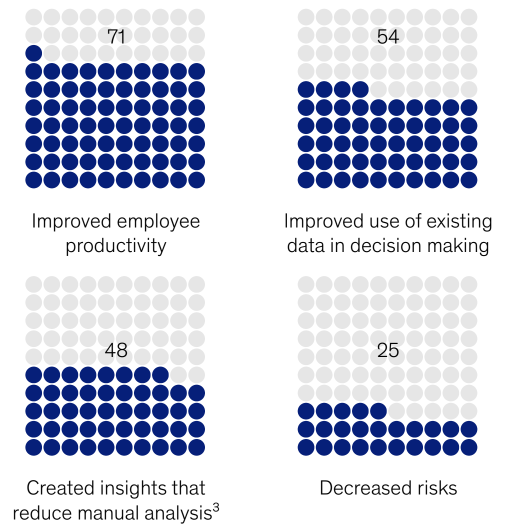
Exhibit 6

In areas where finance functions have already adopted generative AI, CFOs most often cite increased employee productivity as a benefit.

Finance functions' implementation of generative AI tools to date,[1] % of respondents



Ways that generative AI has already created value for the finance function,[2] % of respondents



[1]Questions were asked only of respondents (n = 33) who identified gen AI as a digital and/or automation technology their finance functions are currently using.
[2]Respondents who answered "other" or "not applicable" are not shown. 3 percent of respondents said "not applicable; I do not expect the finance function's use of AI and gen AI to create value."
[3]le, so employees can spend more time on value-adding tasks.
Source: McKinsey Global Survey of CFOs in 32 countries, March 14–April 25, 2024 (n = 126)

McKinsey & Company

In an increasingly volatile world, CFOs have an especially critical role to play in creating financial value—while also dealing with urgent demands and leading the finance function through the current wave of technology-driven organizational change. They can, and need to, be front and center in helping their companies navigate the current environment by balancing short-term management with long-term value creation. While most finance organizations have just started their gen AI journeys, these technologies also present CFOs, and finance more broadly, with a significant opportunity to increase their effectiveness and efficiency.

Ankur Agrawal is an alumnus of McKinsey's New York office, **Christian Grube** (Christian_Grube@McKinsey.com) is a partner in the Munich office, and **Jorge Herranz Bayo** (Jorge_Herranz_Bayo@McKinsey.com) is a consultant in the Madrid office.

How to prepare for the CFO role

Amid decade-high CFO turnover, former chief financial officers share advice on what matters most today for securing the top job in finance.

by Andy West , Ankur Agrawal, Christian Grube, and Karolina Sauer-Sidor

A few years into his tenure in treasury at PepsiCo, Arun Nayar realized that to rise higher, he would need to supplement his financial expertise with operational know-how. To get that experience, he persuaded the company's leaders to give him a lateral role overseeing finance in the global operations division, an area he knew nothing about.

"When I went into those meetings, it was a different language," he recalls. "That was my steepest learning curve. It put me in the deep water, and I had to swim or drown." Not only was the stint instrumental in fulfilling his ambition to become a CFO, but it inspired him to form the No Fear Club, through which he mentors other finance professionals.

The courage to take career risks is necessary for anyone who aspires to lead the finance function at a major company today. CFOs must possess experience and skills that go well beyond traditional expertise in budgeting, planning, and risk mitigation. CFOs now serve as board advisers and CEO consiglieri on organizational priorities and strategy, as performance challengers and innovation champions, as leaders of major investments and transactions, and as convenors of cross-enterprise initiatives.

In today's volatile business environment, CFOs must also weigh the potential impact of geopolitical tensions, technological advances, macroeconomic disruptions, and climate risks. "The job is hard, so you have to have a passion for it," says Karen McLoughlin, former CFO of Cognizant Technology Solutions. And with the number of functions reporting to the CFO steadily increasing, that passion must go beyond finance to raising the performance of the entire organization.

The timing to seek the CFO office couldn't be more fortuitous. Decade-high CFO turnover in the United States and Europe has left large corporations scrambling to fill the role. Almost a third of FTSE 100 companies appointed new CFOs last year[1] and one-fifth of leading US consumer and financial-services companies did likewise, reports executive search firm Crist|Kolder Associates. What's more,

'At every step, there are at least a dozen other folks who are equally competent, an0d often more competent, than you are, and only one can get the big break.'

–**Arun Nayar**

Former executive vice president and CFO of Tyco International and CFO of Global Operations at PepsiCo. He serves on the boards of Amcor, GFL Environmental, and Rite Aid.

[1] Linda Barham, Jenna Fisher, Jim Lawson, and Catherine Schroeder, "Why CFOs are increasingly becoming a flight risk," Russell Reynolds Associates, January 27, 2023.

two-thirds of the new CFOs at S&P 500 companies and more than half of those in Europe were first-time finance leaders—a record high.

To understand how executives can become high-potential candidates for the role, we interviewed eight former CFOs about their finance careers. Not only does their experience cover a broad range of industries and geographies, but all are now corporate board directors involved in hiring CFOs. Our goal—modeled on our colleagues' work on the CEO journey—was to investigate how to succeed at every stage of the CFO life cycle: preparing for the role, making a strong start as a CFO,[2] raising the finance function's performance in midtenure, and realizing leadership ambitions after transitioning out of the CFO role.

The interviews, combined with our research and experience serving CFOs, suggest that CFO hopefuls should embrace the following five priorities: formulating a unique vision for the role, finding the right set of sponsors, bolstering skills in the areas that matter most to the organization, taking professional risks to broaden experience, and seeking opportunities to engage with the board.

Formulate a distinctive vision for the CFO role

The CFO's job has two core dimensions: overseeing the finance function and ensuring the high performance of the organization as a whole. Financial professionals who hope to become CFOs thus need to have a view of how they would realize both parts of their mandate. You should be able to articulate how you would build on the work of your predecessor and what would differentiate you from other candidates.

To gain this perspective, experts recommend developing an independent, outside-in view of the company—its assets, its industry position, and its opportunities and risks. Chris Kreidler, the former CFO of Sysco Corporation and C&S Wholesale Grocers, suggests asking yourself what you think the company's valuation should be, then figuring out what the market is missing about the company's vision. What would a potential long-term investor want the leadership to do (or stop doing)? Are your costs higher than your peers'? Should some assets be divested? Can you spot patterns that leadership may be missing?

'The CFO can't just sit in their office anymore. They have to be able to coordinate across the business, across functions, and get people to collaborate.'

–**Karen McLoughlin**

Former CFO of Cognizant Technology Solutions. She sits on the boards of Agilon Health and Best Buy.

[2] For more, see Ankur Agrawal, Michael Birshan, Christian Grube, and Andy West, "Starting up as a new CFO," McKinsey, January 18, 2023.

It's important that your thesis cover how you would allocate resources toward new growth opportunities. Candidates who understand the key business drivers, industry dynamics, and value creation trends that will matter most for the company's next phase will have an edge over rivals. If sustainability and technological robustness will be essential to the company's future, can you demonstrate your understanding of those areas? Can you analyze operational and commercial KPIs to assess the organization's vulnerabilities and opportunities? Many companies struggle with growth and renewal today, so individuals who see how disciplined innovation and investment can raise performance will defy the traditional (and outdated) image of the CFO as "Mr. or Ms. No."

Since the relationship between the CFO and CEO is critical to successful corporate leadership, you should also consider how you would complement the chief executive. If the CEO is the visionary, the CFO should be a master of execution, suggests Marjorie Lao, the former CFO of LEGO Group and Tandberg (now part of Cisco). In such a case, the candidate would ideally have operational experience, "covering more than just finance but driving the linkages across different departments."

Find diverse sponsors with organizational clout

Most of the former CFOs we spoke with found mentors and sponsors essential to their rise. "At every step, there are at least a dozen other folks who are equally competent, and often more competent, than you are, and only one can get the big break," says Nayar, who had several sponsors before becoming the CFO of Tyco International. To get the right guidance, however, you need to actively seek out individuals who will not only encourage you and highlight your blind spots but whose opinion carries weight in the organization.

McLoughlin considers herself fortunate that her CFO predecessor at Cognizant, as well as the company's CEO, gave her opportunities to branch out to fill her experience gaps. "They both had a knack for seeing when I was starting to get bored, and they would appear in my office suddenly and ask, 'How about we think of doing this?'"

Lao found her mentors' faith in her potential to be critical for raising her own ambition. Her mentor at Tandberg told her, "You may not tick all the boxes [of a CFO skill set], but I know you have the capacity

'Every opportunity you have to work with a more senior person or one who runs a different part of the organization is a job interview.'

–**Chris Kreidler**

Former executive vice president and CFO of Sysco Corporation and C&S Wholesale Grocers. He is a board director of Alyasra Foods, BradyIFS, Soul Foods, and True Blue.

and willingness to learn." Her experience taught her the importance of seeking mentors and sponsors who care about you as a person, not just about your trajectory in the company.

When, six months into a new role, she had difficulty adjusting and wondered if she had made the right move, her mentor not only reassured her that she was ready for the position but also offered to make introductions to other companies if she chose to leave. Kreidler had a similar mentoring approach: as Sysco CFO, he oversaw 163 divisional, market, and regional CFOs and viewed his role as preparing them "to be CFOs somewhere, even if not at Sysco. If you can find a mentor or a boss that has this mentality, that will help."

Often, the best mentors aren't direct managers but instead are individuals in the organization with whom you can openly discuss your aspirations. Seeking out sponsors outside finance—a business unit leader, for example, or the chief technology officer—can also present opportunities to build experience beyond the function and more deeply understand the organization's challenges.

Kreidler recommends finding a sponsor in the area that matters most to the company's performance. At Sysco it was operations, he says, while at PepsiCo, where he spent 11 years in the Yum! Brands group, sponsorship from within the brand organizations (Pizza Hut, Taco Bell, and KFC) was the biggest boon. "Every opportunity you have to work with a more senior person or one who runs a different part of the organization is a job interview," says Kreidler.

In some cases, an external mentor, such as an executive coach, can provide the needed guidance. Axel Strotbek, former CFO of Audi AG, was in his early 30s when he held his first leadership role. He is grateful to a former boss for connecting him with a coach who helped him "reflect on myself, set my personal goals, and develop plans for the years to come."

It's also important to seek the right sponsor for each stage of the journey. Nayar always thought of his career in five- to six-year tranches, at the end of which he set a new ambition. "That helped me figure out who would be the right sponsor to help me get to that level."

Strengthen skills most critical to the enterprise now

CFO backgrounds tend to fall into three categories, several interviewees point out: accounting experts (who may be former controllers), capital markets professionals (often with investment banking backgrounds), and those with operational experience in helping business teams propel performance. While few individuals possess deep knowledge of all three, a CFO has to be conversant in each one. "No CFO checks every box," says Kreidler. Candidates should try to "check as many as they can, but focus on the big, important boxes, the ones that matter

'People leadership is central to the CFO role now more than ever.'

–**Warwick Bray**

Former CFO of Telstra. He sits on the boards of Spark New Zealand and Woolworths Group.

‘The more the CFO can standardize data and processes in the finance organization, the faster and more efficient the function is in supporting decision makers.’

–Axel Strotbek

Former CFO of Audi AG and Volkswagen Group China. He is a member of the ZF Friedrichshafen board and chairs the board of Codasip.

most to that organization,” he says—both within finance and beyond.

Just as with CEOs, the success of CFOs often rests on whether they possess the attributes the enterprise needs at a given time. It’s critical, therefore, for CFO hopefuls to assess their strengths and weaknesses against the company’s strategic needs for the coming three to five years, says Nayar. After an accounting scandal rocked Tyco in 2002, the immediate priority was to stabilize the company’s finances, he says. “When I came on board a few years later, the goal was to bring in strong controls so nothing that had happened in the past would ever happen again.”

What skills do finance leaders need today? They need to have strategic know-how and understand the key drivers of the business: financial, operational, and commercial. “The CFO can’t just sit in their office anymore,” says McLoughlin. “They have to be able to coordinate across the business, across functions, and get people to collaborate.” Critically, CFOs are responsible for the human element of the modern finance function—leading groups of professionals comprising a range of talent profiles. Warwick Bray, former CFO of Telstra, puts it bluntly: “People leadership is central to the CFO role now more than ever.”

Those are all table stakes. Beyond that, CFO skills and experience in two areas are particularly prized today: technology and sustainability. The rapid digitization of finance functions and corporate operations in general makes tech savvy critical. Hiring committees grill CFO candidates about their knowledge of digital transformation, cybersecurity, and generative AI.

“Today, technologies support finance in a much broader way than they did ten years ago,” says Strotbek. “The more the CFO can standardize data and processes in the finance organization, the faster and more efficient the function is in supporting decision makers.” Beyond technology’s operational benefits, the CFO should understand its potential impact on the company’s sector and business model.

Sustainability, both in the sense of climate considerations and broader corporate values, is another high priority for finance leaders. CFO hopefuls should understand the effects these issues have on financial reporting and what vulnerabilities and opportunities they present for the enterprise. “You don’t necessarily need to lead those functions, but you need to have good relationships with the people who do,” says McLoughlin, “and understand the role that finance plays across the spectrum of these topics, because there is no tolerance for missteps." Candidates also need to be mindful of companies' commitments to inclusion and diversity and should demonstrate a track record of paying close attention to inclusion issues, as well as recruiting and supporting diverse teams within the finance function.

One area our interviewees most emphasized developing was external stakeholder management. Several mentioned the sudden elevation into the public spotlight as something for which they were insufficiently prepared. As a CFO, you become the point person not only for shareholders but also for sell-side analysts, investment bankers, and the press, says Christopher Halmy, former CFO of Ally Financial. "The CFO has to be able to communicate the strategy and the results and build relationships in that external environment." To be able to "tell the story behind the numbers," as Bray puts it, you need to cultivate the necessary presence, communication style, and persuasion skills—then find opportunities to demonstrate them to the CEO and the board.

Before McLoughlin became CFO, she attended a few investor meetings, but she wishes she had had more exposure on that front because "you have to hit the ground running the day that you're announced as CFO," she says. "You're the one selling the company to investors, but you're 'selling' with the knowledge that there may be a heavy price to pay if you do or say the wrong thing."

Lead an initiative that really matters

One of the best ways to demonstrate readiness for the CFO role is to successfully steer an initiative that creates significant value for the enterprise, particularly if it involves collaboration with business units. "If you're to be promoted from within," says McLoughlin, "you have to build relationships and trust with the business teams because you want their support. You want them to be comfortable that you have the knowledge and ability to help them do their jobs."

The CEO and the CFO are typically the only ones who have visibility across functional or divisional

'The CFO has overall responsibility for driving operating linkages across the whole business. To do that, you need to have credibility and demonstrated ability to work with each business or functional leader.'

–**Marjorie Lao**

Former CFO at LEGO Group and senior vice president and CFO at Tandberg (now part of Cisco Systems). She sits on the boards of GoTo (GoJek/Tokopedia) Indonesia, Logitech, and MYT Netherlands.

lines, Lao points out, which makes a track record of partnering with other departments a differentiator for a CFO candidate. “The CFO has overall responsibility for driving operating linkages across the whole business,” she says. “To do that, you need to have credibility and demonstrated ability to work with each business or functional leader.”

Ultimately, CFO hopefuls need to be known for something. “You have to do a few things that lead everybody to say, ‘We are much better today than we were yesterday,’” says Nayar. When he was Tyco’s treasurer during the financial crisis, for example, the company received three credit rating upgrades. “A number of board members came to me when we got an upgrade [to say] they felt it was unique that we were able to find our way through this storm and come out strong,” he says.

In Lao’s case, her proving ground at Tandberg was M&A: she led a significant acquisition that gave the company an important competitive edge. Halmy made his reputation transforming the treasury function at General Motors Acceptance Corporation (GMAC) before it became Ally and implementing data-driven technology to power decisions. That success led company leaders to tap him to help prepare the organization for an IPO. As a CFO prospect, “that gave me the leg up from the board’s perspective.”

Making a major bet at a pivotal point in your career takes guts, of course. For Strotbek, assuming the role of Volkswagen’s CFO in China at the age of 40 was a risky move. “I had close ties to the headquarters, but once you’re out there, you’re pretty alone.” During his tenure in China, he focused largely on growth: when he started in 2004, Volkswagen’s market share had dropped from 50 to 15 percent in the wake of a competitor influx following China’s joining the World Trade Organization, says Strotbek. “We had to reinvent ourselves, both operationally and in terms of product technology.” He must have done something right because three years later, he was appointed CFO of Audi, Volkswagen’s premium brand. The experience led him to later send potential CFO successors to China so they, too, could learn from the challenges the market presented.

Find opportunities to engage with the CEO and the board

Let’s face it: to have a shot at the CFO job, you need to be on the CEO’s and the board’s radar. Leading a financial planning and analysis (FP&A) team is one of the better finance positions to get that visibility because it’s closely aligned to the business, says McLoughlin. “It’s got some finance and some strategy to it,” she says. “You might have mini-CFOs in your FP&A group and oftentimes they are controlling the budgets.”

‘The CFO needs to be the person who can tell the CEO ‘No,’ and there are few such people.’

–**Christopher Halmy**

Former CFO of Ally Financial. He sits on the boards of Burford Capital and Mercury Financial.

Consequently, it's natural for the FP&A head to lead the budget presentation to the board. One of the boards McLoughlin sits on regularly invites finance executives to its meetings. "At every meeting, we include someone who is at least one, if not two, layers down from the CFO so they get exposure to us, and we get exposure to them."

Having a specialized set of skills can make you the go-to person for company leaders on specific issues. For example, Bray's experience in investment banking honed his understanding of valuation and investment returns. During his time leading Telstra's mobile business, he was often invited to board and investor meetings to discuss the economic influences and returns on capital in that unit. That exposure made him a known quantity when the board was looking for a new CFO.

Since the CFO role is to be both an ally of the CEO and a source of sober second thought, developing the chief executive's trust is invaluable to a CFO hopeful. Halmy credits his CEO's confidence in his judgment with giving him an advantage as a candidate. "The CEO said, 'That's the guy I trust to do this.'" The reason for that trust, Halmy believes, lays partly in his willingness to candidly share his thoughts with the top boss. Says Halmy, "The CFO needs to be the person who can tell the CEO 'No,' and there are few such people."

Do you have what it takes to be a CFO? The answer may be "Not yet." But by rounding out your experience, daring to make big career bets, and building support within the organization, you can develop the credentials and relationships needed to become a strong candidate. Invest in realizing your own potential, and the confidence to go after the job will follow. As Nayar points out, "The biggest drawback to our ambitions is us—our lack of belief in ourselves."

Andy West (Andy_West@McKinsey.com) is a senior partner in McKinsey's Boston office, **Ankur Agrawal** is an alumnus of the New York office, **Christian Grube** (Christian_Grube@McKinsey.com) is a partner in the Munich office, and **Karolina Sauer-Sidor** is an alumna of the Madrid office.

Advanced FP&A practices for a volatile macroeconomic and business environment

Great models help leaders understand complexity and navigate through uncertainty. Six practical steps for better financial planning and analysis (FP&A) are essential.

by John Kelleher and Marla Capozzi
with Dean Di Giorgio

It isn't easy to forecast the next two to three years when macroeconomic conditions and business dynamics are profoundly complex. Yet as technology races ahead—a major (but by no means only) driver of disruption—many companies continue to build models with the same flawed approaches they've been using for years. Even when their forecasts do approach the bull's-eye, critical data points and assumptions are unclear, inconsistent, or missing entirely.

The mark of a great model is that it's *not* an oracle. Instead, a best-in-class forecast presents actionable insights by being transparent, consistent, and ever-improving. Projections need to be flexible and quickly adaptable. In this article, we identify six practical steps for financial planning and analysis (FP&A) teams to deliver more accurate forecasts—particularly under uncertainty.

Use a clear probability value for all major assumptions and for the model overall

As we've noted for years, probability-weighted, scenario-based forecasts produce the most reliable results. In many FP&A models, however, probability levels are applied haphazardly or not at all, which can lead to very poor decisions. Consider a choice to allocate the same amount of capital for a 90 percent chance of $100 million net present value (NPV) over the next three years versus a 50 percent chance over the same period for $150 million NPV (that is, an expected NPV of $90 million versus $75 million). Framed that way, the choice seems obvious—or, at least, lends itself to more informed debate. But too often, probabilities aren't stated. At one recent North American conference, about 15 percent of senior executives shared that they had never seen a probability value in a cash flow forecast.

If an FP&A department is not using explicitly stated and aligned upon probability values in its forecasting, the results will likely vary widely. For example, in building a cash flow mode, a colleague from one business unit may have used a P10 (that is, a plan that has a 10 percent chance of occurring), and a counterpart from a different business unit may have used a P90 (a plan with a 90 percent chance of occurring) in their consolidating cash flow models, while *neither stated the probability value they used*. These inconsistencies, multiplied across businesses, can lead to highly flawed results.

Being clear about probability values, on the other hand, has second-order benefits. Identifying, for example, a 60 percent probability is a helpful spur to understand what it would take to achieve much higher probability (such as by diversifying suppliers, if the uncertainty hinges on supply constraints). Moreover, when one business unit head presents results by using probability values and confidence levels, we tend to see that other business unit heads feel compelled to do the same. This allows both the head of FP&A and the CFO to develop a better sense of consistency across the businesses. Effective finance leaders, in fact, recognize that a discussion about core assumptions is in itself a process that leads to better decision making. That feeds into another, related best practice: there should always be one—and only one—owner of the model, ideally the head of FP&A. When a model lacks a single, identifiable owner who specifically vets probability values, those values (even when they are indicated in the model) may not be as robust as they appear.

Lay out the true momentum case—and then show management initiatives on top of that

A great forecast starts with a do-nothing momentum case, which presents how the company's businesses are likely to perform based on current trends if managers were to take no additional initiatives. It may sound obvious, but in practice very few businesses model a base case this way. Instead, even when a base case is shown to be declining—let alone when it is presented as plateauing or increasing—it usually builds in planned management initiatives. Strip those out. A momentum case is your bedrock; when you can't show it starkly, every subsequent investment decision can be distorted and amplified by errors such as double counting, overly optimistic (or pessimistic) assumptions, and numbers based on nonrecurring gains or losses.

Once the true momentum case is laid out, the model should then identify management initiatives and present their potential outcomes in layers (exhibit).

Forecasting this way allows for greater accountability—and credit—based on how the initiatives actually fare. It also allows companies to set high but realistic stretch goals. For example, a plan could show that if a company were to introduce a high-potential new product, get to market within 12 months, and achieve a market share of 15 percent within two years, operating profit would increase by seven percentage points. If it were to beat those targets by specified amounts, the plan should show the percentage-point difference that would flow through the P&L. That level of clarity allows not just the CFO but also the CEO and other senior leaders to focus specifically on what's needed to achieve transformative results.

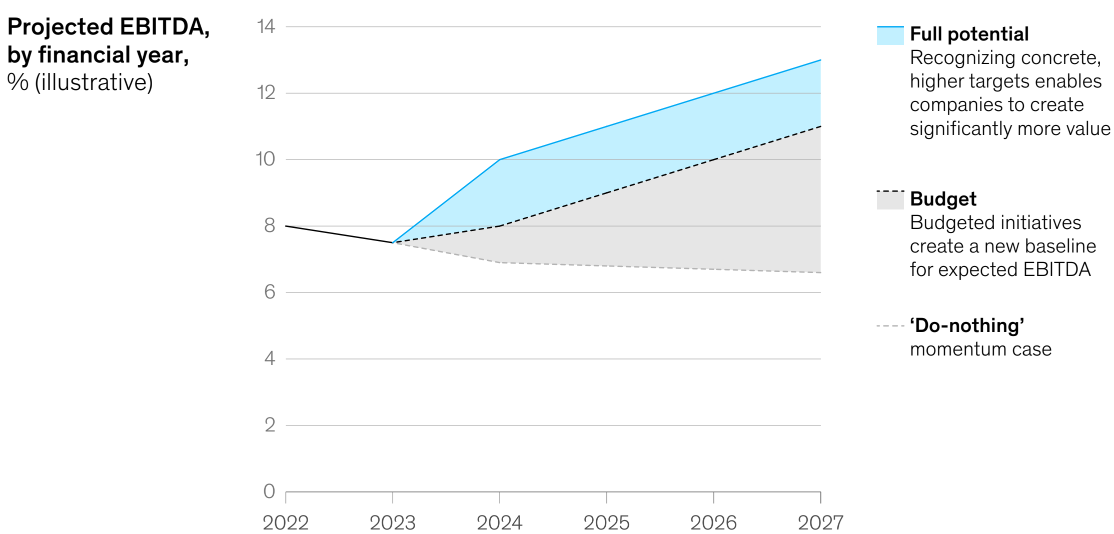
Spell out the 'bear case'

Mike Tyson, the former champion heavyweight boxer, once observed that "everyone has a plan until they get punched in the mouth." Few things, after all, go perfectly as planned, and there's at least a *chance* that a forecast (even one that makes sound assumptions, disaggregates key inputs, clearly layers management initiatives, and assigns appropriate probability levels) will fall well short of the best case—or even a good one. After all, if a forecast has a 70 percent chance of happening, that means it has a 30 percent chance of not happening.

Remarkably, we find that many companies are more likely to plan for a true left-tail event (that is, an outcome that, in a normal distribution, would occur less than 5 percent of the time) than for a not-quite-as-bad bear case, which would be much more probable. A one-in-three or one-in-four chance is not remarkable, and management should not find itself blindsided if it occurs. A great forecast explicitly lays out a bear case, showing what the

Exhibit

Effective FP&A models save time and achieve stretch goals by clearly identifying potential outcomes.



Note: FP&A = financial planning and analysis.

McKinsey & Company

likely drivers would be, what the consequences would mean for cash flow, and how future investments and decisions about capital structure could be affected. Understanding a bear case helps planners not only manage a poor outcome should it occur but also adjust probability levels as key indicators change in advance of that outcome. Too often, postmortems reveal that companies could have taken mitigating actions much sooner. They failed to do so because they never rigorously thought a bear case through.

Make macroeconomic assumptions clear and consistent

We've all seen them: complex, multi-input models that seem at first glance to be comprehensive. But dig a little deeper, and you can find that some of the most important assumptions are inconsistent, unsourced, or missing entirely. This is particularly true for macroeconomic assumptions.

Consider, for example, investment decisions in a country that sees wide swings in GDP. A robust model in that case should clearly highlight the country's GDP assumptions. In fact, even when making forecasts for mature industries that operate in historically stable economies, it's worth pressure testing whether growth (or costs) don't appear unmoored from macroeconomic realities. Yet in too many forecasts, GDP growth is either not an input or is simply inputted without a source—or differs across business units *in the same country*. For example, a forecast for a consumer-packaged-goods company might assume a two-percentage-point increase in GDP growth when modeling sales of "Product A" in one country, and a five-percentage-point increase in GDP growth in the same country for sales of "Product B." That means that at least one of these forecasts is flawed. Possibly, they both are. While not all industries are highly dependent on GDP (high-tech and pharmaceutical companies, for example, are much less affected than companies in, say, the banking or construction sectors), a good rule of thumb is to at least question how changes to GDP or other macroeconomic factors have historically affected the business—and include in your projections the changes that have been most material.

Moreover, all macroeconomic assumptions used should be sourced and kept consistent within their specific country. Better practice is to adopt a median from a few credible, independent sources, making the methodology transparent or, better yet, allowing the model to weight those sources by historical accuracy. Best practice is to look at the patterns of assumptions and compare them with actual results so leaders can learn and ensure that their models learn as well.

Disaggregate inflation rates—'average' inflation can be wildly inapplicable

In our experience, companies typically include industry-specific metrics that matter most for their businesses, such as revenue per available room if they manage a chain of hotels, the size of a country's carbonated-beverage market if they manufacture soft drinks, and the costs of key resources. Sophisticated companies also include publicly available competitor data.

But as well as they know their own businesses, they often make a common, critical mistake when modeling one driver—inflation. In too many forecasts, the inflation rate is presented as a single number, such as the consumer price index (CPI), across every business in a single country (and sometimes worldwide). But why? In the United States, the CPI is a basket of approximately 94,000 goods and services. Large companies don't buy baskets. Instead, they depend heavily on a few select components, whose individual inflation rates can vary substantially. While businesses are at least indirectly affected by hundreds or even thousands of those components, the Pareto principle invariably applies: a few goods or services have tremendously outsize effects. These should be modeled based on disaggregated inflation rates.

As is the case with macroeconomic assumptions, inflation and industry-specific sources should always be clearly identified and can be weighted and automatically adjusted. And though it seems extraneous to add, disaggregated inflation rates should match not only across business units in the same country but also on the revenue and cost sides. Sometimes, we see models where inflation rates for a single product in a single country fail to align—typically because one part of the model defaults to a broader average, and another incorporates a more specific number. That means there's a mistake. Fortunately, it's easily fixed, particularly when sources are clearly indicated.

Relentlessly back test models and reduce variances

Building a model is a process; the point is not just to produce accurate numbers but to generate a constant, evolving series of outputs that become even more accurate, more rapidly, as the forecasted period plays out. It should be obvious that a sophisticated model cannot be one that you "set and forget." On the contrary, setting up the model is just the first step. Projections can be compared with actual results every week—and, sometimes, more often than that.

Sophisticated back testing delves into aggregating details. It may be, for example, that overestimations of some stores canceled out underestimations of others, or that cost of goods sold was very close to the forecasted amount, but components of, for instance, SG&A varied wildly—and that the divergence was netted out by interest expenses that were higher (or lower) than predicted. Companies can't manage a variance if they don't measure results with granularity.

As teams examine variances, they can often identify clear patterns. In one North American–based consumer-packaged-goods company, for example, back testing revealed that forecast monthly sales were overestimated by about five percentage points, month after month—a variance that proved easy to address but could have been corrected much earlier if the team had been conducting back testing every week. Moreover, back testing enables companies to get smarter about how much weight to assign a given component used to make macroeconomic assumptions (such as forecasts of GDP or inflation) and continually fine-tune the model. Revisiting assumptions has always been best practice, even if the process was tedious and too infrequently undertaken. Today, back testing can be automated significantly, and patterns can be identified more precisely by using AI, including generative AI.

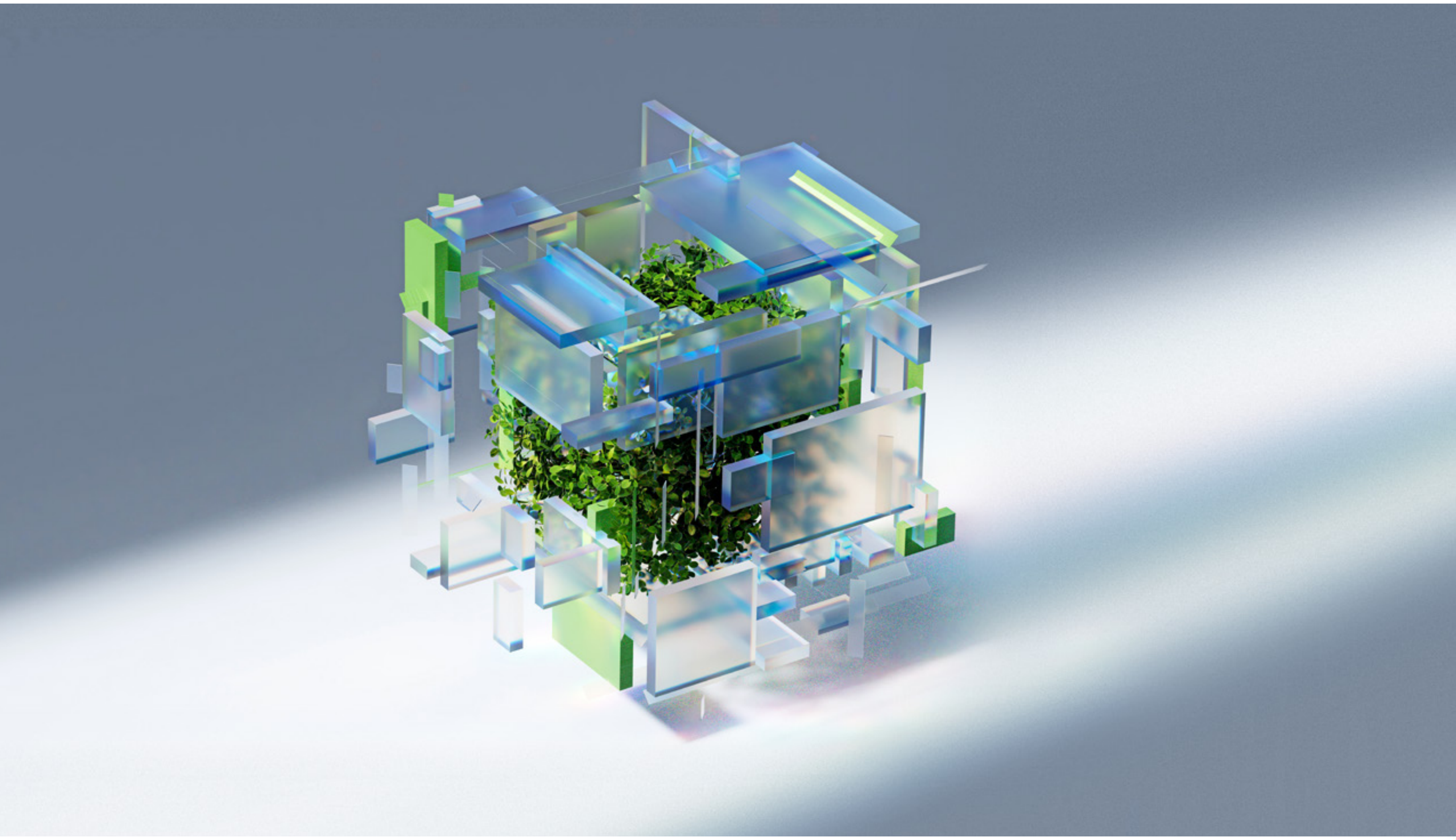
It's hard to make an accurate forecast in the easiest of times; it's almost impossible when conditions are uncertain. But even—indeed, especially—in the face of tremendous complexity, FP&A teams can take specific actions to achieve clearer insights. Six of the most consequential practices are remarkably straightforward. CFOs and their FP&A teams can begin adopting them today.

John Kelleher (John_Kelleher@McKinsey.com) is a senior partner in McKinsey's Toronto office, **Marla Capozzi** (Marla_M_Capozzi@McKinsey.com) is a partner in the Boston office, and **Dean Di Giorgio** (Dean_DiGiorgio@McKinsey.com) is an associate partner in the Montréal office.

Managing carbon: A new role for the CFO

Better carbon management can be a competitive advantage. Here's how CFOs across industries and markets can move beyond "check the box" compliance and enable strategy-driven, carbon-based decision making.

by Hemant Ahlawat, Peter Spiller, and Tim Koller with Erik Ringvold



Carbon emissions are a global challenge, but the way each company responds to the risks and assesses new opportunities should be highly case specific. While compliance is critical, strategy should matter most of all. CFOs must ensure that their organizations meet customer priorities, adapt to regulatory changes, and develop an informed view of carbon management tools. Too often, companies can have multiple, inconsistent, and ineffective carbon data and analyses across their organizations—or lack meaningful emissions data entirely. The finance function is where carbon should meet numbers. In this article, we'll discuss how CFOs can help their organizations assess carbon's importance to strategy, and use emissions data to improve decisions.

The CFO challenge

Across industries, sectors, and company sizes, CFOs not only ensure effective compliance and reporting, but they also play a key role in realizing the organization's core strategic objectives. Carbon management is no exception.

For some companies, tracking and reporting carbon emissions is mission essential, legally required, or both. In addition, particularly in Europe, regulators mandate that companies not only disclose their emissions but also increase their level of assurances—as they would for financial reports.[1] Moreover, a failure to report emissions accurately can have financial and reputational consequences for companies worldwide.

Yet the optimal setting for carbon management is not necessarily "more is better." Different markets have different regulations, including with respect to the quality of assurances that must be given.[2] The status of US climate disclosure regulation, for example, is currently unsettled.[3] Nor is the value-creating proposition of carbon management universal. Investing in inapplicable processes and tools, for example, squanders company resources, and forecasting price premiums requires disciplined analyses.[4]

Carbon management is highly context dependent: the challenges that a United States–based software or biotechnology company confront are clearly different from those faced by, for example, a steel, cement, or energy corporation based in Europe, or a media company in an Asian market. For a CFO—who is at the intersection of strategy, reporting, and resource allocation—it's essential to ensure that the company's carbon management initiatives are consistent within the company's strategic and compliance needs—and attuned to the needs of key external stakeholders.

The optimal setting for carbon management is not necessarily 'more is better.'

[1] In particular, the Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022, amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC, and Directive 2013/34/EU, as regards corporate sustainability reporting.
[2] "A regional comparison of ESG regulations," *Asia Business Law Journal*, August 4, 2023.
[3] See, for example, "SEC stays climate disclosure regulations in response to consolidated Eighth Circuit challenges," *National Law Review*, April 18, 2024; and Paul Davies, Sarah Fortt, and Betty Huber, "The case against the SEC's final climate rules begins in earnest (and what it means)," Harvard Law School Forum on Corporate Governance, April 20, 2024.
[4] See "The hard stuff: Navigating the physical realties of the energy transition," McKinsey Global Institute, August 14, 2024; "How playing offense on sustainability can power e-commerce performance," McKinsey, March 26, 2024; Rob Bland, Anna Granskog, and Tomas Nauclér, "Accelerating toward net zero: The green business building opportunity," McKinsey, June 14, 2022; and "Setting value, not price," *McKinsey Quarterly*, February 1, 1997.

Many essential customers across borders do want to understand a product's carbon footprint, and are beginning to demand greater transparency into underlying metrics.

Many essential customers across borders *do* want to understand a product's carbon footprint, and are beginning to demand greater transparency into underlying metrics. Businesses that use robust carbon reporting can provide their customers with greater transparency, as well as better inform their own opportunities to identify new, differentiated, green-product offerings. Compelling business cases become even stronger under rigorous regulatory frameworks that have global effects, such as the European Union's Carbon Border Adjustment Mechanism (CBAM).[5]

Moreover, CFOs can use carbon reporting to help reduce decarbonization costs. Not only can they zero in on their most important emissions drivers, but they can also make decarbonization efforts more cost-effective by enforcing uniform metrics within the company and improving accountability organization-wide. Investing in more accurate and more granular data can also help inform discussions with suppliers; in fact, many leading value chain players already require supplier disclosure on production-related emissions, and consistent data makes it easier for suppliers to meet emissions targets. And, critically, many investors will expect rigorous detail to understand a company's intrinsic value under various carbon pricing scenarios. These analyses are possible only with robust carbon accounting.

Finally, carbon compliance may be more complex than it initially appears. The implications can range beyond reporting emissions data to include carbon taxation, expenses under emissions-trading frameworks or carbon border adjustment mechanisms, and voluntary carbon mitigation costs such as carbon credits. Firms that lack detailed emissions data will need to fall back on generalized emissions factors to estimate emissions across scopes. These estimations tend to rely on generalized industry-level averages that are neither tailored to each company's specific operations (or those of its value chain partners) nor fully reflect more recent sector improvements. Relying on general frameworks can also be less cost effective. For Scope 3 estimates, rigorous value chain carbon accounting ecosystems such as the Partnership for Carbon Transparency (PACT) of the World Business Council for Sustainable Development can help significantly improve accuracy and reduce the costs of voluntary carbon credit portfolio targets that are in line with the Science Based Targets initiative (SBTi) criteria.

Defining a finance function vision

Today, most companies perform carbon accounting in a rudimentary way, which can limit their ability to keep ahead of regulatory developments and potentially create new value. Core initiatives are often

[5] Regulation (EU) 2023/956 of the European Parliament and of the Council of 10 May 2023 establishing a carbon border adjustment mechanism. In the United Kingdom, a similar regulation is scheduled to take effect in 2027.

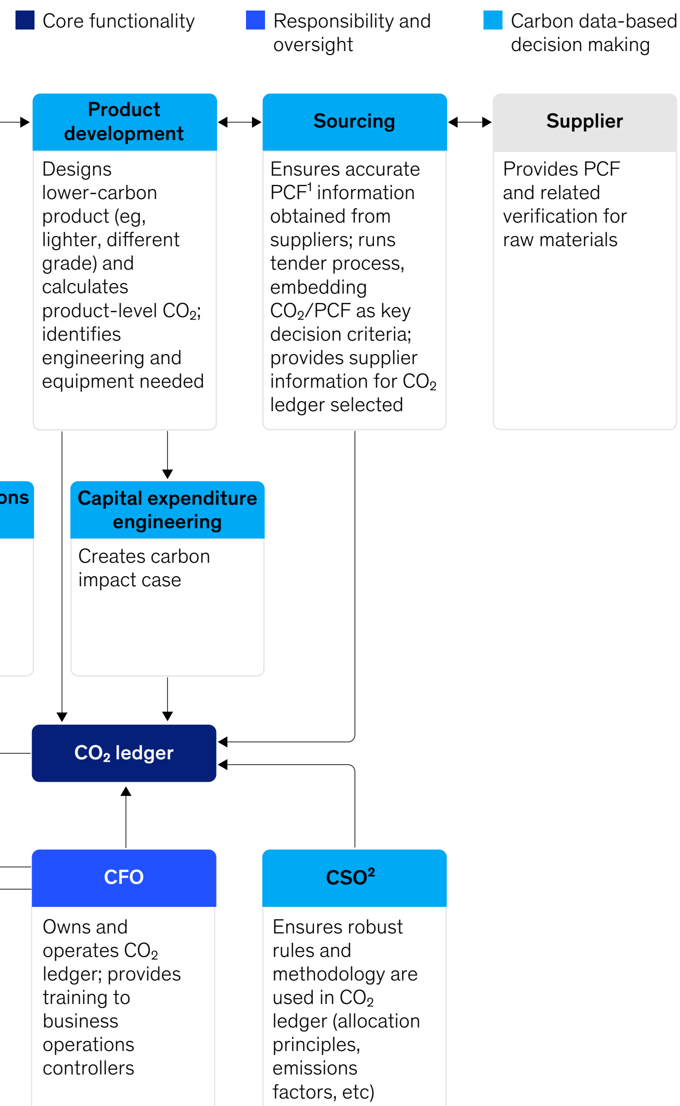
carried out by sustainability teams rather than the finance function. And, critically, carbon management can be driven more by regulations than by strategy.

But consider a finance function in which carbon accounting enables better decision making (exhibit). Finance teams would synchronize carbon accounting with financial accounting, using an

Exhibit

Multiple functions can use product-level emissions accounting to deliver value to the customer.

Illustrative case example



[1]Product carbon footprint.
[2]Chief sustainability officer.

McKinsey & Company

enterprise resource planning (ERP) system to produce a carbon or CO_2 ledger that mirrors relevant finance accounts and bookkeeping rules. Finance teams would also prepare business-relevant KPIs on carbon budgets, intensities, and target achievement, helping other business functions in their daily decision making. For example, if a company's customer for aluminum parts wishes to lessen its European CBAM exposure by reducing embedded emissions, the company's sales team would pass the requirement on to its product development team and work with the finance function to create an integrated business case that ensures a meaningful premium for the specially adapted low-carbon product. Product development would design the product by, for example, reducing materials use and using a low-carbon aluminum grade. The finance function would support the product carbon footprint (PCF) calculation and verification to align with the CO_2 ledger. These functions would also support capital expenditure engineering to create sound business cases that reflect both cost and carbon impacts for the newly required equipment. Sourcing teams, for their part, would scout suppliers that offer low-carbon aluminum grades, ensuring that relevant upstream PCF data on parts and raw materials get verified and reflected in the CO_2 ledger. Sustainability and finance teams would work together to ensure consistent usage of accounting standards, creating internal and external reporting and disclosure documents that are verified and audited by external parties, and oversee overall P&L and balance sheet impact both for financial and carbon effects. In time, these ledgers would integrate with public carbon markets.

Turning vision into action

Effective CFOs turn vision into action, using clear data to inform their decisions. For carbon-based decision making, our experience suggests that finance functions can obtain much clearer, incisive data and take practical steps now. In particular, they can drive consistency throughout the organization, improve internal processes, evaluate and implement the appropriate ERP system, and help ensure that finance has the capabilities and level of cross-organization coordination it needs.

Improving processes

When it comes to combining internal operations with external reporting, the finance function has a head start over other functions; finance professionals can draw from their experience working with accounting frameworks to help meet current and emerging climate disclosure regimes. In practice, that means leaning into lessons from the traditional financial-accounting playbook, such as establishing yearly processes for emissions target setting, determining carbon compensation targets, and budgeting for decarbonization interventions and carbon credits. The accounting function understands the concept of disaggregating and tracing activities (in this case, as they relate to carbon emissions) down to the transaction level, and in a standardized way (as pioneered by PACT), for all activities predicated on sharing data in the value chain. Moreover, they can provide clear emissions data and analyses organization-wide to help managers draw from carbon information to make critical business decisions.

Implement the appropriate ERP system

While well-designed processes are a necessary element of best-in-class carbon management, companies won't achieve game-changing impact without an appropriate ERP system. CFOs need sophisticated software solutions to handle the flow of carbon information and synthesize it in order to make the right decisions. As Dominik Asam, the CFO of SAP SE, explains, "To enable better decisions, CFOs need consistent data and metrics that connect directly to company financial reporting. Too often, businesses and functions within an organization produce different reports, use competing standards, and generate data that lack a clear strategic purpose. This misses the point of an ERP system—which is to accelerate company strategy rather than to slow it down."

Today, many companies are going through ERP upgrades for a wide range of reasons, even if the primary driver is not carbon management. Yet given current regulatory and competitive trends, now is a particularly compelling time to significantly improve carbon management capabilities. ERP systems can be immensely complicated and inflexible, which can complicate making updates and future upgrades. As such, companies are likely best served by approaching carbon ERP implementation with modularity (using APIs, for example) to reduce system dependencies and allow for easier changes in the next few years.

Several new and traditional providers are betting that the rapid growth in carbon accounting needs will lead to a booming market for carbon ERP solutions. Newer players include Persefoni, Watershed, Sinai, Plan A, Emitwise, and Normative, among many others. Emerging software-as-a-service solutions—particularly from earlier-stage companies—tend to offer rapid web-based installation and minimal workload and provide aggregated company information (that is, financial results by service line). These solutions have historically been targeted to chief sustainability officers rather than to CFOs. Their emphasis on speed and simplicity may, however, provide less detail than CFOs and investors are accustomed to.

Since investment decisions (sustainability based or otherwise) almost always involve trade-offs, selecting a solution that provides a basic output from simple tools may indeed be the best option. But for companies seeking to enable much more informed carbon-based decision making, data flows will need to be more thorough, and will likely grow even more detailed in the future. Indeed, in our experience, asking which tool is right *today* is often the wrong question; instead, the objective should be to ensure the organization has a solution and provider that can meet its needs over the longer term.

Multiple incumbent transaction system and ERP players seek to leverage their accounting expertise, integration of financial and carbon accounting systems, ecosystem synergies, and an installed base of large customers to meet more granular carbon accounting needs. Incumbent ERP providers have an advantage: they already process a large share of the company's data relevant for a step-up in carbon accounting maturity, such as bills of material, processing assets, and accounting and allocation rules.

What will the winning ERP solution look like? Robust carbon accounting to ensure regulatory compliance will be the minimum. Achieving product-level accounting—crucial for downstream customers—will require a much more rigorous capability for at-scale life cycle assessments, as demonstrated by BASF's SCOTT tool (see sidebar, "A case study in carbon management: BASF and SCOTT"). A PCF will be accurate only to the degree a tool supports primary data exchange from a company's supply chain. Yet once established, PCFs can be highly relevant to product sourcing, design, marketing, and pricing. These should be further enhanced by robust decarbonization analytics and tracking. Better carbon market intelligence would reduce compliance and voluntary costs. Ideally, each element of the solution would be automatically integrated into report preparation. An effective CFO will demand company-specific functionality to help create differentiating opportunities, including the ambition of overall carbon strategy, regulatory requirements in countries of operation, better insight into a complex product offering, and cost-effective integration with existing ERP systems.

Move beyond inertia

Shifting from a finance and accounting orientation to one that includes carbon management can sometimes feel uncomfortable for CFOs. Because CFOs are rightly attuned to maximizing long-term economic returns—a mission that clearly connects to financial performance and reporting (though, of course, accounting rules should not drive strategy)—it can be hard to prioritize emissions reduction.

A case study in carbon management: BASF and SCOTT

In 2021, BASF initiated the development of its Strategic CO_2 transparency tool (SCOTT). Today, SCOTT enables BASF to identify and publish granular carbon footprints for each of the 45,000 products it sells. SCOTT allows for possible product-level carbon accounting based on life cycle assessment principles across the company's entire product range. The tool uses a mass balance approach to calculate cradle-to-gate emissions using primary data, incorporating the effects of raw materials, manufacturing, utilities, energy consumption, transportation, and waste treatment of emissions.

To achieve this level of insight, SCOTT draws on data for more than 20,000 raw materials produced at 700 plants using 450,000 processes. The methodology is aligned with International Organization for Standardization (ISO) and Greenhouse Gas Protocol product standards, and the results are presented via a digital interface. The tool prioritizes efficiency, automation, and consistency when making calculations—a dramatic improvement compared with time-consuming one-off manual expert product carbon footprint assessments.

By providing clear data on product emissions through SCOTT, BASF can help its downstream customers calculate their emissions from purchased materials and make more informed decisions to reduce these emissions in line with any emission-reduction targets they may have set. BASF has used the value add of carbon transparency as a differentiating factor to attract (sustainability-conscious) new customers and develop lower-carbon products based on renewable or recycled raw materials. In addition, as the stringency of carbon reporting requirements increases, BASF may be able to derive a green premium for its products.

BASF also uses SCOTT as it makes capital expenditure decisions, elevating estimated product footprint to an essential KPI. By understanding the factors that drive product-level carbon footprints, the company can take a more focused approach toward investing in reducing its largest sources of emissions and help achieve its unique emission-reduction ambitions. In parallel, the targets of key executives also include carbon emissions. Reductions are tracked and measured in SCOTT.

Indeed, SCOTT facilitates carbon-based decision making throughout the organization, including among product managers and controllers trained by the finance and sustainability functions, which hold joint oversight of the tool, run business cases, and incorporate carbon into their daily decision making. SCOTT outputs feed into monthly reports to track progress. BASF uses the same forums as it does for traditional accounting, although not yet with the same frequency, and runs a regular cadence of meetings with managers across the organization to identify and address pain points and test new use cases.

As a first step, CFOs should define their company's carbon accounting aspirations: Why is carbon accounting important to this company? Is the goal to meet regulatory standards, or are there material risks in failing to meet the needs of key stakeholders or falling short of capturing clear growth opportunities? It's helpful to ensure that voices from beyond a traditional finance and accounting background are in the room, since both the risks and the opportunities may be greater than initially assumed. Among other actions, a CFO should outline what the company intends to achieve with improved carbon flows, assess mandated disclosures and the year by which the company must achieve a reasonable level of assurance, and define and prioritize use cases where carbon accounting could preserve or create value—from designing and measuring the impacts of effective decarbonization initiatives to making product-level claims for customer engagement and pricing to guiding emissions-informed sourcing and procurement.

Second, CFOs should identity key gaps that must be bridged. For example, it's helpful to map how carbon accounting will build on and fit into existing systems and processes; zero in on competencies, skills, systems, and software that may be missing; and begin identifying and perhaps even selecting providers to support carbon accounting and management, as well as providers of necessary auditing or verification.

Finally, if the strategic rationale is compelling and the gaps can be filled in a value-creating way, CFOs should begin implementation. This typically requires the function to create a road map that specifically spells out the amounts and timing of resources to be allocated to use cases. Nor is allocating *capital* enough; talented employees need to be trained or brought in-house. Decarbonization efforts that have the greatest impact across scopes should be prioritized and followed through in negotiations of customer and other contractual agreements, to reflect the incremental value of emissions tracking and to inform carbon credit purchases—including, when applicable, for Scope 3 emissions compensation.

Carbon management is at the intersection of strategy, compliance, finance, and technology. It's a "hard problem," and one that CFOs are uniquely positioned to help solve. As regulatory standards strengthen, customer demands increase, and new tools emerge, effective CFOs will help their organizations to not only meet reporting requirements but also determine when to integrate carbon management into decision making in order to create value.

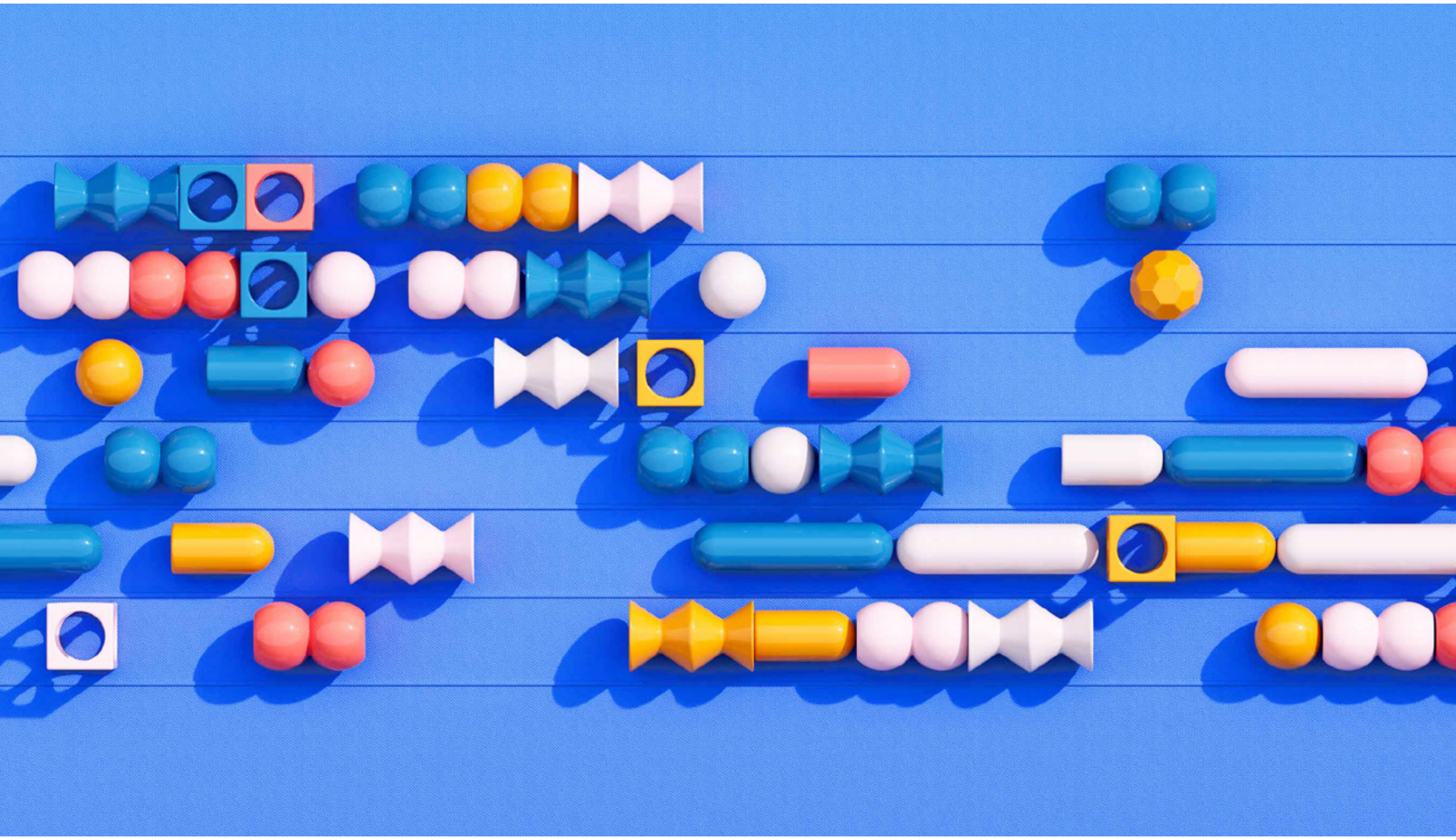
Hemant Ahlawat (Hemant_Ahlawat@McKinsey.com) is a senior partner in McKinsey's Zurich office, where **Erik Ringvold** (Erik_Ringvold@McKinsey.com) is an associate partner; **Peter Spiller** (Peter_Spiller@McKinsey.com) is a partner in the Frankfurt office; and **Tim Koller** (Tim_Koller@McKinsey.com) is a partner in the Denver office.

The authors wish to thank Christian Grube, Jonathan Scott, Thomas Kansy, and Werner Rehm for their contributions to this article.

Active portfolio management: Five practical insights for value creation

Economic upturns come and go, and cost-optimization programs take an organization only so far. But active portfolio management is the underutilized key to creating the most value.

by Andy West, Anna Mattsson, and Jamie Koenig with Santiago Garcia



Active portfolio management should always be "Plan A." Corporations that consistently refresh their business mix outperform their peers in TSR by 3.5 percent over the long term, honing their portfolios to develop, acquire, and divest businesses to realize their enterprise strategy. The goal, after all, is not growth for growth's sake but to maximize returns—which is achieved through a combination of growth and investing capital in an enterprise's most important priorities. Yet despite its demonstrable success, the power of active portfolio management can go overlooked, a litany of excuses standing in the way of change. Remarkably, headwinds and tailwinds are often identified as the leading factors affecting financial performance, even when results are driven more by a strong strategy, solid execution, and traditional competitive forces at work.

Now, as the postpandemic growth boom subsides and a wave of cost-optimization programs runs its course, effective senior leaders are returning to first principles. They seek to maximize free cash flow from invested capital, making sure that each business aligns with company-specific capabilities and industry-critical trends. The best-performing corporations constantly consider whether they're the right owners of every business in their portfolios. Then they act with intent: reallocating capital toward strategic priorities, acquiring *and* divesting businesses to align with their strategies, reinvesting proceeds into valuable opportunities, and overcoming decision biases to create more—and ideally, substantially more—shareholder value. Since markets evolve and competitors are constantly on the move, it's unrealistic to expect that a portfolio that matched competitive conditions just a few years ago should remain the same today, let alone in the next few years. And because your company ultimately has finite resources (especially when it comes to capital, talent, and management attention), it's unrealistic to expect that a static approach to resource allocation will enable each of your businesses to win and keep winning in their respective markets. In this article, we'll look at five key insights for senior leaders as they take a fresh focus on active portfolio management.

1. Benchmark each asset's performance against its external peers, not against one another

Let's start with a quick quiz: If your corporation has an overall CAGR of 5 percent and owns a specific business that delivers a CAGR of 25 percent, is that business a keeper? The answer: it depends. If the business unit's market growth is in line with its peers, then it likely could be an important, and perhaps neglected, source of value creation. But if the business unit's market is growing at, for example, 40 percent per year—in other words, 15 percentage points faster than its own 25 percent CAGR—then it's an underperformer; the operation is losing share and likely destroying value. It may need material investments to catch up and start winning. At a minimum, the causes for the underperformance should be diagnosed. Quite possibly, far from being a unit to invest in, your company should actually *divest* the business.

2. Be pragmatic about the real portfolio synergies that exist among your businesses and understand the upside that other owners could offer

There are trade-offs to owning different businesses regardless of their earnings. Each project in your portfolio competes for corporate resources—not just capital but management attention and organizational talent as well. It's possible that synergies among your businesses pay for these costs, ideally many times over. Traditional sources of cross-asset synergies include selling (customer relationships, sales channels, access to markets or geographies, a "brand umbrella," and specialized marketing expertise), producing (manufacturing footprint and utilization, supply chain network, engineering or production talent, and R&D expertise), and competitive insight (management expertise and access to market knowledge).

But it's also possible that owning separate businesses results in "dis-synergies." For example, a generics pharmaceutical business requires different capabilities from a pharmaceutical company with a portfolio of proprietary medications or a newer, typically nimbler biotechnology company; and a commodity chemicals business can be quite distinct from a specialty chemicals operation. Your businesses' SG&A needs can vary substantially.

If portfolio businesses don't contribute to one another, or if there is a list of material growth or margin opportunities that business unit teams are struggling to execute, perhaps a different industry player or an experienced private equity acquirer could deliver more upside—and pay a premium for the opportunity. The proceeds could then be invested into opportunities where your company has a clear competitive advantage, or released to your shareholders. The objective, again, is not to grow for growth's sake; it's to realize value on the capital your shareholders have entrusted you with.

3. Recognize and mitigate your own biases

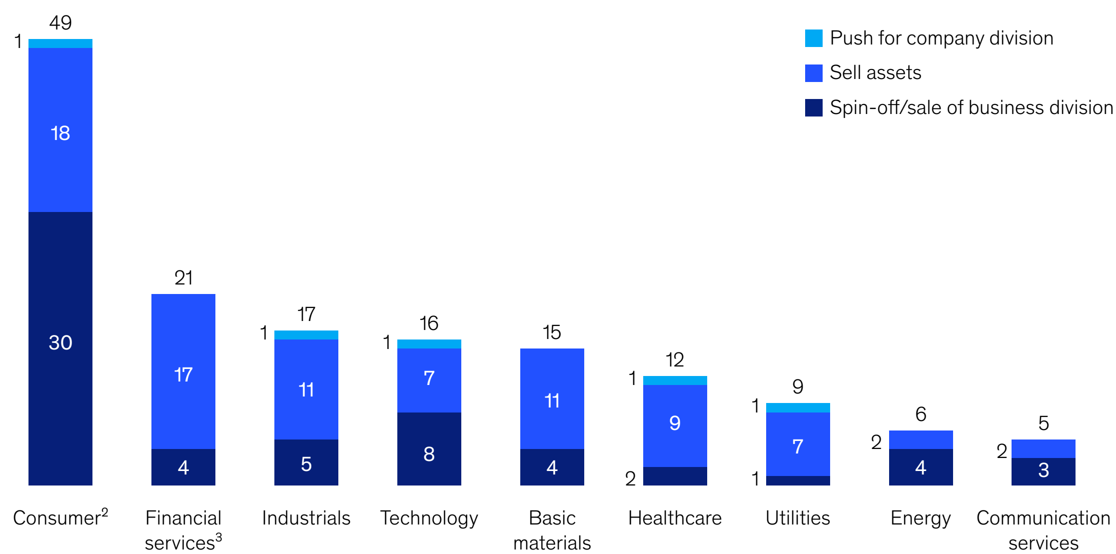
Value creation can be foiled by decision biases—particularly (but not only) when it comes to sunk costs. It's hard for senior leaders who may have made their mark by building up a division to sell once its trajectory has plateaued. Yet a perennial hockey stick projection is as unlikely to pan out this year as it was last year, and facing disappointed investors won't get any easier. For better or worse, activist investors don't get anchored in management biases. Executives who hold together a suboptimal portfolio for too long stir a recipe for activist interest (exhibit). Usually, it makes sense to at least hear out activist arguments.

Executives may also hesitate to pursue divestitures due to concerns about complexity, a perceived lack of interested buyers, and apprehensions about total enterprise size and earnings (however much

Exhibit

Incumbents across sectors can come under scrutiny from activist investors.

Companies publicly subjected to activist demand, by sector, Jan 2023–Sept 2024,[1] number



[1]Includes multiple activists' campaigns against one company; excludes gadfly investors. Data updated as of Sept 4, 2024.
[2]Consumer is made up of "consumer cyclical" and "consumer defensive."
[3]Financial services includes "real estate" and "funds."
Source: Activist Insight database

McKinsey & Company

executives *know* it's preferable to lead a more value-creating company, it can still be tempting to run a larger one). To overcome decision biases that can affect business mix, leaders can take practical steps such as changing the burden of proof (that is, establishing, at least as a thought exercise, that a divestiture should be the default outcome for each business unless managers can prove why it should be retained); strictly categorizing businesses as "grow, maintain, or dispose"; and enforcing an explicit ranking of businesses by order of potential value creation. As usual, there's no substitute for building and presenting a robust and stark discounted cash flow analysis and laying the results on the table. Emotional attachments should not be stronger than tangible returns.

4. There's a cost to waiting—so get moving now

Trying to time the market is hard. Consider divestitures: an ill-fitting or noncore asset is unlikely to be worth significantly more in one or two years under your ownership—and certain to become even less of a strategic priority with each passing month, which, of course, means that its value will only decline compared with peers whose owners provide them with the resources they need. Yet in one recent survey, 77 percent of respondents reported that a divestiture decision was delayed by managers or the board.[1] Those results are consistent with our experience. Managers consistently wait too long to sell assets, even as these businesses lose more value. By contrast, leaders who free up capital today have more options to invest in growth priorities for the businesses where they do have the capabilities to succeed.

Fighting inertia is equally challenging when it comes to acquisitions that bolster your strategic portfolio. The temptation to wait for an incrementally better price should be tempered by the cost of lost time and the possibility that the seller may decide not to divest after all—or to sell but to a different buyer, particularly one of your competitors. Moreover, capturing deal synergies takes time; very few acquisitions are truly plug and play. Even fast-moving integrations can take 18 months to two years to capture most of the synergies. We've found that programmatic acquirers are committed to pursuing the right acquisitions, even at a higher price, so long as a transaction creates long-term value. For sure, the risks of overpaying or conceding too much in deal negotiations should not be trivialized

Leaders who free up capital today have more options to invest in growth priorities for the businesses where they do have the capabilities to succeed.

[1] McKinsey 2024 Separations Survey; n = 83.

and can result in real costs themselves. Yet at all events, a positive outcome starts with committing to the deal thesis; if a transaction makes strategic sense, it's best to start immediately and keep an open mind along the way.

5. Divestitures may be more complicated than they initially appear

As soon as a divestiture decision is made, most managers want to "move on" from the asset. But not all divestitures are created equal, and often a separation needs to be tightly managed. In fact, we've found that 45 percent of separation programs take longer than expected. Leaders cite greater complexity in business separations than they initially foresaw and a lack of dedicated internal resources as the most frequent causes for a delay. Regulatory delays are also increasing—but not always in predictable ways, which only adds to variability and uncertainty.

The challenges underscore that while portfolio management is a strategic undertaking, poor execution can frustrate the best of plans—and that tactical excellence can be a difference maker. Active portfolio management is an ongoing process, both in terms of determining the optimal business mix and following through with the resources and engagement needed to bring it to fruition. It takes insight and effort to create substantial value for shareholders. The lessons are evergreen. With many experts currently forecasting an uptick in buy-side opportunities, there's no better time for managers to take a fresh look at their portfolios and get moving on turning conceptual refreshes into value-creating action.

Successful companies change their business mix year after year, and many of the most effective CEOs of the past two decades succeeded precisely because they doggedly refreshed their portfolios, particularly through acquisitions *and* divestitures. Waiting too long to change your business mix, by contrast, invites a worse outcome. Markets are constantly changing, and your competitors aren't sitting still. The ideal time to get going is right now.

Andy West (Andy_West@McKinsey.com) is a senior partner in McKinsey's Boston office, **Anna Mattsson** (Anna_Mattsson@McKinsey.com) is a partner in the Zurich office, **Jamie Koenig** (Jamie_Koenig@McKinsey.com) is a partner in the New York office, and **Santiago Garcia** (Santiago_Garcia@McKinsey.com) is an associate partner in the Miami office.

The role of HR leaders in M&A: An interview with Lisa Blair Davis

The global head of HR for Johnson & Johnson MedTech explains why HR's presence is critical in all phases of dealmaking.

The HR function plays an important—if often unrecognized—role in M&A. When it comes to bringing together separate businesses, structures, and cultures, "people make all the difference," says Lisa Blair Davis, the global head of HR for Johnson & Johnson (J&J) MedTech.

Davis has seen and helped drive substantial growth in the healthcare company's medical-device business in her 25-plus years with J&J. During that time, the organization has acquired companies in a range of critical segments, including electro-physiology, orthopedics, surgery, and vision. Since 2022, it has spent nearly $30 billion to acquire two companies in the cardiovascular space: Abiomed and, most recently, Shockwave Medical.

In a recent conversation with McKinsey senior partner Andy West, Davis explores topics relating to talent, retention, and what it takes to produce growth-focused M&A. She explains why she believes that HR leadership needs to be involved in the entire M&A process rather than just stepping in after a deal is done. She also shares her insights on the industry and her approaches to leadership and strategy development. An edited version of the conversation follows.

Andy West: Culture and talent are usually at the top of the list of risk factors associated with M&A. You have just done two major deals. How did you get agreement to pursue these growth-focused deals with people, talent, and intellectual property at the center?

Lisa Blair Davis: We start with our portfolio, asking key questions like, "Where does J&J want to compete? In which high-growth segments do we have a strong competitive advantage? Where can we scale or build upon our existing footprint? Where can we best access the patients who need care?" In the case of Abiomed, for instance, cardiovascular is one of the fastest-growing areas in medtech and medical care, and it's something that J&J really wants to be part of. We wanted to build upon capabilities we already had with electrophysiology, but we also had to approach the deal thinking, "What could we do to make Abiomed even better inside J&J than Abiomed could have done on its own?"

That's the first part of it. The next step is making these deals successful, and that's where people come in. HR is involved early in the diligence process, with my team and me asking, "Who are the senior leaders of this organization? Who makes up the board of directors? What are the types of things that are going to be on their minds?" We try to get really smart on that while a lot of the technology assessments and the other parts of diligence are going on. We also engage in conversations on pricing and other topics associated with the diligence process. But I will tell you, at the 11th hour—when it comes down to closing and signing the deal—it's always about people. It's all about setting up the company for success within J&J, ensuring they're welcomed and equipped to continue to grow.

'At the 11th hour—when it comes down to closing and signing the deal—it's always about people. It's all about setting up the company for success.'

Andy West: How do you get share of voice or share of attention on things that can be as amorphous as people- and talent-related issues?

Lisa Blair Davis: J&J, over many years, has invested in this capability, and we have a team at our corporate headquarters that specializes in due diligence. They're very skilled at what they do, which, in some ways, makes my job much easier. I call them in at the right time, when I know things are starting to heat up. We try to gather as much public data as we can at that stage—before we formally go into diligence. I always want to be as prepared as possible, which is essential to earn the right to have those people-related conversations during diligence.

I want to know what changes of controls we might be dealing with. How long has the senior-leadership team been in place? What organizational factors will be important to them so that we can start to shape and think about what the integration approach would look like? Who do I need from J&J to lead this integration? How do we put the integration team together? We try to anticipate potential concerns or sensitive topics for their senior-leadership team and aim to be as educated as possible. So we're very clear on what we need to uncover during the diligence phase.

Collaborating throughout the process

Andy West: High-growth assets come with high-growth talent, but not every executive wants to come along. How do you deal with that risk?

Lisa Blair Davis: The worldwide chair of medtech and I meet with the target company's CEO during the diligence period and say, "Tell me about your team." The discussion is very open ended. I'm not coming in with a spreadsheet to fill out. It's more like, "Who's really important on your team? Help us understand what you know about your team. What's going to motivate them?" We get a lot of insight that way. On the recent Abiomed deal, I met with both the worldwide chair of the company and its chairman and CEO. And the CEO talked us through his team, telling us what was important to Abiomed's culture. That information set the framework for us to figure out what other information we needed to get through the diligence process.

We followed a similar process recently when we acquired Shockwave Medical—sitting down with the CEO to learn more about his team and what matters most to them. With that information, we can determine who we need to involve in the integration: some roles are important for the integration, but they may not be the right fit for some individuals. A

'Meet with the target company's CEO during the diligence period and say, "Tell me about your team." The discussion is very open ended. . . . We get a lot of insight that way.'

‘One thing I have learned in my experience with acquisitions is that sometimes the little things turn into really big things. And sometimes the things that we think may be big things for the company are going to be little things.’

CFO of a publicly traded company isn’t typically going to join us and be a business unit CFO inside of J&J, for example.

There isn’t just one formula, but we do seek to understand the organization we’re acquiring, and what’s important to it, through the seat of the CEO.

Andy West: It sounds more collaborative than people let on.

Lisa Blair Davis: It is. We have to start with a message of, “We want you, and here’s what we could do together,” versus us coming in saying, “We already have the answers.” Obviously, we admire these companies. We’re paying premiums because they have built things that we want to take to an even bigger scale. We need to identify those individuals who can help lead that because we don’t believe we have all the answers.

Sustaining the momentum for change

Andy West: Let’s talk about momentum. How do you keep everyone focused on the business during an integration?

Lisa Blair Davis: For me, an acquisition is like a launch. You have one time to launch a new product, a new service, whatever that is. In the case of Abiomed, we were launching Abiomed inside of J&J. Yes, we have a deal model. Yes, it has a business plan that it wants to achieve. It has growth targets. But we need to hit those immediately. Because if your launch doesn’t go well, it’s much harder to get back on track versus continuing to build upon a launch and letting it grow.

We’re very intentional and very measured about what that growth needs to be and what the success factors need to be for month one, for quarter one. We might be tracking retention, sentiment inside of the organization, business performance, R&D milestones, clinical trial enrollments—but with each deal, the success factors could be a little bit different.

With Abiomed, it was important that we retained key talent—specifically, the R&D teams and the field sales force that were out directly with the customers every single day. How did we do that? We made sure to expand the role of Abiomed’s worldwide president, Andrew Greenfield, who had end-to-end accountability for that business globally. He was the one who was setting the tone for the rest of the organization on what it meant to be a part of J&J. We made sure to amplify what Andrew needed to do within the organization to retain that critical talent.

Andy West: How do you start to integrate acquired companies in ways that are not overwhelming or confusing?

Lisa Blair Davis: Very delicately. As new businesses come in, I think it's the integration leader's role to make sure to monitor people's engagement with all parts of J&J because the organization can be overwhelming. We're a matrixed organization. We have our own lingo, and sometimes you need translators. That was a role that I and [J&J integration leader] Michael Bodner played for Andrew Greenfield and his leadership team. We were intentional about where we would amplify and add resources—whether that be dollars, people, capabilities—to Abiomed so that the division could scale at the rate that it, together with J&J, wanted to.

We were constantly reassessing the situation. One thing I have learned in my experience with acquisitions is that sometimes the little things turn into really big things. And sometimes the things that we think may be big things for the company are going to be little things. You never quite know how things will materialize unless you're actively in conversations and seeing how things are landing inside the organization.

Assessing culture and talent

Andy West: What advice would you give to others on managing high-performing talent and addressing culture?

Lisa Blair Davis: Talent and culture can be one and the same or two distinct topics. Let's break them apart here. I look at culture as, what does it mean to exist inside of an organization? How do things get done? What really matters? What do leaders pay attention to? What do leaders roll their eyes at? It's important to get the essence of what the culture is at an organization as you're bringing in people from the target company. People often ask, "What's the J&J culture?" And I say, "There are many separate cultures. But I know what holds us together, and that's 'Our Credo.' That's what we always start with."

But there are different mechanisms by which business gets done. Take the Abiomed acquisition, for example. It's operating in interventional cardiology. In that market, what does it mean to have customers who are interventional cardiologists? What are they expecting with the cadence of innovation? How do the customer engagements happen?

Once we understand the market the company is operating in, then we can more easily adapt J&J's talent strategies to match it. I'm not going to bring into that space a bunch of people from J&J who have never worked in interventional cardiology or don't know that market and have to get skilled up. In that case, what really mattered was keeping the professionals who had engagements with the interventional cardiologists so that we could maintain that growth.

One of the things that I heard about early on from people at Abiomed was the demand on the company's field team. The team members were on call and sometimes covering large territories. So what could we do with our resources to help supplement and offset some of those work demands that they weren't able to do on their own? Those are all things that you learn about the organization through a lot of inquiry—trying to understand what the marketplace is and the stressors on its talent.

The other thing about Abiomed we learned very early on was about its R&D and innovations. The company has an R&D center in Aachen, Germany, under Thorsten Siess, who invented the Impella heart pump, which is an unbelievable, lifesaving product. We wanted to make sure that the team around Thorsten felt engaged and that Thorsten felt like he had what he needed to keep innovating and being the inventor that he is.

Andy West: Relative to the diligence you did, did the Abiomed organization and culture match your expectations?

Lisa Blair Davis: It very much matched what we found through our diligence conversations. Did we have it 100 percent right? No, but we were 90 percent there. As I mentioned, J&J's culture is made up of a lot of different cultures, depending on where you go among our businesses all around the globe. But there's still a connectivity across all those sites, and that connectivity is thinking of patients first. There wasn't a person that I met at Abiomed, the day after signing, who did not talk about patients first. That was so in line with J&J. I feel like we started from the same spot with Abiomed and J&J.

Andy West: That concept of finding common ground resonates. What also resonates is the idea that many different cultures can exist in an organization.

Lisa Blair Davis: I think one of the other factors—which can be an advantage, mostly, but sometimes a disadvantage—is that J&J is so large. We have so many employees who may have worked for us before, and then, as we do acquisitions, people rejoin us. They have their own J&J stories that they get to tell inside the organization. For example, I had worked with Abiomed's US vice president of sales previously at J&J, and, when he returned, he was able to share some insights about the company and his own experiences. We need to amplify those voices so they can help others understand what it means to work here. That's a lot more relatable than having me or the worldwide chair come in and tell the J&J story.

Doing the homework

Andy West: What advice would you give to other HR leaders looking to help drive their companies' M&A strategies?

Lisa Blair Davis: I would say, make the business development person one of your closest allies. Know what you can talk to them about because things in the meeting are sometimes happening pretty fast. Identify those resources that can help you get smarter about what the company is trying to do. Sometimes people are afraid to ask questions in the big room, which is fine. But definitely find another reliable way to get the answers you need. This will help you get really good at framing issues from a people perspective, from a talent perspective, that are going to affect the deal. Do your homework—be ready.

Andy West: Any other lessons learned from the more recent deals?

Lisa Blair Davis: Don't think that you have only one opportunity in retaining top talent. Just because we send one retention signal during due diligence doesn't mean we can't turn around six or 12 months later, when we know more about people's skills and roles and what the company needs, and send another kind of signal. You don't want to box yourself in too much, especially financially, by retaining people who, once they're on the other side of the integration, decide it isn't the right place for them but, because of the incentives set out initially, don't want to leave.

'You learn about the organization through a lot of inquiry—trying to understand what the marketplace is and the stressors on its talent.'

‘One of the biggest growth opportunities for an HR professional is leading an integration or being on an integration team. Raise your hand. Make it known that you want to have these experiences.’

Andy West: You have been very involved in M&A. How has that affected you as a leader?

Lisa Blair Davis: I feel very fortunate that I stumbled into this space very early in my career. I was in the right place at the right time, but it’s never too late to learn. One of the biggest growth opportunities for an HR professional is leading an integration or being on an integration team. Raise your hand. Make it known that you want to have these experiences.

Specific to HR leaders, I say you have to be very comfortable thinking about every single aspect of HR delivery to lead an integration. All those parts must come together to make the new organization work. It’s not just the business partnerships; it’s knowing how the compensation systems are going to work, how the benefits teams are going to work, how employment contracts are going to work outside the United States. Everything must be woven together. It truly is an opportunity to deliver HR in a much more end-to-end way.

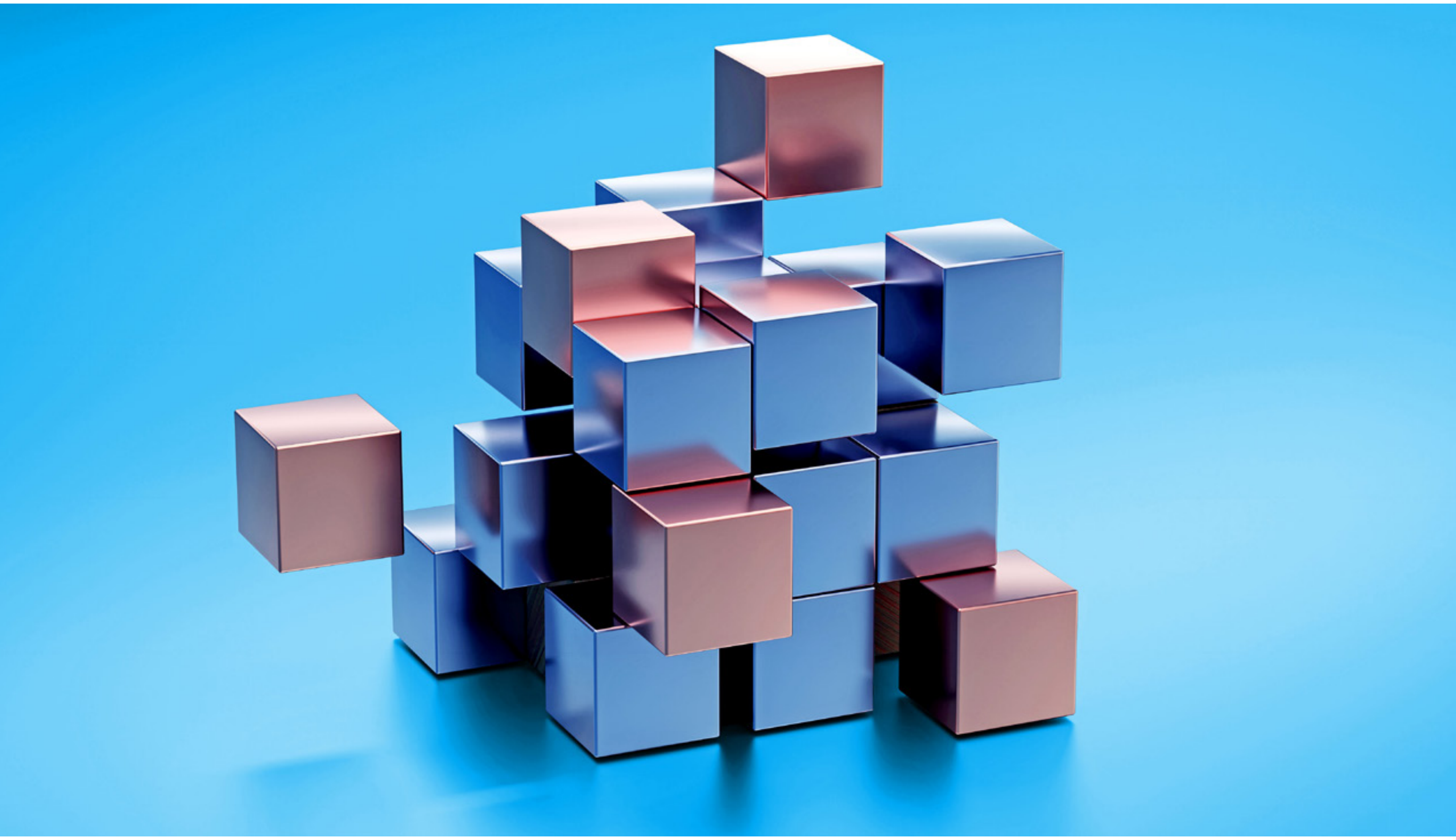
Lisa Blair Davis is the global head of HR for Johnson & Johnson MedTech. **Andy West** (Andy_West@McKinsey.com) is a senior partner in McKinsey’s Boston office.

Comments and opinions expressed by interviewees are their own and do not represent or reflect the opinions, policies, or positions of McKinsey & Company or have its endorsement.

What I learned from Daniel Kahneman

Daniel Kahneman, the psychologist whose findings helped launch behavioral economics, passed away in March 2024. The encouraging words he shared with me offer good news for organizations.

by Tim Koller



One night, over dinner, Daniel Kahneman[1] changed my perspective on value creation. Why do so many people, including leaders of large corporations, draw back from acting more boldly, even when taking incremental risks can create much greater returns? And perhaps more important: Can anything be done about it?

Kahneman explained to me that while it's hard to change human nature, it's much easier for *organizations* to take practical steps to overcome human decision biases. By understanding the inherent irrationality of how people make decisions—including a strong tendency toward loss aversion—companies can successfully encourage managers to allocate more resources for more value-creating projects.

His insights were a revelation to me. I've been a consultant for more than 40 years, nearly all of that span at McKinsey. Over those decades, I've been blessed to work with not only brilliant colleagues but also many of the most effective business leaders in the world. From the very start, I sought to understand and explain how companies could allocate their resources to maximize value over the long term. With that mission in mind, my coauthors and I wrote what turned out to be a best-selling book on corporate valuation, *Valuation: Measuring and Managing the Value of Companies*; next year will mark its eighth edition.[2]

Yet from the time I began analyzing companies (this, even before I was a consultant), and for years afterward, I was puzzled: Why don't companies take obvious, rational actions to maximize long-term value? It's up to senior leaders to allocate resources to the projects that create the largest cash flows over time. Some projects deliver outsize, sustainable returns; it's clear that these initiatives should receive more company resources. Other investments deliver lower or even negative returns. These businesses should receive fewer resources—or none at all.

Yet even when the data and conclusions are indisputable and highly capable CEOs and CFOs recognize what needs to be done, their companies often still fail to allocate resources as they should. Instead, managers and their teams fall back to the same ways of doing things. The companies don't maximize value. Or worse, they watch upstarts and competitors disrupt their businesses. It doesn't seem *rational*.

But it's human. Thanks to Daniel Kahneman, we now understand human nature—and all of its apparent irrationality—much more clearly. Kahneman and his research partner, psychologist Amos Tversky, found that people didn't make decisions in the ways that economists had traditionally assumed. Harvard University psychologist and author Steven Pinker said of Kahneman: "His central message could not be more important, namely, that human reason left to its own devices is apt to engage in a number of fallacies and systematic errors, so if we want to make better decisions in our personal lives and as a society, we ought to be aware of these biases and seek work-arounds. That's a powerful and important discovery."[3]

Kahneman's published work was primarily about *individual* decision making. I, along with my collaborator Dan Lovallo, had the opportunity to work with Kahneman on how *organizations* might improve their decision making. It was while we were having dinner that I asked him straight out, "If people don't behave in an economically rational way, is there any hope for organizations?"

[1] Dr. Kahneman died in March 2024 at age 90. He won the Nobel Prize in economics, although he was a psychologist. That's a testament to the impact of his insights, along with those of his collaborator, Amos Tversky, who died in 1996. Their work laid the foundation for what we now call "behavioral economics" and "behavioral finance."
[2] Tim Koller, Marc Goedhart, David Wessels, *Valuation: Measuring and Managing the Value of Companies*, seventh edition, New York, NY: John Wiley & Sons, 2020.
[3] Robert D. Hershey Jr., "Daniel Kahneman, who plumbed the psychology of economics, dies at 90," *New York Times*, March 27, 2024.

Yes, Kahneman assured me. “I’m much more optimistic about organizations than individuals,” he said. “Organizations can put systems in place to help them.” Managers can develop rules and processes that help overcome inherent decision-making biases.

Drawing on Kahneman’s insights, my colleagues and I have proposed (or adopted from others) several techniques to help organizations understand and improve their decision making in resource allocation. In particular, our research finds that large organizations often suffer from four decision-making biases that Kahneman’s work helps solve: groupthink, loss aversion, confirmation bias, and anchoring.

Groupthink and its sibling concept “sunflower management” lead to a lack of debate about important decisions. In groupthink, individuals are reluctant to raise ideas that might be different from what they perceive as the emerging consensus. With sunflower management, executives try to guess what the most senior person wants to hear rather than expressing their own points of view and then bend their own views accordingly. While the best solution is a culture of debate, fostering a strong obligation-to-debate culture can take years to develop (and unfortunately, much less time to destroy). Short-term techniques to ensure that valuable insights are heard can include assigning someone to be a devil’s advocate, insisting that the most senior people don’t express their views until everyone has had a chance for input, bringing in subject matter experts (not just the top management team), and, for really big decisions, putting in place a red and blue team approach in which two teams are assigned to take opposite points of view.

Loss aversion is the idea that human beings weight losses more than they do gains and, therefore, pass up promising investment opportunities. Dan and I cowrote with Kahneman the *Harvard Business Review* article, “Your company is too risk-averse.”[4] We showed that what mattered was not the riskiness of an individual project but how that project contributed to the overall risk of the company’s portfolio of projects. We found that, too often, companies pass up attractive projects and focus on the risk of each one. But when companies aggregate projects, they achieve a natural diversification effect and can realize a better financial result without taking on much, if any, additional risk.

Confirmation bias is the tendency to search only for data or evidence that supports a hypothesis. For example, a management team might develop a hypothesis about a strategic direction for a business and, consciously or otherwise, highlight only confirming data. As a result, they will miss

Managers can develop rules and processes that help overcome inherent decision-making biases.

[4] Dan Lovallo, Tim Koller, Robert Uhlaner, and Daniel Kahneman, “Your company is too risk-averse,” *Harvard Business Review*, March–April 2020.

Our research finds that large organizations often suffer from four decision-making biases that Kahneman's work helps solve: groupthink, loss aversion, confirmation bias, and anchoring.

information that might send them in a different direction. Overcoming confirmation bias is relatively simple, so long as organizations follow Kahneman's counsel to put rules in place that must be followed. All it takes is discipline and enforcement by top management to insist on asking the right questions.

Anchoring is the tendency to make decisions based on past (or even irrelevant) information. Large organizations tend to anchor their budgets and resource allocation decisions based on what they did last year, with only minor deviations. As a result, their budgets won't be aligned with any potential strategic shifts that top management may want to make. Once again, putting in place rules that Kahneman recommended can overcome significant bias. For example, an organization might create a rule that every strategic initiative in the budget must be fully funded.

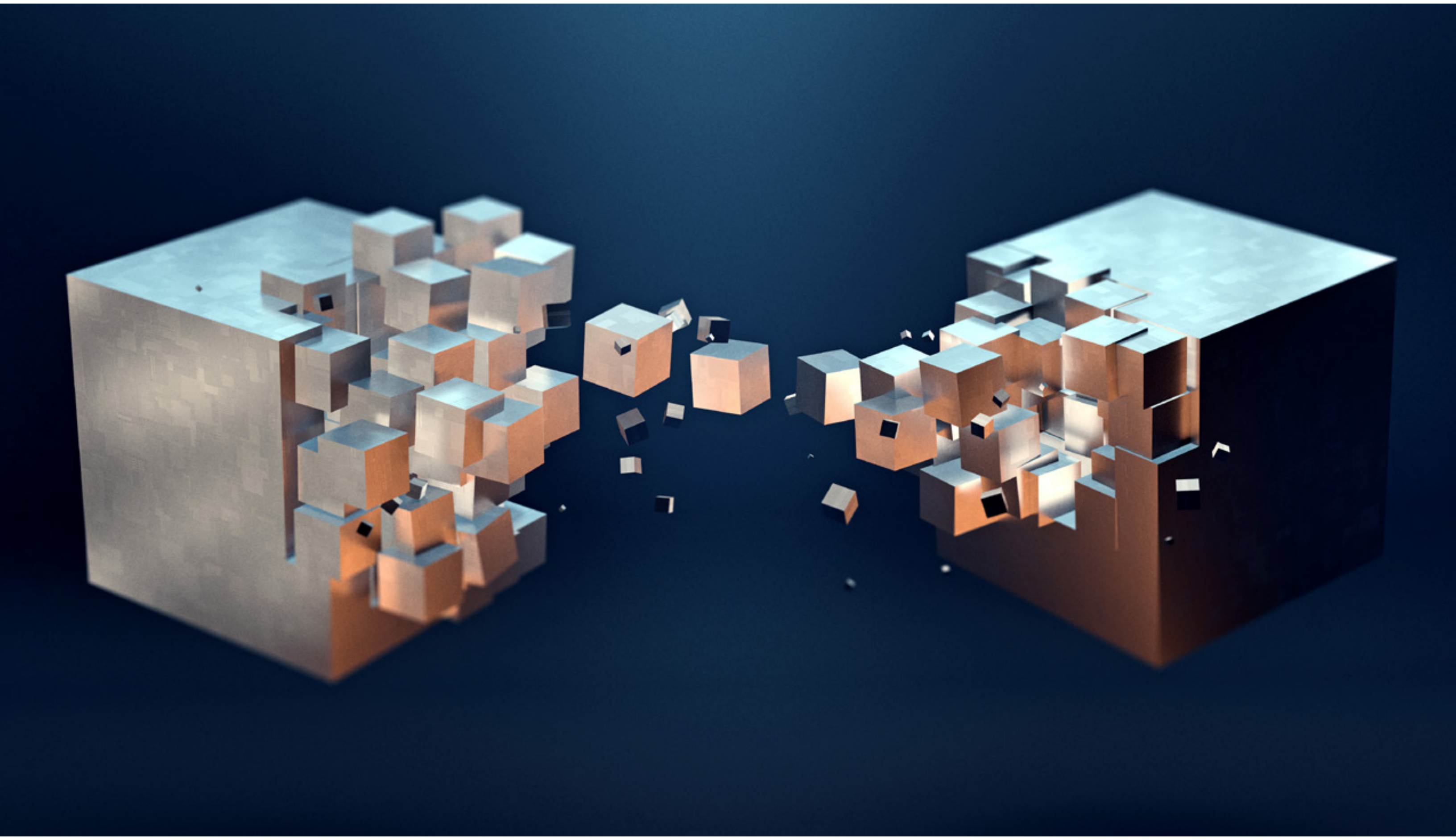
These rules may feel unnatural, and indeed they often go against human nature. But while you can't change human nature, thanks to Kahneman, I've learned that you can change how organizations approach resource allocation. Debiasing decision making helps companies achieve value-creation opportunities that were there all along.

Tim Koller (Tim_Koller@McKinsey.com) is a partner in McKinsey's Denver office.

Is your ‘conglomerate discount’ a performance discount or a communication problem?

A corporation with multiple businesses should not be valued less than the sum of its parts—so long as those parts perform in line with their peers and investors have the transparency they need.

by Andy West, Tim Koller, and Werner Rehm with Yann Camus



Math is wonderful—because it works. Consider a classic valuation question: Is the whole worth the sum of its parts? Put another way, should the total value of a conglomerate be *less* than the value of its operating companies, if each business were measured on a stand-alone basis? The answer is no, of course not. Two plus two does not equal five, and when it comes to conglomerates, it should not equal three, either. Yet too often, investors and executives can fall into the trap of assuming there should automatically be a "conglomerate discount."

Companies and investors alike fall into the trap of mixing up a conglomerate discount with a "performance discount": the assumption that lower-performing businesses should be valued less than their peers. In this article, we address how to separate issues of underperformance, which reduces valuation, from solid performance resulting in an inappropriately low valuation simply because investors don't fully understand the value proposition. We offer suggestions to company leaders to ensure that their enterprise is communicating the full value of its parts.

Conglomerate underperformance: An investor perspective

The term conglomerate discount seems to have been coined by Michael Porter, who argued in 1987 that multibusiness companies are valued lower than the sum of their parts *just because* they are conglomerates.[1] Ever since, conglomerate discount proponents have contended that individual businesses owned by conglomerates are valued lower than pure-play businesses in the same industry. Does the market agree? Clearly, the wave of companies traditionally considered to be a "conglomerate"—that is, a corporation that owns a range of significantly different businesses—crested decades ago.[2] Moreover, companies that diversify beyond adjacent or near-adjacent businesses do tend to underperform, as measured by returns to shareholders, though this general observation does not hold for each individual corporation.[3] There are indeed strong performing conglomerates, such as Danaher, Heico, and IDEX. Each of these corporations has a track record of demonstrating a strategic fit for their portfolio businesses, managing performance, and considering divestitures. The bottom line, though, is that it is uncommon for a conglomerate's business units to lead their peers in return on invested capital or organic growth.

Assessing conglomerate performance isn't easy—for investors or, often, for company leaders themselves. Rotating portfolio businesses on a regular basis, programmatic M&A, and accounting-driven allocation of corporate costs can make it more difficult to accurately measure segment performance. But even after recalibrating using sophisticated methods, performance numbers still speak for themselves. Conglomerates don't exhibit high upside in TSR, are highly dependent on the markets they compete in (as is the case, for instance, in emerging versus developed markets), and may no longer be the best owners of a business.

A peer group with more companies is not better if the companies aren't true peers.

1 Michael E. Porter, "From competitive advantage to corporate strategy," *Harvard Business Review*, May–June 1987, Volume 65, Number 3.
2 Baruch Lev, "The rise, fall, and rise? Of the conglomerates," NYU Stern, January 15, 2021; Hillary Chabot, "Why conglomerates are breaking up," Babson College, July 19, 2022.
3 Joseph Cyriac, Tim Koller, and Jannick Thomsen, "Testing the limits of diversification," McKinsey, February 1, 2012; Sandra Andersen, Chris Bradley, Sri Swaminathan, and Andy West, "Why you've got to put your portfolio on the move," *McKinsey Quarterly*, July 22, 2020.

What's an investor or senior executive to do? The first step is to get the value right, using the right peer group and key metrics for valuation analysis. If there *is* a valuation gap, leaders can drill deeper to understand what's driving the difference.

Multiple issues at the core of value assessment

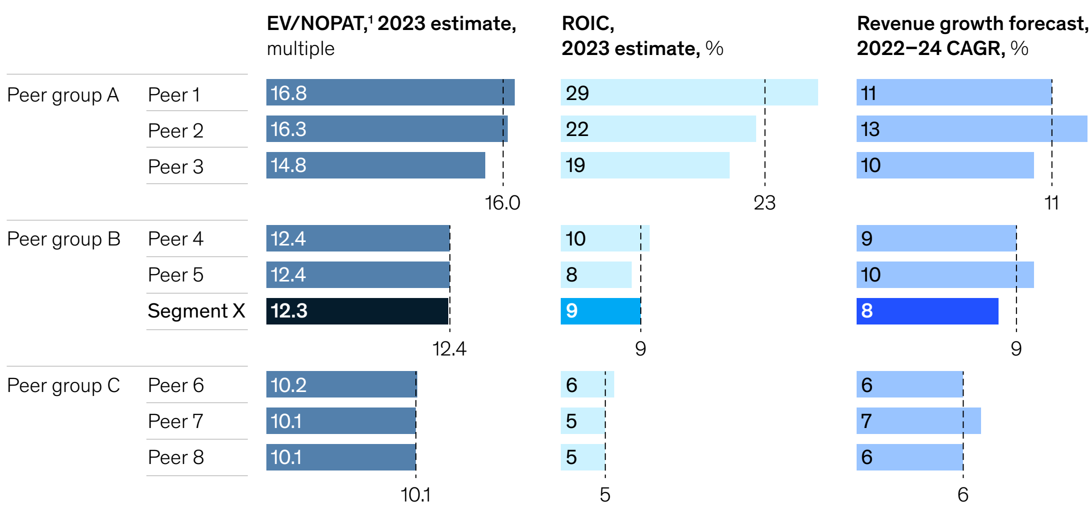
Trading and acquisition multiples, if used correctly, can help triangulate value and serve as a helpful check for a discounted cash flow (DCF) analysis. The exercise falls short, however, if the wrong peers are selected. To select the right ones, make sure that you understand their growth and return on capital compared with the segment you're examining. A peer group with more companies is not better if the companies aren't true peers. We often see practitioners select a broad range of companies for a business segment and apply an average (or median) multiple to the segment—an exercise that presupposes that the businesses actually *are* peers. In practice, a bigger peer group distorts the picture; it is more likely to include oranges that spoil an apples-to-apples comparison.

An important benefit of selecting the right peers is the perspective provided by seeing better performance in action—demonstrating what the segment could be worth if it were managed to its best potential. For example, consider how to approach the valuation of an illustrative conglomerate's business segment, which we'll call "Segment X." Peers can be broken down into very different groups that have material differences in their business models and performance. The spread in average ROIC and revenue growth per peer group is reflected in the spread in valuation multiples. Selecting the right peer group will inform the appropriate ratio of enterprise value to net operating profit after taxes (exhibit). Consider the following example, in which group A has significantly better performance than the segment we want to value (Segment X), and group C's performance is significantly worse. Practitioners would be better served using just the peers in group B, even though it's a small group.

Exhibit

When valuing a business within a conglomerate, compare its performance with that of a 'true peer.'

Financial metrics by peer group



[1]Enterprise value to net operating profit after tax.
Source: Tim Koller, Marc Goedhart, and David Wessels, *Valuation: Measuring and Managing the Value of Companies,* 7th edition (Wiley Finance)

McKinsey & Company

A poorly defined peer group can lead to a significant valuation error. Often, we find that a so-called conglomerate discount disappears completely if investors measure each business unit against its true peers. It's worth noting, too, that a slightly inapplicable peer group might be a good indicator of what the business *could* be worth if it were to make certain changes—which can serve as a valuable guide going forward.

Another key issue in the valuation of conglomerates is the various ways that companies can allocate corporate costs—including sometimes having a large "corporate" cost bucket in addition to segments. For an accurate comparison, segments should be as "fully loaded" as a stand-alone business with the same cost structure would be. A half-baked allocation can result in strange margins and opaque profit estimates. A segment's EBITDA or operating profit might or might not be similar to a stand-alone company's metrics. Discrepancies can distort both multiples and DCF. Indeed, simply applying a pure-play multiple to the reported segment profit is the biggest mistake we see, because the segment profit will often not be comparable to a pure-play company's accounted-for profit.

While there is no perfect way to resolve these issues, companies should be alert to the typical warning flags in both DCF and multiple valuations—reported margins, growth, and returns on capital that are significantly higher or lower than those of peers. One interesting check is a "what it would look like" exercise: because revenue reporting is typically pretty clean, you can apply peer margins to reported segment revenue, ignore any unallocated corporate costs, and check the result with the margin or profit of the conglomerate. What would that output look like? Is it close, or lower? One can do the same exercise with analysts' expected revenue growth. If either or both is lower than the peer aggregate, you've identified a performance discount, not a conglomerate discount as commonly understood.

Why transparency is essential

Let's say that after a thorough analysis, leaders conclude that the conglomerate is indeed undervalued versus its performance potential. We believe that the lower valuation is often explained by investors being skeptical about companies that are not transparent about segment performance and strategy. If *you* were an investor and couldn't quite figure out the organic growth or true EBITDA of a business segment, would you assume that it is performing well? It's important to presume that investors are smart. They want to know details about the segments, and they want to know how a big corporate center manages the complexities of a conglomerate to create value.

Tell a clearer equity story

The absence of a clear investor narrative about why the conglomerate is the best owner of each asset—and the failure to make a long-term value creation strategy explicit for each business unit—can contribute to an actual conglomerate discount, at least when compared with the corporation's own aspiration and strategy.

Transparency doesn't just happen. It's up to the conglomerate to provide granular income information, key balance sheet metrics, and bridges from "reported profit" to "organic growth" on a segment level. The CEO and CFO should provide sufficient financial information at the business unit level to enable a separate valuation of high-performing segments. The level of detail in a public company's annual and quarterly reports may be insufficient for investors to build a robust DCF model.

For example, the presence of a fast-growing software or digital business within a traditional industrial conglomerate can be underestimated if it's just too small to be visible. Complicated ownership and partnership structures—such as in natural resources companies with joint ventures, real estate investment trusts, and exploration ventures—can also obscure visibility and affect

Clouding future growth sources through complex structures and investment vehicles can exact a real cost if it reduces what should be a higher share price.

valuations. Companies should carefully evaluate these factors, as they tell a clearer equity story. To be sure, there are trade-offs (such as tax considerations) in determining how new initiatives should be structured. But clouding future growth sources through complex structures and investment vehicles can exact a real cost if it reduces what should be a higher share price. It's up to the CFO to make sure investors can see through the clouds.

Last, senior leaders might think that because they can put some issues on hold until they are resolved—such as an underperforming part of a business segment—there's no need for greater transparency. This might be true: companies do shuffle small parts of segments around, or adjust corporate allocations slightly, to manage perceptions instead of managing performance. Yet these efforts can often come back to haunt the organization; companies can't push off underperformance forever, and they're better off addressing issues openly with commitment and action.

Addressing a central issue

Conglomerates' corporate centers are in competition with equity markets for investors' capital. Investors understand how to diversify; how much, if anything, should they pay a conglomerate to diversify for them? Executives need to develop a compelling narrative for investors to understand the value proposition of a conglomerate that stays together. In particular, they should justify the corporate center by identifying real synergies, now and in the near and immediate terms. In particular, leaders should provide transparency into resource allocation and cash synergies. Achieving enterprise-wide synergies is something that a conglomerate can do, but investors cannot. Ultimately, if the organization is not efficient, the corporation will underperform.

Conglomerates can proactively reallocate resources and ensure that their best businesses are not constrained from achieving growth. It should be clear to investors that executives are doing this; for company leaders, it's essential to ask whether the organization is getting the most out of its businesses. Because strategic priorities shift at the enterprise level—and ideally, portfolios move as well—a strategic plan should always address whether the company is still the best owner of each business. If it isn't, leaders should consider strategic joint ventures or outright divestitures. If a company is not the best owner, it should strongly consider selling that business or spinning it off.[4]

[4] See Jan Krause, Anthony Luu, Robert Uhlaner, and Andy West, “Achieving win–win spinoffs,” McKinsey, October 21, 2021; Lee Dranikoff, Tim Koller, and Antoon Schneider, “Divestiture: Strategy's missing link,” *Harvard Business Review*, May 2002, Volume 80, Number 5.

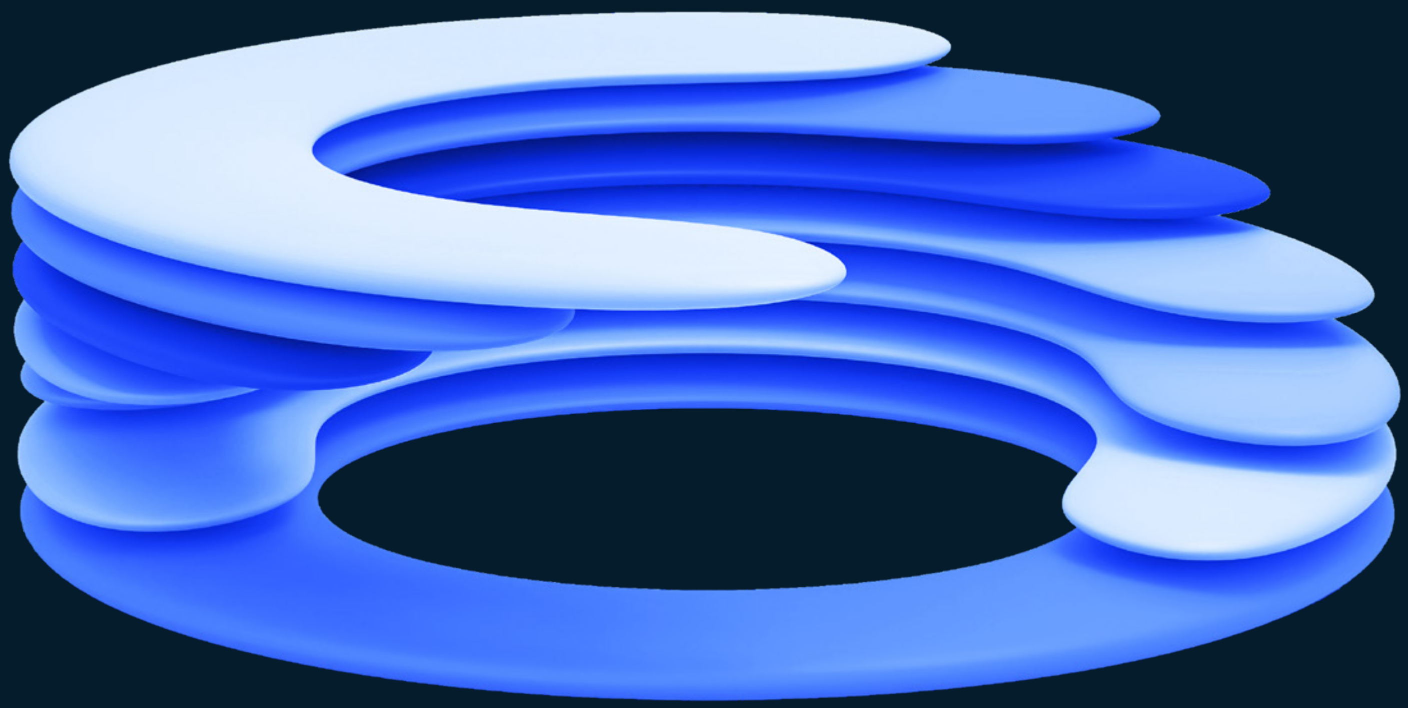
Capital should not be allocated to a nonstrategic business just because capital has always been allocated to that business before.

The fact that a corporation owns multiple, different businesses should not, at least theoretically, result in a conglomerate discount. But in practice, it often leads to a performance discount if the corporate center is not world class. A company, after all, should always be worth the sum of its parts—and the parts should be valued based on their true performance.

Andy West (Andy_West@McKinsey.com) is a senior partner in McKinsey's Boston office, **Tim Koller** (Tim_Koller@McKinsey.com) is a partner in the Denver office, **Werner Rehm** (Werner_Rehm@external.McKinsey.com) is a senior adviser and an alumnus of the New Jersey office, and **Yann Camus** (Yann_Camus@McKinsey.com) is a consultant in the New York office.

Looking back

Smart money? Retail investors, intrinsic investors, and the Magnificent Seven.



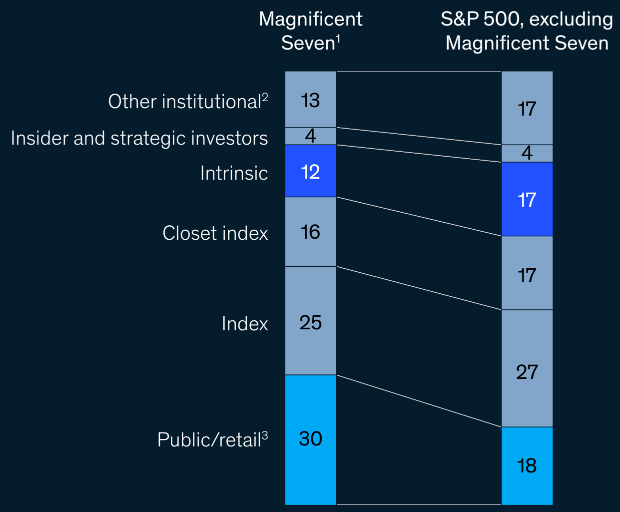
The S&P 500 index is value weighted, which means that each company's contribution to the index reflects its individual market capitalization. This year, through July 2024, the index has risen almost 16 percent, driven in large part by the outsize returns of its largest constituent companies, popularly known as the "Magnificent Seven."[1]

Yet there's also a curious difference by investor category: *intrinsic* investors (the class of investors that take and hold a position in a company over long periods, after rigorous due diligence of its intrinsic ability to create long-term value) have lower shareholdings in the Magnificent Seven than in other S&P companies—12 percent of the Magnificent Seven, versus 17 percent for other S&P companies. By contrast, *retail* investors (nonprofessional investors who tend to buy and trade stocks over shorter holding periods) disproportionately own Magnificent Seven shares—30 percent of the Magnificent Seven, compared with 18 percent for other S&P 500 companies (exhibit).

Exhibit

Retail investors hold a higher share of the 'Magnificent Seven' than intrinsic investors—and a much lower share of other S&P 500 companies.

Investor base, by type, Q2 2023, %



[1]The 7-largest companies by market capitalization on the S&P 500, as of June 30, 2024: Alphabet, Amazon, Apple, Meta, Microsoft, NVIDIA, and Tesla.
[2]Other institutional investors include broker–dealer, trader, activist investors, and other active investors that cannot be classified into any other category.
[3]Public/retail ownership includes only retail investors and other noninstitutional investors/funds.

McKinsey & Company

[1] The seven largest companies by market capitalization on the S&P 500, as of June 30, 2024: Alphabet, Amazon, Apple, Meta, Microsoft, NVIDIA, and Tesla. McKinsey CP Analytics; S&P 500 Realtime Quote, Yahoo Finance, accessed August 1, 2024. See also, David Gura, "Wall Street calls them 'the Magnificent 7': They're the reason why stocks are surging," NPR, December 13, 2023.

Whether one or a few stocks are overpriced, of course, requires a deeper analysis of each company's value relative to its fundamentals. In the past, we've observed that when retail investors drive up a company's share price, it sometimes indicates a bubble for the company's share price. There is too much uncertainty about the future of the Magnificent Seven to draw that conclusion, however. But, as ever, investors should be able to articulate what they believe future performance must be in order to justify the current price.

Tim Koller (Tim_Koller@McKinsey.com) is a partner in McKinsey's Denver office, and **Prateek Gakhar** (Prateek_Gakhar@McKinsey.com) is a senior knowledge expert in the Gurugram office.

Podcasts

Learn more about these and other topics on our corporate-finance, strategy, and other podcasts, available for streaming or downloading on McKinsey.com, as well as on Apple Podcasts and Google Podcasts.

BOARDS AND GOVERNANCE

Helping boards manage geopolitical risk with Jon Huntsman Jr.
In a conversation with a board director and former diplomat, two McKinsey experts offer advice on how boards can guide their organizations through volatile times.
Celia Huber, Ziad Haider, and John Huntsman Jr., with Sean Brown

How to prepare for the CEO role
Becoming a high-potential candidate for the top job starts with asking the question: Why do I want to be the CEO?
Carolyn Dewar and Vik Malhotra, with Sean Brown

Who is productive, and who isn't? Here's how to tell.
More than 50 percent of workers say their productivity is down. Managers who understand what motivates different types of workers can boost their engagement and help them find more satisfaction at work.
Aaron De Smet and Angelika Reich, with Roberta Fusaro

CORPORATE FINANCE

The transformation imperative for midcap companies
Transformations, when done right, can enable midmarket companies to unleash their full potential.
Kedar Naik, Mauricio Janauskas, and Zak Gaibi, with Sean Brown

Six strategies for growth outperformance
Three experts discuss the recipe for fostering growth in today's uncertain economic climate.
Jill Zucker, Kate Siegel, and Rebecca Doherty, with Sean Brown

What your most important investors need to know
Investor relations strategy should prioritize long-term investors who are the true owners of your company.
David Honigmann, Jay Gelb, Karl Mahler, and Werner Rehm, with Sean Brown

Perspectives on a slower era in private markets
Insights are presented from McKinsey's most recent *Global Private Markets Review*, including the state of the industry in 2023 and trends likely to affect investors in 2024.
David Quigley and Fredrik Dahlqvist, with Brian Vickery

Driving long-term business transformation
What it takes to get transformation right: Setting a company up to operate better today and handle disruption and change tomorrow with energized, creative employees.
Kevin Carmody and Roman Regelman, with Sean Brown

Child and adolescent mental health as a proving ground for innovation
Although one in five people will experience a mental health malady as a child, effective diagnosis and treatment often remain elusive. The Child Mind Institute seeks to bring innovation to the problem.
Dr. Harold Koplewicz, with Erik Roth

DECISION MAKING

Managing the risks around generative AI
The transformational technology will require every member of an organization to be a risk professional.
Ida Kristensen and Oliver Bevan, with Sean Brown

Why strategists should embrace imperfection
In a world of rapid change, looking for certainty can obscure opportunity. Taking smaller yet bold steps provides a more sure-footed path through uncertainty.
Charles Conn and Rob McLean, with Sean Brown

M&A

How programmatic M&A fosters long-term resilience
Executing regular small deals is not only the most effective M&A strategy but also makes companies more resilient. Here's how programmatic acquirers beat the market.
Jeff Rudnicki, Joanna Stone Herman, Patrick McCurdy, and Tobias Lundberg, with Sean Brown

Using M&A as a launchpad for transformation
Transactions can play a significant role in large-scale transformation, presenting a time of intensified focus on change and a heightened sense of ownership and accountability—the building blocks of transformation.
Alex Liu and Chris Hagedorn, with Sean Brown

Agile business portfolio management
Companies that regularly refresh their portfolios tend to outperform, but deciding when and how to divest a business may be the most challenging part of M&A.
Andy West, Anthony Luu, and Obi Ezekoye, with Sean Brown

January 2025
Designed by McKinsey Global Publishing

This McKinsey Practice Publication meets the Forest Stewardship Council® (FSC®) chain-of-custody standards. The paper used in this publication is certified as being produced in an environmentally responsible, socially beneficial, and economically viable way.

Printed in the United States of America.