The Granularity of Growth
Need for Dynamics in Strategy

Helsinki University
Finland June 5th, 2008
The Granularity of Growth

1. Growth Ambition
   - Grow or go: Fast or slow

2. Growth Direction
   - Where to compete + M&A

3. Growth Performance
   - Firing a growth MRI

4. Growth Architecture
   - Granularity & Scale: 1000 cells?
Grow or go matrix: cycle 1 performance

Performance 1984-1994, 100 Largest US Companies

<table>
<thead>
<tr>
<th>Revenue</th>
<th>GDP</th>
<th>S&amp;P 500</th>
</tr>
</thead>
<tbody>
<tr>
<td>High</td>
<td></td>
<td>Unrewarded</td>
</tr>
<tr>
<td></td>
<td></td>
<td>11</td>
</tr>
<tr>
<td>Low</td>
<td></td>
<td>Challenged</td>
</tr>
<tr>
<td></td>
<td></td>
<td>27</td>
</tr>
</tbody>
</table>

TRS
Two ways to grow, two ways to go

<table>
<thead>
<tr>
<th>Segment</th>
<th>Companies with TRS &gt; 12.5%*</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Aggressive growth, without margin decline</td>
</tr>
<tr>
<td>2</td>
<td>Steady growth with improving performance</td>
</tr>
<tr>
<td>3</td>
<td>Aggressive growth, with margin decline</td>
</tr>
<tr>
<td>4</td>
<td>Steady growth, stable or declining margins</td>
</tr>
<tr>
<td>5</td>
<td>Low growth, low capital return</td>
</tr>
<tr>
<td>6</td>
<td>Low growth, high cash flow distribution</td>
</tr>
<tr>
<td>7</td>
<td>Acquired</td>
</tr>
</tbody>
</table>

* 1984–2004 CAGR
** 100 top US companies as of end of 1984 surviving between 1984 and 1994. To obtain this list, we merged the top 70 survivors based on revenues and the top 70 based on market capitalization. From this list, 5 companies were excluded due to insufficient data (Salomon Smith Barney, AIG, Citicorp, AMEX, and Schlumberger)

Source: CPAT
On average, large companies do not grow by gaining share
Revenue CAGR breakdown (average), percent, 1999–2005*

Overall sample

- Portfolio momentum **
  - Total growth
  - M&A
  - Market Share gain

* 416 fully decomposed companies
** Includes impact of portfolio changes mainly due to mergers, acquisitions, and divestitures
Source: McKinsey Large Company Growth Decomposition Database
Growth differences also mostly driven by momentum and M&A

Large company sample growth decomposition, 1999 – 2004*

* 416 fully decomposed companies
** Relative contribution obtained by summing all revenue additions/subtractions caused by each of the levers
Source: McKinsey Large Company Growth Decomposition Database
## Portfolio quality becomes apparent at segment level, not industry level

* ISIC: International Standard Industrial Classification, SIC: Standard Industrial Classification, GICS: Global Industry Classification Standard

Source: Global Vantage, WIM, Global Insight, Compu stat, McKinsey analysis
Granularity

Not commonly used in business yet ... but widely used in scientific and engineering circles

Refers to the size of the components of a larger system

Cuts through the tyranny of the “averaged view”
Portfolio momentum is important for growth and value creation
Percent CAGR, 1999-2004

Company classification

Average market growth of portfolio***
Percent

<table>
<thead>
<tr>
<th>Revenue growth</th>
<th>TRS performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>Low</td>
</tr>
<tr>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>High</td>
<td>Low</td>
</tr>
</tbody>
</table>

- **Growth Giants**: 10.0%
- **Unrewarded**: 6.7%
- **Performers**: 3.2%
- **Challenged**: 3.3%

* 99-04 CAGR of World Gross Output
** 99-04 CAGR of MSCI World Index (-2.1%)
*** Includes changes in market growth due to portfolio shifts

Source: McKinsey Growth Decomposition database
The more cylinders fired, the higher the growth and TRS performance
End of year 1999 to end of year 2005, percent (number of companies) N = 416 decomposed companies

<table>
<thead>
<tr>
<th>Growth cylinders</th>
<th>Average revenue CAGR</th>
<th>Average TRS CAGR</th>
<th>Growth performance classification</th>
</tr>
</thead>
<tbody>
<tr>
<td>Firing on 3 (6)</td>
<td>33.4</td>
<td>40.2</td>
<td>Exceptional</td>
</tr>
<tr>
<td>Firing on 2 (65)</td>
<td>22.1</td>
<td>16.5</td>
<td>Great</td>
</tr>
<tr>
<td>Top-decile firing on 1 (96)*</td>
<td>19.8</td>
<td>14.7</td>
<td>Good</td>
</tr>
<tr>
<td>Firing on 1 and not misfiring on more than 1 (153)</td>
<td>12.7</td>
<td>10.3</td>
<td>Poor</td>
</tr>
<tr>
<td>Not firing on any or misfiring on more than 1 (192)</td>
<td>3.4</td>
<td>3.7</td>
<td></td>
</tr>
</tbody>
</table>

* Top-decile pattern group overlaps with the other groups in chart.
* "Fire" determined as top quartile performance on cylinder, "misfire" as bottom quartile

Source: Decomposition database
Growth Enablers: Leading Granularity at scale

- **Growth Direction**:
  - Horizons
  - Decomposition
  - Momentum
  - M&A
  - Market share
  - Insight

- **Scale Platforms**:
  - Portfolio
  - Investment volume
  - M&A engine
  - Insight engine
  - Leadership capacity

- **Granular Strategies**:
  - Nano-segments
  - Staircases
  - 3+ year horizon
  - Gated “funding”
  - Diversification
  - Cycle specific

- **Granular Blueprint**:
  - Matching market texture
  - Matching decision texture
  - Managed at 100+ clusters
### Don't stop in a downturn

Reaction to upturn or downturn in a major segment, percent of companies

<table>
<thead>
<tr>
<th>Company reaction</th>
<th>Upturn/flat</th>
<th>Downturn</th>
</tr>
</thead>
<tbody>
<tr>
<td>No reaction</td>
<td>40</td>
<td>60</td>
</tr>
<tr>
<td>Increase market share in affected segment*</td>
<td>27</td>
<td>7</td>
</tr>
<tr>
<td>Divest in affected segment**</td>
<td>6</td>
<td>10</td>
</tr>
<tr>
<td>Divest in other segment**</td>
<td>6</td>
<td>7</td>
</tr>
<tr>
<td>Acquire in affected segment**</td>
<td>27</td>
<td>13</td>
</tr>
<tr>
<td>Acquire in other segment**</td>
<td>13</td>
<td>12</td>
</tr>
</tbody>
</table>

* Share gain in top quartile (i.e. 3.3% for both 2002 and 2003
** Sum of acquisitions (divestitures) for segments in period 2002-04 represents more than 11% (14%) of 2001 sales (corresponds to 2.5 years of acquisitions at top inorganic quartile rate and 3 years of divestments

Firing the M&A cylinder is the most value-creating step one can take during a downturn – only a small minority of companies seize this opportunity.