Building an engine for growth that funds itself

You don’t have to look far to finance your growth ambitions.

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To drive growth, you first have to find the fuel—and for many companies, that's not so straightforward. Internal and external obstacles, including onerous approval processes, and short-term stock-market impact, can make it hard to fund promising ventures. But it doesn't have to be that way.

Our research shows that many companies that consistently post top-line growth operate with what we call an investor mind-set. They continually squeeze funds from underperforming areas and allocate the savings to new ventures or existing programs that have the potential to scale. In other words, they fund their own growth.

As simple as that might sound, this investor approach is a significant departure for many executives, who tend to be consumed with cutting costs and playing it safe by banking marginal gains. They fall victim to a common behavior that drives only short-term profit: taking the savings from often highly disciplined cost-cutting programs and dropping the cash to the bottom line.

Growth leaders are different. They constantly scour for savings across the business. They know exactly where each incremental dollar of savings should be reinvested to drive new growth, and they know the ROI of every dollar invested. In our experience, it often takes a significant event, such as a new CEO or business-unit leader, an acquisition, or a transformation to turn around a declining business, to jolt the business into action. While these catalysts are effective motivators, business leaders intent on driving growth (and in some industries or sectors facing stiff headwinds, investing only in growth might not be the best option) don't have to wait for them to occur to build the Investor DNA into their organization.

This Investor approach is most effective as part of a purposeful and diversified approach to driving growth (Exhibit 1).

The Performer approach, where businesses continually optimize commercial functions (marketing, sales, and pricing) can yield a massive source of investment funding. The Creator approach pours those investments into new products, services, or business models to drive future growth. The true power of the Investor profile is reflected in a recent McKinsey survey, which revealed that 51 percent of top-growth companies use Invest as their primary growth approach (vs. 20 percent for Create and 28 percent for Perform), though there is significant variance by sector (the Investor premium is significant in pharma, for example, but much less so in automotive and assembly).

How to think and act like an Investor

For companies looking to jump-start their growth ambitions, the Investor approach can be a fast way to achieve results. Investing in proven winners—initiatives that are already driving growth but may be underfunded—can put points on the board quickly. Sustaining that, however, requires leaders to be intentional in making the necessary commitments to change the business's growth trajectory. That includes making a number of "big moves" (as our colleagues who authored *Breaking the Hockey Stick* call them) to improve productivity and dynamically reallocate funds. It also requires putting in place new processes and using data to make better decisions. In fact, data and analytics are the top differentiating capabilities between high-growth Investor companies and their peers, according to McKinsey research (Exhibit 2).

1. Find the money and squeeze

Investor companies can uncover hundreds of millions of dollars in savings. This isn't some

Exhibit 1 Three strategies for organic growth

theoretical pot of money that will materialize in the distant future; often, companies can begin banking the new funds in a matter of weeks or months. Here are three steps high-performing companies take to find the biggest savings opportunities:

Get real about transparency.

For growth leaders, there's no such thing as black-box spending, in which you invest money in a service or program and wait to see how it works out. Instead, these companies insist on radical transparency, demanding to know the exact purpose of each dollar spent as well as the anticipated return. They put in place processes, metrics, and simple dashboards that allow them to get a clearer view of how their spend is performing. Increasingly, we're seeing the maturation of IoT technologies) that can now provide near real-time insights into process and performance, particularly in logistics, supply-chain management, and manufacturing.

On the commercial front, Western Union provides an example of a systematic approach to bringing transparency to media activities. The company

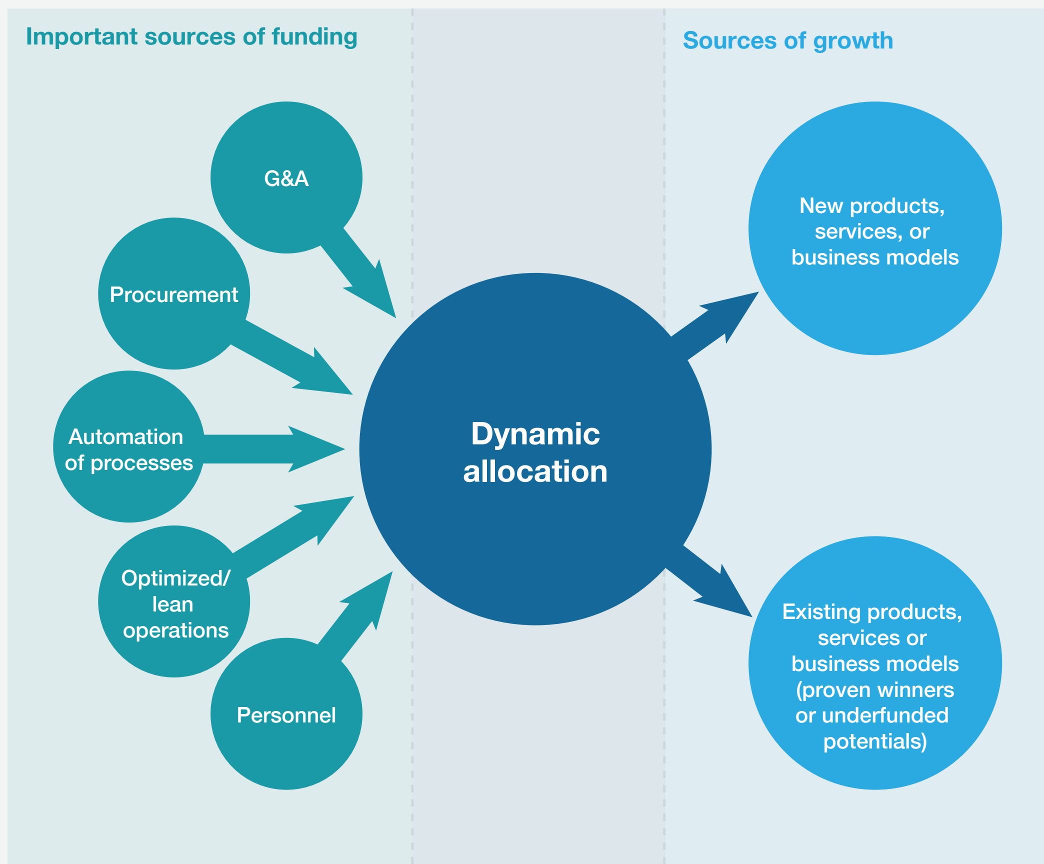
embarked on a program to break down the efficiency and effectiveness of its media spend. It consolidated its agency roster and improved the way it negotiated commercial terms with its agencies. That work included developing a better understanding of costs, which allowed it to be more precise about bidding out the work. The company also put in place different effectiveness measures.

Drive maximum productivity.

Just as underperforming programs sometimes continue to receive funding out of inertia, some processes may continue to churn along even though there are faster, cheaper alternatives. High-performing Investor companies continually scour their organization for outdated, inefficient ways of operating. To get the full benefits of productivity, each process should be in the top 30 percent for the industry.[1] A few of the most promising areas of focus are:

- **Efficiency.** Leading companies engage in detailed process mapping, looking for opportunities to streamline operations, eliminate redundant

Exhibit 2 **Overview of the Investor approach to funding your growth**



processes, and hunt down opportunities to rationalize partnerships. Advanced analytics has emerged as a powerful capability in driving new levels of efficiency. Utility transmission and distribution operators, for example, that are able to use advanced analytics to predict maintenance activities can reduce their costs by 10 to 20 percent, while improving asset reliability.[2] Simplification can also be useful in improving efficiency. One telecom provider reduced its product portfolio by 80 percent before streamlining its digital experience and supporting platform.[3]

- **Procurement.** Adding rigor to procurement of products and services by benchmarking prices, soliciting bids, moving some services in house, and driving for transparency can unlock significant savings. When it comes to marketing, we've found that by analyzing ongoing costs such as agency and overhead, companies can uncover savings of 10 to 20 percent on marketing spend. Digital has the potential to radically increase savings as well. In a recent McKinsey survey, chief procurement officers said they expect their digital procurement programs to increase annual savings by 40 percent.

- **Automation.** Advances in analytics have allowed companies to unlock significant efficiencies, resulting in enormous savings through reduced time, errors, and personnel costs (often while also improving the customer experience and overall performance.) Robotic process automation, for example, is able to cut policy conversion time by 50 percent for insurance companies while one large financial institution used RPA to reduce processing costs by 80 percent.[4]

Trim the excess.

We have found that in most organizations, general and administration expenses (G&A) and personnel are likely to yield the biggest cost-saving opportunities. The most effective personnel savings are based on rethinking processes and ways you work as well as revisiting strategic priorities, rather than simply letting go of people. When done correctly, best-in-class businesses reduce overlaps in activities, eliminate inefficiencies, and focus personnel on growth activities. One consumer-goods company readjusted its strategy to focus on customer service and innovation, allowing it to cut back on capabilities that didn't support those specific capabilities. This led to roughly 20 percent in savings in personnel costs. But cuts must be approached with care. G&A includes some critical activities, such as enabling innovation and developing talent. When done correctly, however, the impact can be profound. One global chemical company invested substantial effort in identifying discrete cost-saving opportunities across functions, tracking performance and involving hundreds of employees company-wide. It succeeded in reducing G&A by more than 20 percent within one year and sustaining its improvements for more than three years thereafter. In all, the company realized savings of well over $100 million and earnings before interest, taxes, and amortization (EBITDA) margin improvements of about three percentage points over two years, and then sustained it.[5]

2. Find and fund the opportunities

The most successful companies prioritize the opportunities they uncover so that they can quickly allocate funds and people to them as they become available. Those opportunities generally come in two flavors: first are proven winners—existing programs that could outperform with greater investment. The second are promising new areas that require funding to acquire or launch. A good example of the first is when Geico dug deep into the return on its marketing spend and found that advertising drove the fastest growth. So over the course of 15 years, it tripled its marketing budget—and increased market

share by 150 percent, in essence pulling money out of underperforming programs to fund a proven growth engine. For other companies, the growth drivers will be different; the important thing is to find what drives growth for *your* company—and fund it.

To be ready to allocate funds quickly to the most promising opportunities, successful companies take the following steps:

- **Identify and fund the high-potential opportunities:** Most companies have plenty of data on hand to pinpoint the areas of greatest potential. This should yield insights both on where to invest for immediate growth and where investments are most likely to pay off over the long term. Former Comcast Cable CEO Neil Smit said that when he joined the company, it was selling over a million subscriptions a year to its high-speed data (HSD) service, yet HSD had received little investment. "It's a high-margin product. We're underpenetrated. That's the product we have to drive the hardest," Smit recalls. Chase took a similar approach when creating Sapphire Reserve, a credit card targeting affluent millennials, with a rich set of benefits (travel, experiences) to break through the clutter of the marketplace. The initial launch was so successful that Chase doubled down by cutting $200 million in selling, general and administrative (SG&A) costs to fund the benefits as they continued to expand the program. This effort led to 13 percent growth in the credit-card business in 2017, with Reserve cardholders spending six times more than the industry average. As companies search for opportunities, they should also mine their frontline workers, who can be an important source of intelligence on trends and opportunities. Many businesses find it helpful to create an "opportunity map" of potentially lucrative hot spots. The best companies, however, run advanced analytics against internal and external data sets from a variety of sources to build a picture of the future opportunity, not the historical reality.

- **Reallocate funds and people dynamically:** High-performing Investor companies have mastered the art of dynamic allocation. Research from McKinsey shows that dynamic reallocators, those that reallocate at least 49 percent of the previous year's budget, achieve a compound annual growth rate in total return to shareholders of 10 percent, compared with just 6.1 percent for static allocators. Roughly 57 percent of companies in the top quartile for growth actively manage their portfolios based on ROI, according to a recent McKinsey survey. And it's not just about putting funds to use; it's about focusing your best talent on where the growth is. One digital healthcare business credits effectively allocating people's time with making the difference between a 60 percent growth rate and one that's 20 percent. Effective allocation, however, requires discipline to follow through and a clear set of metrics that decision makers are aligned around. Leadership alignment on priority markets, in fact, is the top Investor activity for top-quartile growth companies.

- **Fund a continuous, systematic stream of acquisitions.** Programmatic M&A can be a powerful lever for growth. Companies that use it well invest up to 30 percent of their market cap each year in acquisitions that mesh with their strengths. To do that, however, requires constant work to maintain a healthy pipeline of target companies. Corning, for example, did due diligence on an average of 20 companies per year and made an average of five bids to maintain its pace of three acquisitions per year. This approach helped it to break out of the middle tier in its sector to become a top grower.

- **Be disciplined in prioritizing opportunities.** To keep the process untainted by bias or territorial thinking, it must be rigorous and transparent, taking into account both the opportunities and the needs of the organization as a whole. One leading CPG set up a "global reinvestment council" of more than 20 leaders from across countries, regions, and functions to review business priorities against investment ideas and to make the tough calls on whether to focus on new ventures or pour funds into existing operations.

3. Embed the capabilities

To fund your own growth, disciplined decision making must become the new normal rather than a one-off exercise. Here are some critical steps to take:

- **Build a rigorous budgeting process.** Rigor in budgeting requires clarity about current budget performance and a commitment to allocating spend to drive growth. Zero-based budgeting (ZBB), for example, requires teams to rebuild their annual budgets from zero, with no carryover from the previous year. This process helps to identify small and not-so-small pockets of waste that can add up to big savings. While it is common for budget owners to use bottom-up budgeting, for truly breakthrough results, they need systematic visibility into budgets, clarity about what to measure, accountability for ambitious targets, and governance mechanisms to challenge budgets and reallocate resources. As Lila Snyder, executive vice president and president of global e-commerce at Pitney Bowes, put it, "We've set pretty explicit metrics for each business around the types of margins and the types of investments that we're willing to make. It's been very important to have that in the background, because it's easy to get distracted one quarter to the next when you're seeing growth but maybe not seeing margin."

- **Build mechanisms to surface investment opportunities.** Finding opportunities to save and reinvest requires engagement from across the enterprise, from finance experts to product owners to business-unit leaders. But while the spirit of cooperation may be strong, without dedicated mechanisms to surface opportunities, those good intentions often amount to little. A leading consumer company set up a "fighting fund" where internal sponsors can apply for investment, using a business case and proven ROI. The company implemented a quarterly application cycle, with requalification required at agreed upon stage-gates when teams must submit detailed business cases as part of their reapplication.

- **Support data-driven decision-making.** Investors of any sort are only as effective as the data they rely on. Many bring in data scientists to set up a robust analytics capability. Once they identify the highest-potential areas for investment, they use analytics to develop a more granular view of where—and how—to double down, investigating by city, segment, region, product, or even demographics, using a mix of methods. One leading consumer company worked with artificial-intelligence specialist Spark Beyond to analyze hundreds of thousands of inputs. The analysis helped it to identify meta trends in the data that pointed to pockets of growth targeted down to the suburb, nationality, even family size. In developing effective analytics, it's important to focus on rationalizing data and creating common standards (for KPIs, metrics) so that investment performance across activities is comparable.

While operating like an Investor requires specific capabilities, the key differentiator is mind-set. Without a near-fanatical leadership commitment

Are you thinking and acting like an Investor?

- Where are you going to find the next 20 percent of your funds to invest in growth?
- Do you know where the largest pools of funds in your business are?
- What percent of your G&A costs have you reduced in the past year?
- Are you reallocating more than 40 percent of last year's budget into different areas?
- How often do you reallocate your resources?
- Do you know where you'll invest your next incremental dollar?
- What are the five areas of your business that are growing the fastest or have the potential to grow the fastest?
- What data are you using as the basis of your allocation and investment decisions?
- What is your top talent working on, and is that driving growth for the business?

to continually squeezing money from existing programs *and* the discipline to invest in growth, companies will find themselves missing out on their potential. ■

[1] Chris Bradley, Martin Hirt, and Sven Smit, "Strategy to beat the odds," McKinsey.com, February, 2018

[2] Jiri Franta, David González, Jesús Rodríguez González, and Rui de Sousa, "Harnessing the power of advanced analytics in electricity networks' asset management," McKinsey.com, April 2018.

[3] Shital Chheda, Ewan Duncan, and Stefan Roggenhofer, "Putting customer experience at the heart of next-generation operating models," McKinsey.com, March 2017.

[4] Federico Berruti, Graeme Nixon, Giambattista Taglioni, and Rob Whiteman, "Intelligent process automation: The engine at the core of the next-generation operating model," McKinsey.com, 2017.

[5] Alexander Edlich, Heiko Heimes, and Allison Watson, "Can you achieve and sustain G&A cost reductions?" *McKinsey Quarterly*, October 2016.

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