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Why business building is the new priority for growth

It can help companies diversify their revenues and keep pace with shifting customers and markets. But incumbents often lack the skills they need.

by Shaun Collins, Ralf Dreischmeier, Ari Libarikian, and Upasana Unni

Business building is the top priority for organic growth at companies during the COVID-19 pandemic, and incumbents are launching new businesses with ever greater frequency, according to our new global survey.[1] The findings suggest that companies that prioritize business building tend to grow faster than their peers, respond with greater resilience to volatility and economic shocks, and, as they gain experience building businesses, see more success from it. But not all companies succeed: only 24 percent of new businesses launched in the past ten years are viable large-scale enterprises today.

To shed light on the differences between outperformers and also-rans, our survey included more than 800 company executives across a range of industries, sectors, and geographies. So far as we know, this was the first at-scale research to explore corporate business building. The survey revealed that an impressive 52 percent of executives consider business building a top-three (or higher) priority for growth. We also found that a small set of companies enjoy success rates two times higher than those of high-potential start-ups (24 percent versus 8, respectively).[2] The experience of these companies clarifies the winning approach to launching and scaling new businesses. As more companies adopt these successful practices, a new wave of innovation could arise from not just entrepreneurial efforts but also *intra*preneurial ones. That would boost organic growth and improve the prospects of companies looking to jump into the top tier of performance.

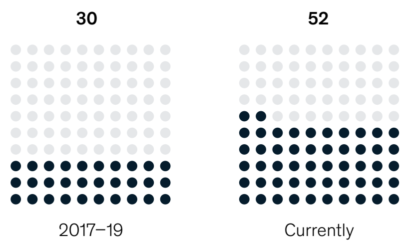
[1] For the purposes of this research, we define business building as the creation of new products or services for which a company does not have an existing footprint, or the building of completely new business models.

[2] As a proxy for the success rates of high-potential start-ups, we considered the share of start-ups admitted to a leading incubator that went on to reach a Series C investment round or beyond.

Exhibit 1

Business building is an increasing priority for executives in the transition to the next normal.

Organizations with new business building as a top-three strategic priority or higher, % of respondents



~1.7× more businesses currently view new business building as a top-three strategic priority or higher

Source: McKinsey Global Survey on business building, August 2020

The new priority for organic growth

Even before the pandemic, our own experience indicated that business building had become more important for incumbent companies looking to use innovative business models, products, and services to meet the threats and opportunities of a digitizing world. The COVID-19 crisis has accelerated and intensified that trend. In many industries, the pandemic has rewritten rules and upended assumptions, all while diminishing—or threatening to diminish—existing revenue streams. Replacing lost revenues, of course, requires finding new forms of growth. And while M&A remains an essential part of the growth playbook, P/E multiples remain high, and acquisitions can be expensive. Moreover, organic growth often creates greater excess returns to shareholders than dealmaking does, even during more normal times.

We studied four different approaches to organic growth and found that business building was the most effective among them.[3] Some 74 percent of companies that chose business building as their main strategy grew at rates above the average of their industries. Only 58 percent of the companies that prioritized different strategies did. No wonder so many executives ranked business building as a top-three priority for 2020 (Exhibit 1). And these companies are putting their money where their priorities are, allocating, on average, one-third of their organic-growth capital to business building—more than twice as much as the laggards do. The shift to business building isn't confined to a few sectors or regions. In all those we surveyed, companies give business building pride of place on the corporate agenda (Exhibits 2 and 3).

Downturns are often times of innovation, of course—companies such as Airbnb and Uber were launched during the Great Recession. But the rise of business building as a priority for executives could suggest that incumbents are muscling into the start-up space at an unprecedented scale. A resulting surge of innovation may already be visible in the greater resilience that business builders have shown during the COVID-19 crisis. Thirty-four percent of the companies that prioritized business building experienced no change or an improvement in growth as a result of COVID-19. Only 26 percent of companies that prioritized other organic-growth strategies did.

Where business builders stumble

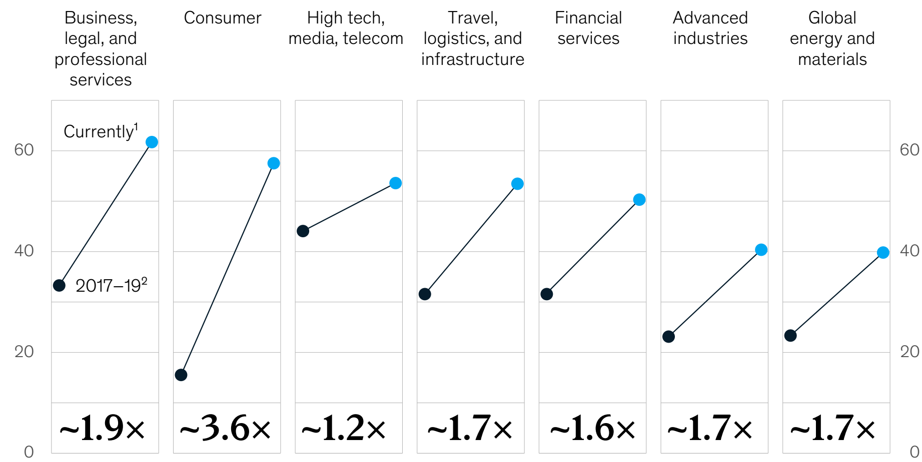
Only a small segment of companies capture most of the growth from business building: of the viable large-scale businesses built in the past ten years, respondents report that 66 percent of them were created by only 20 percent of incumbent companies. These leaders say that this approach to growth helps them meet shifting customer expectations, protects them against industry disruptions and economic shocks, and increases their organizational agility (Exhibit 4).

[3] Our research examined four different approaches to organic growth: business building; investments in existing products, services, or commercial activities that had generated organic growth in the past; optimizing core commercial capabilities (such as sales, marketing, and pricing) to improve performance; and creating new products or services in which a company had an existing footprint.

Exhibit 2

New business building has increased in priority across sectors.

Organizations with new business building as a top-three strategic priority or higher, by industry, %



[1] n = 730.
[2] n = 729.
Source: McKinsey Global Survey on business building, August 2020

Meanwhile, most companies have yet to see their business-building efforts bear fruit: only 24 percent of the new businesses in big corporations become viable large-scale enterprises, even as respondents say they expect the success rate to rise in the future. Businesses that cannot scale up their operations encounter a range of barriers to success, from insufficient time and resources to a lack of operational freedom from the core business. But the following two reasons were cited most frequently by the less successful business builders:

A lack of adaptability

Commenting on the business building they were most familiar with, 30 percent of failing businesses cited unexpected disruptions in the market and business environment as the biggest reason these news businesses fell short of expectations. This might seem intuitively obvious. In business, after all, just about the only certainty is that the future is uncertain and will bring unforeseen challenges that are difficult to plan for.

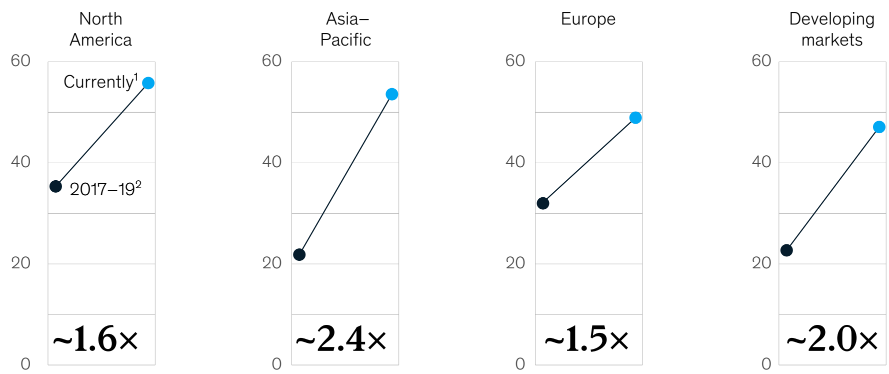
But disruption isn't the real problem, which is the inability of so many new businesses to adapt and pivot effectively when circumstances change or they get information that challenges their previous assumptions. Although executives cannot necessarily predict which challenges their companies will face, they can prepare for them. We have found, for example, that successful business builders put in place "learning buffers"—a budget cushion permitting an effective response to the uncertainties of launching any new business. This approach avoids bringing activity to a halt amid endless rounds of approvals.

Just as important, successful business builders understand how markets and customers might be changing. They constantly test their new businesses' products, services, and business models to spot problems early, while there's still time to make midcourse

Exhibit 3

New business building has increased in priority across regions.

Organizations with new business building as a top-three strategic priority or higher, by HQ region, %



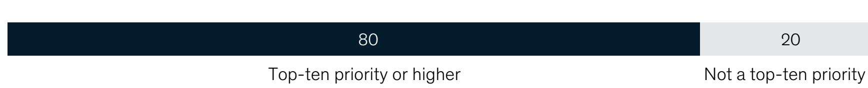
[1]n = 836.
[2]n = 837.
Source: McKinsey Global Survey on business building, August 2020

Exhibit 4

Companies build new businesses to create new revenue streams, meet customer expectations, and more.

Reasons for prioritizing business building, 2017–19,[1] % of respondents

Importance of building new businesses, 2017–19,[2] % of respondents

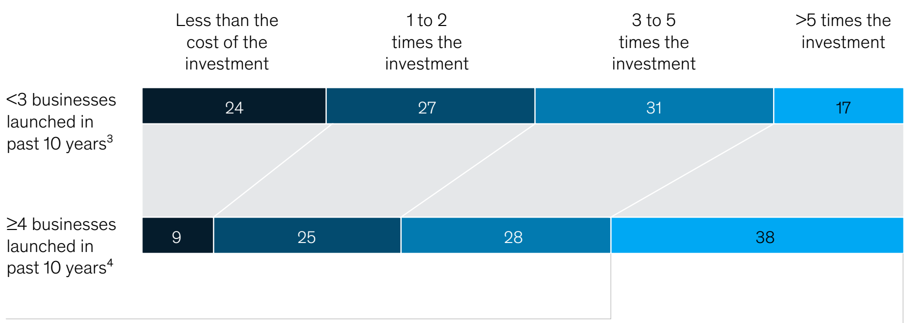


[1]Question: "What are the primary reasons your organization prioritized the building of new businesses from 2017 to 2019?" (Respondents were able to select two reasons, thus the total does not sum to 100%; results exclude respondents who selected "Don't know"; top-ten priority n = 661, top-three priority n = 263.)
[2]Question: "From 2017 to 2019, how important was building new businesses compared with other strategic priorities at your organization?" (Excludes responses for "Don't know" and is scaled to 100%; n = 846.)
Source: McKinsey Global Survey on business building, August 2020

Exhibit 5

Frequent business builders see higher average return on investment.

Average return on investment[1] for frequent versus less frequent business builders,[2] % of respondents



~2.2× more common for organizations that launched 4 or more businesses to experience an average return on investment of 5+ times the investment versus less frequent business builders

[1]Question: "What has been the average return on investment for the businesses your organization launched to customers between 2010 and 2017?" (Excludes responses for "Don't know" and is scaled to 100%.)
[2]Question: "Approximately how many new businesses has your current organization launched to customers in the past ten years?"
[3]n = 370.
[4]n = 241.
Source: McKinsey Global Survey on business building, August 2020

corrections. Keeping a close eye on the right kinds of data also reduces the possibility of encountering a catastrophic surprise. And successful business builders, we have observed, pull the plug quickly if they find that the value expected simply isn't there—and they have a process for pulling it.

An inadequate strategy for scaling the business

Business building is all about reaching scale: significant and profitable customer penetration in a target market. Underperforming business builders were half as likely (23 percent) as high performing ones (52 percent) to have a strategy for acquiring customers profitably at scale.

Companies that win the battle for scale—where successful new businesses create two-thirds of their value—build for scale from the beginning.[4] In our experience, one of the things they get right is a focus on meaningful metrics that show real customer demand, not the phantom demand arising from "buying" scale through unprofitable deals or blanketing social media with advertising. They understand what a valuable customer looks like and invest resources to target that specific profile. Perhaps most important, obvious though it might sound, they create their plan for scaling the business from the very beginning, with a clear direction for attracting new customers at a cost that allows for profitable growth.

Learning by doing

Business building can be learned. Low as the success rate might be, our survey shows that companies that have launched at least four new businesses in the past ten years were upward of twice as likely to generate returns of five or more times their investment than less frequent business builders were. This suggests that business builders learn from experience and can even improve their rate of success over time (Exhibit 5).

[4] Sonia Barquin, Ralf Dreischmeier, Sascha Hertli, Jerome Königsfeld, and Andrew Roth, "The big boost: How incumbents successfully scale their new businesses," August 2020, McKinsey.com.

Exhibit 6

Top business builders focus on leadership, customers, and talent.

Factors in place[1] for businesses performing below versus above expectations,[2] % of respondents

Factor	**Above[3]**	**Below[4]**	**Difference,** percentage point
CEO/new business leader ownership	74	42	32
Effective strategy for achieving profitable customer acquisition at scale	52	23	29
Top-tier talent within industry occupied by critical roles	39	15	24
Clear and structured process from ideation to scaling	47	25	22
Modern technology and data architecture	46	26	20
Data- and hypotheses-driven decision making	35	19	16
New business product/service meets target-audience needs	60	46	14
Agile working methods	39	26	13
Sizable and/or growing target market	55	43	12
Operational freedom from core business	43	37	6
Effective collaboration with external vendors	35	29	6
Sufficient time and resources	45	39	5
Championing of new business from senior leaders and/or board members	46	43	2
Cross-functional talent model	36	34	2
Team members' incentives aligned to success of new business	19	21	–2

[1]Question: "Which of the following statements were true of the new business while it was being built (ie, from concept development through to customer launch and initial scaling)?"
[2]Question: "How would you categorize the status of the new business today?"
[3]"Operational; significantly exceeding core business leaders' expectations for scale or growth"; n = 88.
[4]Includes answers "Operational but performing below core business leaders' expectations for scale or growth" and "Discontinued and/or never launched to customers"; n = 307.
Source: McKinsey Global Survey on business building, August 2020

Part of this success results from a portfolio effect. Instead of betting on a single new business, leading companies build a series of businesses, diversifying risk and generating above-average returns. Meanwhile, they build the capabilities needed in the core of the company to launch and scale new businesses successfully. About two-thirds of the large-scale enterprises built in the past ten years were developed by companies that took a portfolio approach and successfully built more than one large-scale enterprise.

BP, for example, created its Launchpad in-house business-building engine to set up five businesses focused on digitally led low-carbon ventures. It aims to have revenues of $1 billion each ("unicorns") by 2025. Similarly, Goldman Sachs sees business building as a crucial pathway to the growth and durability of its earnings in the context of the company's longer-term financial goals, which include ROE, efficiency, and CET1.[5] Goldman's new businesses include digital consumer banking (with Marcus by Goldman Sachs as the flagship brand) and initiatives in transaction banking. These businesses are getting traction. At the 2020 investor-day presentation, Goldman said its digital consumer-banking initiatives generated about $860 million in revenues in 2019, up from just $2 million in 2016.

[5] Common equity Tier 1.

Other practices are crucial to the success of leading business builders (Exhibit 6), as well:

The role of leadership

It might seem obvious that respondents would cite the leadership role of both the parent company's CEO and the head of the new business as the most important differentiator of successful business builders. After all, leaders at every level of the organization shape and inspire the actions of employees.

From a different perspective, however, this finding is less obvious. Many venture capital (VC) firms believe that nothing matters as much as the entrepreneur who runs the new business. Of course, incumbent companies differ from VCs in the two-way linkages that run between them and their new businesses, creating a virtuous circle. In other words, established companies have talent, funds, market insights, intellectual property, brands, data, and other assets that can give their new businesses a decisive edge over stand-alone start-ups. In return, the parent companies rightly expect to receive new revenue streams, capabilities, business models, products, and services. When this virtuous circle gets going, incumbents can better meet the pace of change in their industries by finding new business models that satisfy shifting customer needs.

These two-way exchanges can be tricky to achieve. It's difficult to combine the strength of an incumbent with the agility of a start-up. That's why leadership takes on an outsize role. CEOs of parent companies must counter the familiar arguments against business building, including internal doubts that organizations can progress beyond their traditional operating models and ways of thinking. What's more, it may not be easy to convince investors that a company's investments in new businesses will yield better returns than investments in other growth opportunities. The CEO and the head of the new business must also collaborate to identify and overcome such obstacles as bureaucracy, the allocation of overhead, and slow decision making.

Interestingly, it seems to be less important whether or not the leader of the new business comes from the corporate parent. Both companies that build new businesses more successfully and those that don't hired the head of the new business internally about two-thirds of the time. Why do some internal hires thrive while others don't? In our experience, internal hires require time, ring-fenced from other responsibilities, to drive the new business. They must be willing recruits rather than conscripts. And they may need to be somewhat insulated from the greater career risk of taking on this new role, even though the rewards too may be higher. These matters deserve the CEO's attention.

The heart of success in business building is to manage these challenges successfully and to identify a person who is committed and entrepreneurial—someone with extraordinary drive and sales instincts, as well as a willingness to challenge orthodoxies when necessary.

Finding tailwinds

Successful business builders also have an exceptional understanding of the markets in which they play. They can not only identify markets that are sizable, growing, or both but also fit new products to the needs of these markets. That makes sense, given the research showing that the single biggest determinant of a company's performance is the industry in which it competes. Industry effects are so substantial that average companies in great industries tend to outperform great companies in poor ones. If your company competes in an industry subject to headwinds, business building can help you edge investment toward attractive subsectors in more promising industries or reveal innovations that can help you capture market share in slower-growing industries. Fifty-five percent of successful business builders cited a sizable or growing market as a success factor. Only 43 percent of the laggards did. Successful business builders were also more likely than respondents reporting lagging businesses to say that the product or service the new business intended to offer met the needs of the target audience closely (in other words, there was good product–market fit).

Beating the odds requires thorough research into sizable, growing markets available to your company and their most attractive profit pools. Here you may benefit by taking an "outside view": building a statistical assessment of your new business by examining a reference class of similar ones.

Then start testing your business model and product fit with customers. Are you meeting a crucial market need, for example? Yes, that is a fundamental question, but too often the answer is assumed. In banking, for instance, many attackers used digital-friendly tools to target millennials—only to realize too late that older generations are digitizing more quickly than younger generations are accumulating wealth. A thorough, insightful analysis of profit pools can help you avoid such pitfalls. Once leading business builders identify an attractive market, they help ensure that their products are a good fit by following an agile test-and-learn approach that integrates design thinking.

Committing talent

Talent is the crucial ingredient in any corporate endeavor. In our survey, successful new businesses were more than twice as likely as underperformers to have top-tier talent—and to deploy it in critical roles. Further, these companies invested in talent from the get-go. Successful new businesses were almost twice as likely as underperformers to employ 20 or more people on launch, and almost two times as likely to employ 80 or more people.

Talent and capabilities are closely interrelated. The companies of nearly all respondents had a substantial need to improve their business-building skills—they cited a wide range of gaps, especially digital ones. The largest number of responses cited the design of the user experience and user interface as a gap. Modern IT and data architectures and digital marketing and sales came next, followed by agile operations.

A clear strategy—and a structured process

As the foregoing discussion of customers and markets indicates, the top agenda item for leading business builders is strategy. A rigorous approach to the entire business-building process, from initial brainstorming to scaling, is important. Of the companies that successfully scaled up new businesses, 47 percent reported having clear processes in place for the whole journey, compared with only 25 percent of companies that failed to scale their new businesses successfully. In our experience, it is critical to channel the early excitement of business building into structured milestones and deliverables, with a sprint cadence that supports rapid progress.

Too often, for example, parent companies expect new companies to break even in a few months—which rarely happens, even in a fast-moving, agile world. Companies subject to this kind of impatience risk pulling the plug too quickly. Some businesses that are unprofitable at the six-month mark nonetheless scale up thereafter, while others continue on a path to oblivion. To identify scalable new businesses, look to more midstream metrics, which are less likely to be financial than customer based. Steer clear of vanity metrics, such as share of voice or traffic, and resist the temptation to pour money into marketing to, in effect, buy customers. Look instead at their lifetime value, which should be greater than or equal to twice the cost of acquiring them. New businesses risk flaming out when they try to scale if customers don't actually value the product enough.

Business building has rocketed to the top of the corporate agenda. It provides the way forward whether your company must diversify its revenues, increase its organic growth, parry disruption, or rapidly meet the changing needs of its old and new customers. But to launch and scale new businesses, companies must deliberately develop new capabilities: structuring, leading, and staffing the new venture; building a deep, nuanced understanding of the market opportunity; and creating a successful strategy for the long-term, profitable acquisition of customers.

Business building offers a unique opportunity to incumbents: the chance to marry a start-up's agility and rapid growth potential with the resources and wisdom of an established company. That is a powerful combination. Q

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