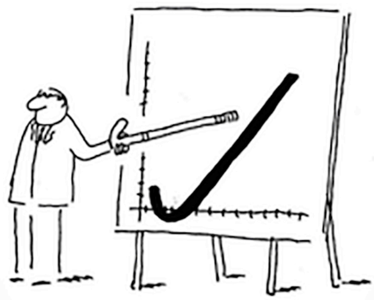
STRATEGY
BEYOND THE
HOCKEY STICK



PEOPLE, PROBABILITIES, *and* BIG MOVES *to* BEAT THE ODDS

CHRIS BRADLEY | MARTIN HIRT | SVEN SMIT

McKINSEY & COMPANY

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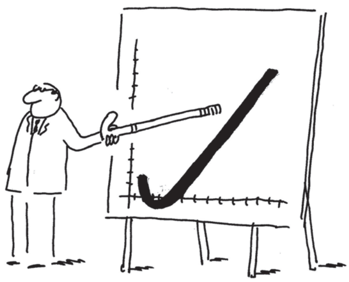

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To

Bini, Walter, and Hildegund Hirt

Bibi, Jan-Ferdel, and Ute Smit

Mel, Olivia, Alice, and Harriet Bradley

And to our

Partners and Colleagues at McKinsey & Company

for giving us the opportunity to beat the odds.

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STRATEGY
ROOM

Introduction

Welcome to the strategy room

In the strategy room, human bias and social dynamics can prevent the necessary big moves from getting on the table, let alone getting executed. In this book we arm ourselves with hard data from thousands of companies to take the "social side of strategy" head on.

Isn't there another way?"

We hear that all the time, and you must have asked yourself that question, too—probably more than once. Perhaps after an exhausting marathon of strategy sessions that are supposed to be discussions but really are just presentations. Perhaps after feeling compelled to say "yes" to another investment proposal with uncertain prospects. Perhaps after one of the usual discussions to re-allocate resources to growth opportunities that go nowhere.

Over decades of working with hundreds of the most senior business leaders around the world, we agreed:

"There has to be another way . . ."

Books about improving the strategy process fill our shelves, packed with frameworks and anecdotes that claim to crack the code of successful strategy.[1] As interesting as these books are to read, as inspiring as their case examples are, it seems we are still short a breakthrough. Today's strategic challenges are, in fact, very similar to what they've been over the ages, despite the serious efforts of a lot of smart people.

This book belongs on a different shelf. Rather than relying on the traditional approach of best practices and inspiring anecdotes, we use broad and deep empirical research. We have identified a small number of performance levers that, according to the factual evidence we compiled—and our experience in implementing them—can be used to greatly increase your odds of success. We believe we've also found the one—often overlooked—factor responsible for many of the conundrums facing us in the strategy room, the one factor that has perplexed generations of business leaders, the factor that causes so many strategies to not work out as planned. That factor is what we call the social side of strategy.

In this book, we use empirical insights to finally help you and other business leaders chart a course to address the social side of strategy and, as a result, develop better, bigger, bolder strategies.

There *is* another way!

You are not alone

As we begin our journey together through the empirics and the social side of strategy, let's peer into the strategy room and look at some of the scenes playing out there. These scenes probably feel familiar to you because they are surprisingly common despite all those books and articles about how to get to better strategy, better decisions, and better business performance.

As the strategy process starts, the team agrees that this year you will avoid huge documents with 150 slides and endless appendices. You commit to having real conversations about the future of the business and the tough choices you'll have to make. Then, two days before the first meeting, three of those 150-page documents land in the CEO's in-box with a thud. So much for real conversations. You are back wading through details in carefully scripted presentations that numb the senses before anybody has a chance to fully grasp the content.

Or, you decide that you need to have a deep strategic rethink after a stretch of indifferent results. The top team agrees on a change in direction. The board approves. Then the CFO takes over and turns that vision into a first-year budget. The boldness oozes away as those who stand to lose resources mount rear-guard actions and as other immune responses to real changes kick in. Somehow, that bold rethink produces a new budget that looks a lot like last year's budget. It's back to business as usual.

How about a third scenario? The strategy is agreed on. It all looks good on paper, and there is loads of compelling backup. But, somehow, deep down, everybody senses that the strategy is nothing more than hopeful thinking. It is a little too kind to the egos of the people who made it and a little too unwilling to embrace the harsh reality of competition. People two or three levels down in the organization—the ones who engage with actual customers, the ones who often weren't really part of the strategy process—conclude that management is stuck in a bubble, roll their eyes, and just get on with what they were doing. All that "new" strategy ends up being good for is justifying some uneconomic projects—the ones labeled "strategic" because they lose money; everybody knows that no real change in trajectory will happen because of them.

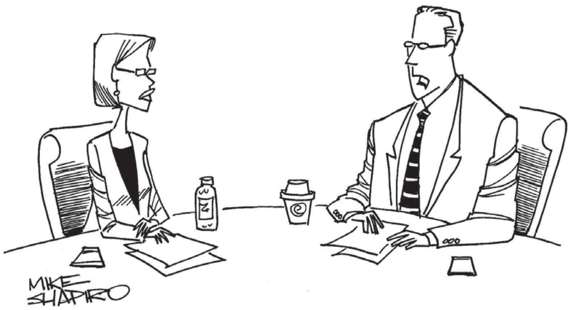
Even if you are the CEO, it can feel at times as if the inertia caused by individual behaviors and social dynamics is rather hard to deal with—and getting in the way of doing the right thing for your business. One of our client CEOs in Australia recently reflected: “I am well aware of the fact that we should be moving faster in that direction, but I have to bring the team along.”

You might be in the enviable position of leading an agile start-up or an amazing, Amazon-scale institution that still operates like it did on Day 1. If so, congratulations. You may find some of the empirics in this book interesting because of what they show about what works and what doesn’t in strategies, but you should really just keep doing what you’re doing. If you are like the managers we more commonly come across, however, you will easily recognize the symptoms we are talking about and be keen to confront the social side of strategy. And even if you are Amazon-like, you might use some of the insights shared here to see a slip coming ahead of time.

The villain is the social side of strategy

We all know that we go into the strategy process loaded with individual and institutional biases and that group dynamics in the strategy room often distort results. But that’s where the thinking about social dynamics usually ends. How often are we making an explicit effort to understand these factors and to properly deal with them? Don’t we tend to shrug our shoulders and soldier on? Too often, we seem to pretend that the strategy process is just about solving an analytical problem, knowing deep down that the analysis is really the easy part.

Frameworks and tools, the likes of which you find in your typical business book or consulting deck, can be useful in structuring your thinking and can help generate ideas. Unfortunately, they usually don’t help us break through the real barriers to good strategy. The simple reason: The social side of strategy can overwhelm the intellectual side.



"Collins, it's been brought to my attention that your secret institutional biases are in direct conflict with mine."

Peter Drucker famously said that "Culture eats strategy for breakfast."[2] Nowhere is that more evident than in the strategy room. How can that be? After all, that room is full of smart and experienced people who welcome an intellectual challenge. But strategy isn't the only thing that's at stake here. Jobs—even careers—are on the line, too. You can lose your job or status if you overpromise or under-deliver on your performance goals. So, not surprisingly, caution reigns—and a strategy process that is about job protection rarely produces the best outcomes for the company. The budget process intrudes, too. You may be discussing a 5-year strategy, but everyone knows that what really matters is the first-year budget. Inevitably, other sorts of games are played. Most managers, for instance, will try to secure resources for the coming year while deferring accountability for the returns on these investments as far as possible into the future—maybe even long enough that people will have forgotten about the original commitments, or that they themselves will have moved on to the next position. Even the most successful business leaders are human, after all.

The strategy room is full of so many competing agendas and social games that you might have sometimes wondered why people spent so much time and effort on the analysis and presentation preparations in the first place.

The outcome of all these dynamics is the hockey stick, confidently showing future success after the all-too-familiar dip on next year's budget. Truly, if ever there was one, the hockey stick is the icon of the strategy process. If we just mention the phrase, we get a knowing glance and a wry smile from the executives we've shared our research with.

With this book, we want to break the hockey stick. We want to address the social side of strategy, so the big moves that drive economic profit and shareholder value can actually happen.

Where is the outside view?

For more than 5 years now, the three of us have invested in understanding why things get bogged down so easily in the strategy process and on developing a new angle on how to deal with the issues. Having spent decades consulting with hundreds of companies across the globe, and having seen countless strategic plans, we began this journey by drawing on our personal observations. But we also decided to take our own medicine: We have tried to push past the usual anecdotes and juxtaposed experience with the reality of hard facts on corporate performance. We supplemented our observations with detailed research and analysis of several thousand of the world's largest companies. These are big-sample empirics—not the traditional collection of a few dozen, interview-based case studies.

We found that in most strategy rooms there simply aren't enough data, and certainly not all the right data. That may seem to be an odd statement, given our complaints about all those 150-page documents and their endless appendices. But those documents tend to take too narrow a view of the world. They are based on an "inside view"—the data from your own industry, the perspective of your own company, and the experience of your own team and of the executives in the strategy room.[3] The materials in strategy rooms today provide detail, but no reference data with predictive power. Interestingly, the more detailed the information you have, the more you lead yourself to believe that you know; and the more your confidence grows, the higher the risk of arriving at the wrong conclusions.[4]

When changing times demand a really big shift in strategy, this inside view turns out to be even more of a problem. It's an inside view of the wrong world, and you are caught blindsided.

"He's been brought in to give us the ultimate out-of-the-room perspective."

Rather than an ever-more-precise inside view, strategy needs an "outside view," where data about the thousands of other experiences by other executives and their companies in other strategy rooms are brought into your own strategy room to shape the discussion. Why benchmark just your operational KPIs when you could have an equally compelling, objective reference point for your strategy? Why not calibrate how good your strategy really is against a broad set of comparative data?

The problem, you might say, is that every situation is unique, right? "No other company has our brand, our resources, our set of competitors, our customers, our challenges, our opportunities." And companies aren't exactly sharing all their data with the world to make it easy for you to compare yourself against them, anyway. Well, yes. That's why there never has been a comprehensive database of strategic success and failure—until now.

We looked at publicly available information on dozens of variables for thousands of companies and found a manageable number of levers—10, in fact—that explain over 80 percent of up-drift and down-drift in corporate performance.[5]

We'll share those data with you in this book, to give you that "outside view." We will show you a way to see how your strategy stacks up—before you ever leave the strategy room, and before you start to execute your strategy. If you don't think you've given yourself strong enough odds of success, you can fall back, regroup, and reformulate your strategy to improve your chances. All that, before you start down a costly road that might just find another dead end. We will give you a new way of gaining confidence in bold strategies that change the direction of your business, because you will be able to now know the chances of your strategy succeeding, calibrated against a verifiable yardstick of corporate performance.

In the sports world, golf announcers can tell the odds that a pro will make a putt of a certain length, because the data on all the putts by all the pros have been compiled. Football stats buffs can tell you the odds that a team will win based on the score, the quarter, the number of first downs, and the name of the quarterback, because all that data have been aggregated across league games over many years. The same sort of data is now available about corporate strategy.

Making big moves happen

To get ahead of ourselves a little bit: The data show, in particular, that many companies are simply not bold enough—their strategies are not designed for *big moves*. All too often, the result is incremental improvements that have companies just playing along with the rest of their industries.

We are sure you've seen it yourself: Even if there is a major business opportunity and someone comes in with a breakthrough idea, it tends to get whittled down. The idea feels too risky; too different from what other players are doing. Some people might feel left out. It seems safer to come up with a plan that just varies slightly from last year's, to spread resources across the whole business rather than bet heavily on the break-out of one single unit.

"I used to to be incentivized to underpromise so I could overdeliver. Now I just hide under my desk."

We recently saw one CEO ask his team for aggressive growth plans. He got them back and liked many of them—only to have to cut back because there was no way to fund them all. In the end, he did not want to frustrate all but a few of his team by disproportionately allocating resources to the likely break-outs, and instead granted some resources to all the businesses. Needless to say, none of them were funded well enough to achieve a real breakthrough. Another CEO asked his team for bold moves and received an M&A idea for growing a new service business in the US. The idea passed a rigorous due diligence process, but then he got cold feet. Yet another CEO came up with a plan to leapfrog to 5G mobile communications technology that would have provided a temporary competitive advantage in Europe, but then felt the board was unlikely to approve that bold plan and self-censored the proposal to protect himself. He settled on a plan that was not much more than an extension of the past.

Our research indicates that to make sustained progress relative to competing businesses, you need to, foremost, choose the right markets to compete in, but also to pull hard enough on at least some of the levers we've identified to clear well-quantified thresholds. The good news is: These big moves do not come at the expense of increased risk. In fact, our data show that the biggest risks might lie in not moving at all.

This might sound a bit fluffy for now, but as you go through the book we will get you the hard data you need and the factual insights to support your decisions.

The journey ahead of us

We intend to take you now on a journey through the strategy room that will eventually get you to a better chance of knowing the right big moves—and to an understanding of the social side of strategy that will let you actually execute those moves. For now, we will leave you with the assertion that our insights dovetail. The data—the outside view—play a big role in giving you a chance to successfully address the problems caused by the social side of strategy and its drag toward inertia, toward small moves that feel safe.

In many ways, our insights resemble the discoveries of behavioral economists, which trace all the way back to Herbert Simon in the 1950s but which have really gathered steam over the past couple of decades with both Daniel Kahneman and more recently Richard Thaler earning Nobel Prizes in Economics. Traditionally, economists considered everyone to be acting rationally, which led to rigorous-seeming curves that were easy to comprehend but in the real world rarely predicted actual behavior. It turned out that people don't view their lives as a series of utility curves. Behavioral economists shed light on how people think and behave.

Like these behavioral economists, we have learned that purely rational approaches—the next 3 × 3 matrix, the latest best-practice case studies—rarely help in achieving breakthroughs in strategy. But observations of what's really going on in the strategy rooms—and in the boardrooms of corporations all over the globe—give us hope that it is actually possible to generate an outside view that will improve the quality of strategy and, consequently, business performance. After a long series of spirited discussions with many of your peers and our partner colleagues around the world, we feel ready to shed new light on what's going on in the strategy room.

Based on our empirical observations and insights, we will take the strategy discussion out of the realm of the theoretical and into the realm of actual behavior, then lay out our data so that you yourself can shape new, more fruitful conversations with your team.

"I DON'T KNOW MUCH ABOUT STRATEGY BUT I KNOW WHAT I LIKE."

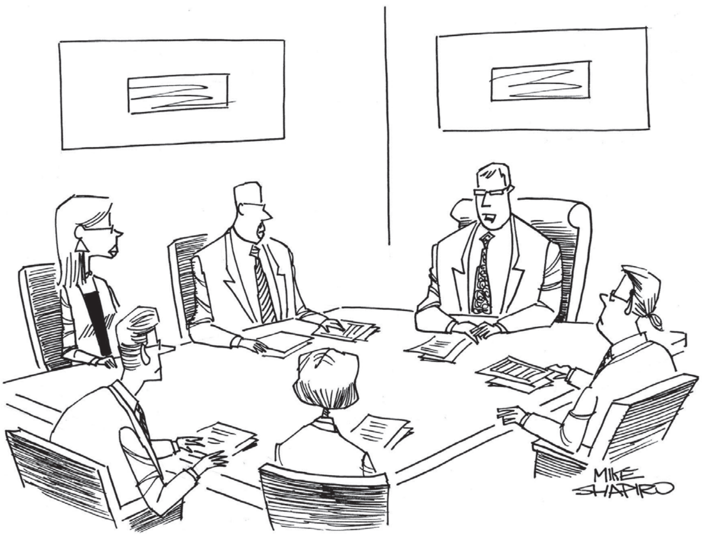
If we do this right, you will have a chance to raise your game in many ways, so that you:

- Improve the quality of strategy proposals that are discussed in your strategy room
- Engage in a very different, more collaborative and learning-oriented strategy dialogue with your team
- Experience more authenticity, more rigor, and better challenges in your strategy room
- Make less biased, better strategy decisions, calibrated against the empirics of an outside view
- Lead your team with more courage to make big moves, take calculated risks, and more vigorously commit to the execution of your strategies

To help you tame the social side of strategy, we'll start by exploring why it's so hard to manage. Then we'll lay out a new way of tracking progress based on comparisons against the whole universe of companies, not just against your prior performance or against your industry. We'll go into depth about how to think about the 10 key variables (which we refer to collectively as your endowment, your trends, and your moves), so you can figure your odds of success—and improve them while there's still time. Finally, at the end of the book, we will share with you very practical advice, eight shifts designed to help you change the dynamics in your strategy room. For instance, we will explain how to turn the strategy process from a staccato event into a continually evolving conversation. We'll explain how to get away from spreading resources thinly and actually re-allocating resources to potentially big winners; how to change your focus from setting budget targets and toward generating big moves; how to end sandbagging; and more. These shifts can make your strategy process far more effective and, we hope, a lot more energizing, too.

What will you need to do? Just two things: Get ready to embrace the social side of strategy, and be prepared to throw open the windows of your strategy room to allow for a data-driven, outside view to enter the discussion.

If you are ready to do so, you will experience your own business and your own leadership team in a new way; you will develop better strategies; and you will have a better chance of executing them well. In short, you will have a better shot at beating the odds.



“We’re going to exceed last year’s performance by doing everything exactly the same.”

Chapter 1

Games in the strategy room—and why people play them

Strategy is precisely the wrong problem for human brains and the right problem for playing games, especially when the "inside view" goes unchecked.

Many corporate strategy planning processes begin with a memo like the one on the following page. You've probably seen them before—or written some yourself. They typically lead you and your colleagues to spend months doing lots of work employing sophisticated tools, getting lots of inputs, and using lots of data.