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Emerging markets on the move

How to seize a $30 trillion opportunity

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This Quarter

For more than a decade, *McKinsey Quarterly* has focused close attention on emerging markets. The coverage has been deep and broad, including special issues devoted to Africa, China, India, and Latin America, along with a steady stream of perspectives from senior executives, McKinsey experts, and other thought leaders.

This issue of the *Quarterly* reflects our efforts to take stock of a fast-moving competitive arena that can yield rich rewards for those who participate successfully. "Winning the $30 trillion decathlon: Going for gold in emerging markets" distills a set of ten priorities for multinational companies. This essay, which shows that companies (like decathletes) prevail only if they are strong and consistent in every "event," is an abridged version of the introduction to a new publication on competing in emerging markets (available at mckinsey.com/features/30_trillion_decathlon). You'll also find in this issue several new articles that focus on specific elements of a successful emerging-market strategy: using cities as a lens for strategy setting, designing products that can cost effectively meet consumer needs, building brands, and reaching end consumers through the diverse retail channels that predominate in these markets. Although growth has recently been slowing in China and some other emerging markets, the opportunities are enormous: in 2010, developing economies represented 36 percent of global GDP but just 17 percent of sales for 100 of the world's largest global companies.

Winning will require multinationals and domestic champions alike to display strong leadership skills, a theme developed in an interview with Chanda Kochhar, CEO of India's ICICI Bank. Kochhar also mentions, encouragingly, the progress that women are making in Indian companies. McKinsey has been conducting its own research on women in senior management since 2007, and in this issue we present, for the first time, a synthesis of our findings in Asia, Europe, and North America. Other highlights include new McKinsey thinking on the business value of social media (including its productivity benefits and new sources of competitive intelligence), as well as intriguing new research on Apple's recent growth trajectory and the implications for other corporate innovators.

And don't miss the thought-provoking summary of recent McKinsey Global Institute research on strains the global labor market will probably experience in the years ahead and on the changing nature of work. Both issues will have profound implications for senior executives, particularly as they marshal their forces to compete more effectively in emerging markets.

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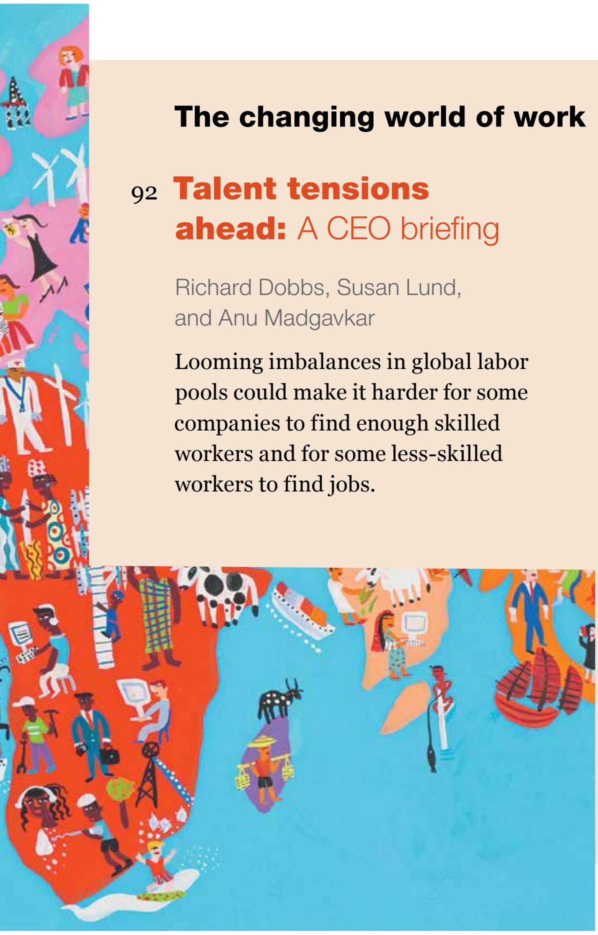
Peter N. Child
Director, London office

On the cover

Features

Taking social networks beyond marketing



The changing world of work

Idea Exchange

Readers mix it up with authors of articles from *McKinsey Quarterly*
2012 Number 3

In our previous issue, Harvard Business School's Cynthia Montgomery reflected on the unique value that strategic leaders can bring to their companies, and McKinsey's David Court, Jonathan Gordon, and Jesko Perrey assessed marketing measurement. Here, the authors respond to readers' comments on mckinseyquarterly.com.

How strategists lead

Rohit Saxena
Associate general manager, GMR Group, India

"Defining a strategist as a meaning maker and voice of reason really helps to simplify the complex problems in today's corporate world. It would be great to hear about some mechanisms that can tap strategists at the bottom of the organizational hierarchy; they often get lost."

The author responds:
"Managers throughout an organization's hierarchy need to understand and embrace strategy. If the strategy is clear, people can align their own activities with that goal in mind, pushing beyond generic best practices and creating tailored solutions. If a strategy isn't clear, managers have both a right and a duty to press for clarity; when those queries aren't answered adequately, there is reason to doubt the firm's prospects. It's also worth noting that it takes time and practice to develop the skills and sensibilities of a strategist; one shouldn't wait until he or she is in a leadership role to begin."

Measuring marketing's worth

Adriana Hoppenbrouwer
Marketing director, Hunkemöller, the Netherlands

"I believe there is one question marketers are forgetting to ask: how can I delight my consumer? In the middle of so much data and competitive pressure, we are forgetting to put the consumer back in the center of a company's decisions. We are missing opportunities for innovation, fresh thinking, and customer loyalty."

The authors respond:
"You're right. A good marketing strategy always puts consumers at its center, and therefore all marketing analytics must start with a deep understanding of the consumer decision journey. When used properly, analytic tools enhance marketing's ability to serve the consumer. Marketing is a balance of art and science, but the balance is often skewed too heavily toward art. Using data can help marketers develop programs that excite consumers, demonstrate accountability, and maximize the bottom line. Data and creativity are partners—not rivals."

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Correction note
On page 42 of our previous issue ("Leading in the 21st century"), Carlos Ghosn's comment beginning with the words "It is a paradox: on the one hand, you have to be more confident and secure, but on the other, you have to be a lot more open and empathetic," was misattributed to Josef Ackermann. We regret the error.

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The perils of best practice: Should you emulate Apple?

Marla M. Capozzi, Ari Kellen, and Sven Smit

Outliers are exactly that. Duplicating their performance is harder than we might wish.

It's no mystery why companies emulate their most successful peers. Tried-and-true approaches often seem preferable to starting from scratch, whether for developing new products or running efficient supply chains. The quest for such methods went global during the 1980s and 1990s as European and US companies sought to retool their operations by transplanting Japanese factory practices, such as kanban and just-in-time production. Management consultants—ourselves included—naturally facilitate the process by extolling successful companies as models from which others can learn proven practices that reduce risks.

However, perils abound when truly exceptional companies morph into ever more ubiquitous examples. Observers and management theorists alike, blinded by star power, eventually assume that everything these companies do should be regarded as best practice—often without examining the context in which they derive their success or without parsing the true nature of their accomplishments. Managers tempted to distill universal insights from what are in fact *exceptional* companies put their own businesses at risk for strategic or operational missteps.

Others before us—notably Bob Sutton and Jeffrey Pfeffer at Stanford, Adrian Wooldridge at the *Economist*, and Phil Rosenzweig at IMD—have issued warnings about best-practice traps and management-theory fads.[1] Yet the desire to emulate is often stronger than mere rationality, even in the face of repeated evidence that most companies won't achieve the anticipated outcomes and that some will suffer a hard fall. Research by our colleagues, for instance, has shown that lockstep benchmarking may lead to "herding" effects that, over time, diminish emulators' margins.

Apple is today's all-purpose innovation icon. In the past three years alone, more than 1,500 published articles have mentioned both "Apple" and "innovation" (a Google search displays hundreds of millions of results). As of this writing, Walter Isaacson's comprehensive biography of Steve Jobs has held a place on the *New York Times* best-seller list for over 40 weeks. Nearly 40 books on Apple and Steve Jobs have been published since his death, in October 2011—celebrating the company's can-do culture, breakthrough product designs, global supply chain prowess, and legendary cofounder. A unique confluence of leadership, talent, strategy, and technology has brought Apple extraordinary success and raises the question of how relevant a model the company can be for others as they chart their own innovation course. To answer the question of how exceptional Apple actually is, we analyzed its growth using the analytic technique that underpins the 2008 book *The Granularity of Growth*.[2]

This approach, at its core, entails disaggregating the sources of growth into three categories. The first is to compete in the right markets and harness their momentum to expand sales of current products and services. The second uses M&A to, in effect, purchase growth. Finally, companies can grow organically, through market share gains from existing or new products and services.

Since 1999, the more than 750 companies in our database have, on average, derived a negligible portion of their growth from organic share gains of any kind.[3] Apple, by contrast, has grown almost entirely through share gains. And that's just the beginning of its uniqueness. Of the companies that have expanded through market share growth, only a few have created new markets from whole cloth, either by being the first to enter entirely new geographies or through "disruptive" innovation that creates completely new products, services, or business models. In fact, our research shows that from 1999 to 2008, Apple was the *only* global incumbent to create entire new markets, repeatedly, from disruptive innovation. This analysis, it should be noted, does not consider industry attackers or start-ups—only incumbent companies and their efforts to create new markets.

Just how unique is Apple's performance? We looked at our database's top ten companies that grew by creating new markets. Apple was the only one among the top ten to capture this growth through disruptive innovation and one of only three to derive more than 5 percent of its annual growth from creating new markets. Nine companies grew by entering fast-growing emerging markets. Seven of those nine, including the other two whose annual growth from creating new markets exceeded 5 percent, were from the telecommunications sector. (The remaining two were a consumer products company and a conglomerate.) At the same time, Apple's 7.9 percent growth from disruptive innovation represented 45 percent of its company-wide growth. For others among the top ten, the average growth derived from entering new markets was just 21 percent of total growth.

Apple's performance also has been singular among its peers in the innovative high-technology sector. The company's growth through market creation is about six times higher than that of the second- and third-ranked companies achieving rapid growth by creating new markets—Lenovo and Cisco. In other sectors, including consumer packaged goods, retail, and health care, incumbents' growth through creating new markets was close to zero or in some cases slightly negative.[4]

Apple does deserve its place in today's hierarchy of esteemed companies by virtue of its unique accomplishments; its innovative products, services, and business models; its culture; and its processes and capabilities in areas

Exhibit

Companies that innovate at scale outperform competitors in their sector.

For 322 companies in 6 sectors that showed positive organic growth from 1999 to 2007

Type of organic growth	**Consistent year on year** (ie, 70% of total over time frame)	**Frequent but not year on year** (ie, 50% of total over time frame)	**Sporadic**	**Limited**
Share of companies[1]	6%	22%	50%	21%
Absolute CAGR,[2] 1999–2007, %				
Organic growth (share gains)	14.2	3.9	–0.7	–2.3
Growth through M&A	4.8	3.9	3.0	2.2
Momentum growth				
Portfolio unchanged	10.6	6.0	6.6	6.0
Portfolio changed	0.5	0.1	0.1	–0.1
Total revenue growth	**30.1**	**13.9**	**9.0**	**5.8**
Total returns to shareholders (TRS),[3] %	23.5	10.3	7.5	5.9

[1]Figures do not sum to 100%, because of rounding.
[2]Compound annual growth rate.
[3]Includes both public and private companies that were public between 1999 and 2007.

such as supply chain management—not to mention the extraordinary leadership of its cofounder and current executives. In addition, we don't mean to say that companies should *never* emulate Apple or other truly exceptional businesses. Many companies can draw new insights from Apple's achievements in design, brand loyalty, and retailing, to name a few things. Rather, our analysis is a cautionary tale suggesting that executives take a clear-eyed view of the companies they want to emulate, as well as the returns and outcomes they expect from doing so.

An alternative to the headlong pursuit of disruptive innovation is what we call an "innovation at scale" strategy: repeatable and sustainable organic growth across the organization from new products and services—growth that builds on the foundation of a company's core business. Analysis of more than 300 companies indicates that from 1999 to 2007, companies that showed positive organic share gains, year over year, for 70 percent or more of that time frame were, on average, twice as likely as other companies in their sector to outperform competitors as measured by total returns to shareholders. Companies that innovated at scale successfully at least 50 percent of the time were also more likely to outperform, but to a lesser degree (exhibit).

This approach, too, is challenging: just 6 percent of global incumbent companies innovated at scale 70 percent of the time during this period. Still, the data suggest that identifying ways to exploit existing assets, including technology, organizational capabilities, or business model strengths, is within the reach of many more incumbent companies than might succeed in creating new markets, as Apple and few others have done.

[1] See Jeffrey Pfeffer and Robert L. Sutton, *Hard Facts, Dangerous Half-Truths and Total Nonsense: Profiting from Evidence-Based Management*, Cambridge, MA: Harvard Business Press, 2006; Adrian Wooldridge, *Masters of Management: How the Business Gurus and Their Ideas Have Changed the World—For Better and for Worse*, New York: Harper Business, 2011; and Phil Rosenzweig, "The halo effect and other managerial delusions," mckinseyquarterly.com, February 2007.

[2] See Mehrdad Baghai, Sven Smit, and Patrick Viguerie, *The Granularity of Growth*, Hoboken, New Jersey: John Wiley & Sons, 2008, which rests on a proprietary database of more than 750 large global companies that we have continued updating and analyzing. The research on which this article is based draws on that database and on public documents from Apple and other companies.

[3] For example, a disaggregation of growth for companies in our database between 1999 and 2005 shows that of the overall 8.6 percent top-line annual growth achieved by the average large company, just 0.1 percentage points came from market share performance, 5.5 percentage points from the market growth of the segments in existing business portfolios, and 3.0 percentage points from M&A.

[4] We measured the average movement in portfolio growth across each sector.

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Airlines

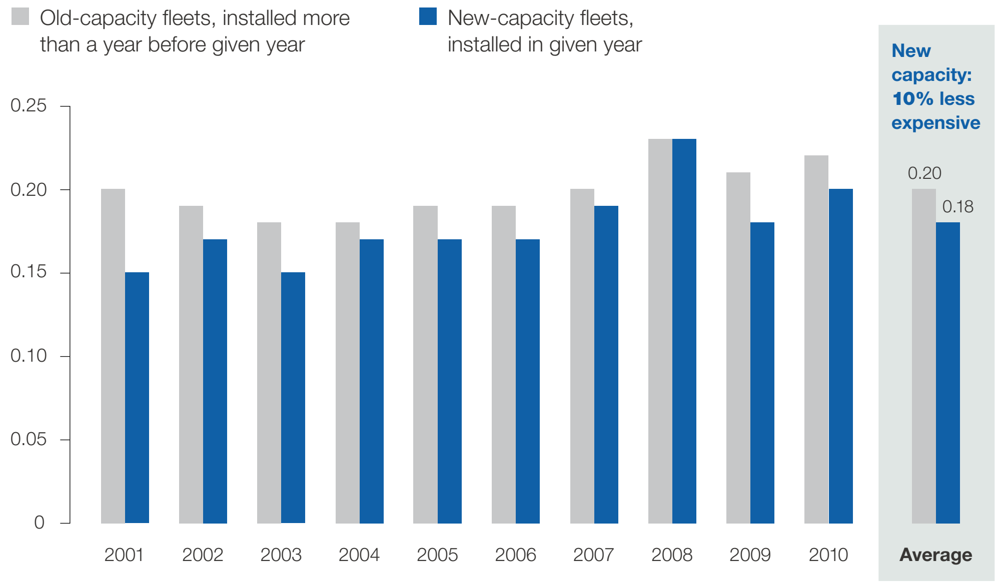
Sizing the advantages of incumbency

Alex Dichter, Ekaterina Khvatova, and Corrado Sala

Incumbents in network-based industries, such as telecommunications, usually benefit from economies of scale that set high barriers to entry for new players. Airlines are an exception to this rule. Our analysis of the performance of the top nine US airlines over the last ten years indicates that the industry's new capacity is about 10 percent less expensive to operate than existing capacity,[1] since newer planes are typically more efficient and require less maintenance than older models. Carriers with newer fleets thus enjoy operating benefits that help them to offset the capital costs of new planes and to charge less for flights than do established airlines that have older planes or may be locked into long-term leases.

Lower operating costs give airline entrants an edge.

US airline industry's operating cost per available seat kilometer,[1] $



[1]Based on 9 top US airlines: Alaska Airlines, American Airlines, America West (now US Airways), Continental (now United Airlines), Delta Air Lines, Northwest Airlines (now Delta Air Lines), United Airlines, US Airways, Southwest Airlines.

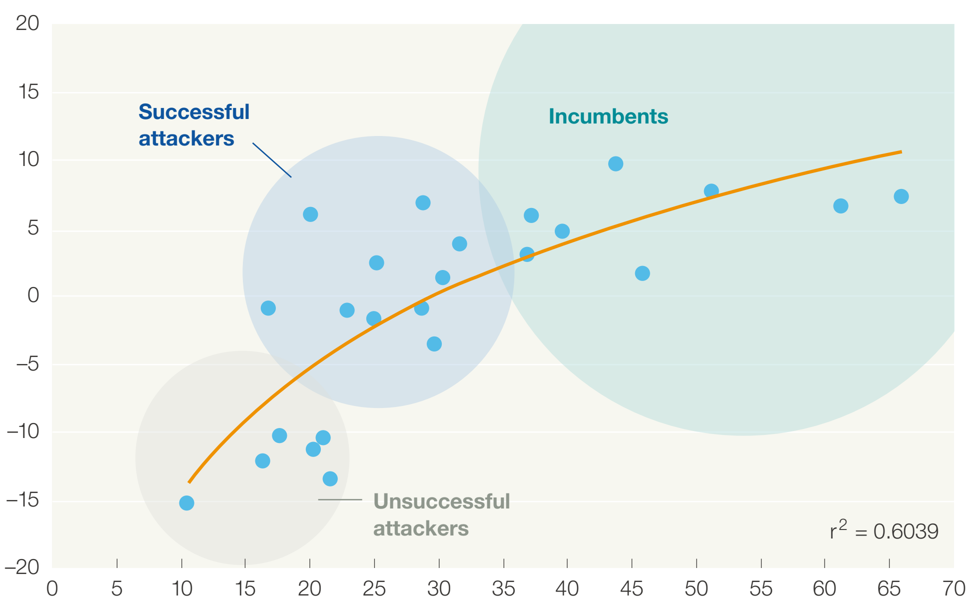
Source: Air carriers' financial data (Form 41) and Lundkvist fleet database, UBM Aviation

This cost edge among entrants helps create the perpetual oversupply and depressed margins that characterize the airline sector. It also contrasts sharply with the situation in telecommunications, where depreciated fixed assets provide a cost edge that upstarts find hard to match. Companies in capital-intensive industries where network effects predominate should always be scanning their environment for signs that new technologies might deliver operating savings that swamp the economic advantage incumbents expect to enjoy by not incurring new capital costs. ○

[1] The industry's new capacity costs about 10 percent less (per available seat kilometer) to operate than existing capacity.

Telecom incumbents benefit from depreciated assets.

Telecom industry's relative EBITDA margin,[1] %



Market share, %

r^2 is the proportion of variance explained by a regression.

[1]Relative EBITDA (earnings before interest, taxes, depreciation, and amortization) margin calculated by subtracting market average EBITDA from that of individual players.

Source: Merrill Lynch; World Cellular Information Service; McKinsey analysis

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Green products

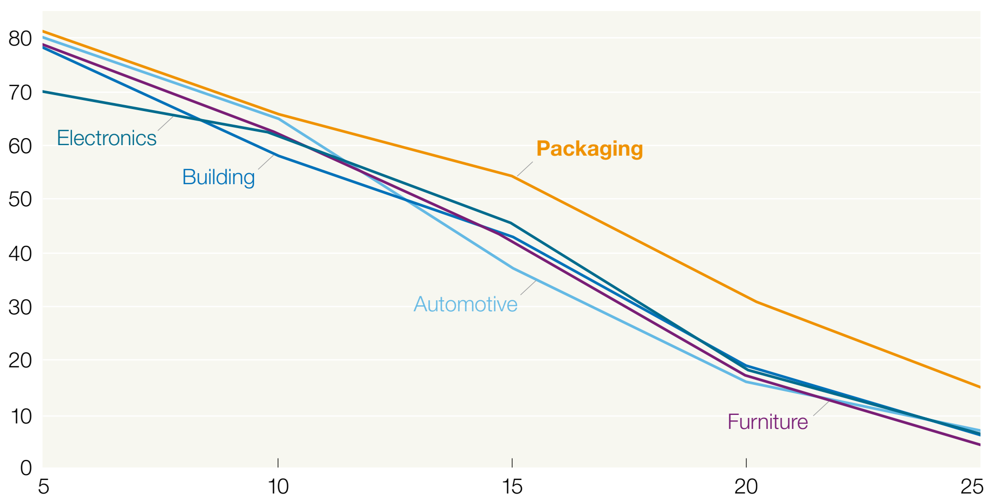
How much will consumers pay to go green?

Mehdi Miremadi, Christopher Musso, and Ulrich Weihe

Will consumers pay more for green? It's a crucial question whose answer could affect the sustainability of industry value chains: after all, many companies will pay a premium for green products and services only if they can charge customers more down the line, according to a recent McKinsey survey of 500 executives. When we then surveyed 1,000 consumers in Europe and the United States, we found that many will pay more—but only up to a point. Upward of 70 percent of consumers surveyed about purchases in the automotive, building, electronics, furniture, and packaging categories said they would pay an additional 5 percent for a green product if it met the same performance standards as a nongreen alternative. But as the premium increases, the willingness to pay melts away. For all but one category (packaging), less than 10 percent of consumers said they would choose green products if the premium rose to 25 percent.

Mehdi Miremadi is an associate principal in McKinsey's Chicago office, **Chris Musso** is a principal in the Cleveland office, and **Ulrich Weihe** is a principal in the Frankfurt office.

Share of consumers picking green, %



Green premium (ie, additional charge), %

Overcoming a bias against risk

Tim Koller, Dan Lovallo, and Zane Williams

Risk-averse midlevel managers making routine investment decisions can shift an entire company's risk profile. An organization-wide stance toward risk can help.

Much of the commentary about behavioral economics and its application to managerial practice warns against overconfidence, for biases in human behavior might lead managers to overstate the likelihood of a project's success and minimize its downside. Often overlooked are the countervailing forces—amplified by the way companies structure their reward systems—that lead managers to become risk averse or unwilling to tolerate uncertainty, even when a project's potential earnings far outweigh its potential losses.

Midlevel executives should be risk neutral when making repeated decisions about the many smaller investments a company might make—expanding a consumer goods sales force into a new geography, for example, or introducing an electronics firm's product line extension. Decisions about projects of this size don't carry the risk of financial distress, and aversion to risk at this level stifles growth and innovation. Moreover, when a large number of projects are in play, risk aversion is unnecessary because, statistically, it's extremely unlikely for all of them to fail unless they are highly correlated with the same risks.

Yet managers at this level exhibit an unwarranted aversion to risk. In fact, when faced with multiple variations of the same small- to midsized project—say, \$20 million to \$40 million—a typical manager will choose a smaller investment with lower up-front costs over a larger one with a longer payback period. As long as the smaller option is enough to meet his or her own earnings goals, the additional risk of a larger project more than outweighs the benefits to *him or her*, even if it presents little additional risk to the company and even if an increase in net present value more than offsets that additional risk.

Last year, we reported findings indicating that executives are as risk averse about small investments as they are about large ones.[1] In surveys, they demonstrated extreme levels of risk aversion regardless of the size of an investment, even when its expected value was strongly positive.[2] This suggests that the level of risk aversion is remarkably constant within organizations, when in fact it should vary by the size of an investment and its potential to cause financial distress.

Since then, we've been testing these findings in a variety of organizations and found that the tactics companies use in their capital allocation and evaluation processes often exacerbate the natural bias against risk. As a result, many companies wind up with the same degree of risk aversion at the corporate and individual levels—squandering the risk-bearing advantages of size and risk pooling that should be among a company's greatest strategic advantages.

In fact, we frequently run across CEOs stymied by the struggle with risk; decisions that may serve the best interests of individual executives (by minimizing the risk of failure) actually hurt their companies. As the CEO at a manufacturing corporation observed, its business unit–level leaders gravitate to relatively safe, straightforward strategies with earnings goals that seem reachable, even if they mean slower growth and lower investment along the way. Many nonexecutive board members have told us that their companies are not taking enough risks.

Much of the typical risk aversion for smaller investments can be attributed to a combination of two well-documented cognitive biases. The first is *loss aversion*: people fear losses more than they value equivalent gains. The second is *narrow framing*: people weigh potential risks as if there were only a single potential outcome (akin to flipping a coin only once), instead of viewing them as part of a larger portfolio of outcomes (akin to flipping, say, 50 coins). Together, these two biases lead to a distinctive set of preferences outlined in Daniel Kahneman and Amos Tversky's prospect theory, which was largely the basis for Kahneman's 2002 Nobel Prize in Economics.[3]

Companies can reduce the effects of risk aversion by promoting an organization-wide risk approach through steps such as these:

- Up the ante on risky projects. Risk-averse organizations often discard attractive projects before anyone formally proposes them. To encourage managers and senior executives to explore innovative ideas beyond their comfort levels, top executives might regularly ask them for project ideas that are risky but have high potential returns—and then ask them to develop promising proposals further before a formal review. Top executives could also require managers to submit each investment recommendation with a riskier but more profitable version of the same project.

- Consider both the upside and the downside. Executives should require project plans to come with a range of scenarios or outcomes, including both failure and dramatic success. Doing so will enable project evaluators to understand better the potential value of a project and its sources of risk.

  These scenarios should not be just a baseline, plus or minus an arbitrary percentage. Instead, when evaluating, say, the introduction of a new consumer goods product, managers should explicitly consider what a "home run" scenario—one with high market share or high realized unit prices—would look like.

- Avoid overcompensating for risk. Managers should also pay attention to the discount rates they use to evaluate projects. We repeatedly encounter planners who errantly use a higher discount rate just because an outcome is more uncertain or the range of possible outcomes is wider. Higher discount rates for relatively small but frequent investments, even if they are individually riskier, do not make sense once projects are pooled at a company level. Instead, companies concerned about risk exposure might adopt a rule that any investment amounting to less than 5 to 10 percent of their total investment budgets must be made in a risk-neutral manner—with no adjustment to the discount rate.

- Base performance evaluations on a portfolio of outcomes, not a single project. Wherever possible, managers should be evaluated on the performance of a portfolio of outcomes, not punished for pursuing more risky individual projects. Evaluations of personal performance would be based on various combinations of outcomes. In oil and gas exploration, for example, executives' rewards are based on the performance of a fairly large number of wells (not individual ones)—as many as 20, in one company.

- Reward skill, not luck. Companies need to understand better whether the causes of particular successes and failures were controllable or uncontrollable and eliminate the role of luck, good or bad, in structuring rewards for project managers. They should be willing to reward people who execute projects well, even if those projects fail as a result of anticipated but uncontrollable factors, and to discipline people who manage projects poorly, even if those people succeed thanks to luck.

• • •

In short, companies must revisit a range of investment project principles, and the corporate center, which by nature has a broader risk perspective, must provide more guidance. The result should be a better balance between overconfidence and risk aversion—and new avenues to growth. o

[1] Tim Koller, Dan Lovallo, and Zane Williams, "A bias against investment?," mckinseyquarterly.com, September 2011.

[2] We tested the reactions of 1,500 executives from 90 countries to a variety of investment scenarios. When presented with a hypothetical investment for which the net present value would be positive even at a 75 percent risk of loss, most respondents would accept only a 1 to 20 percent risk of loss, and responses varied little even when the size of the investment was smaller by a factor of ten.

[3] Daniel Kahneman and Amos Tversky, "Prospect theory: An analysis of decision under risk," *Econometrica*, March 1979, Volume 47, Number 2, pp. 263–91.

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1F

On the cover

Emerging markets on the move

Dig deeper by reading our new compendium, *Winning the $30 trillion decathlon: Going for gold in emerging markets*. A downloadable PDF is available at mckinsey.com/features/30_trillion_decathlon.

Winning the $30 trillion decathlon: Going for gold in emerging markets

Yuval Atsmon, Peter Child, Richard Dobbs, and Laxman Narasimhan

By 2025, annual consumption in emerging markets will reach $30 trillion—the biggest growth opportunity in the history of capitalism. To compete for the prize, companies must master ten key disciplines.

The Industrial Revolution is widely recognized as one of the most important events in economic history. Yet by many measures, the significance of that transformation pales in comparison with the defining megatrend of our age: the advent of a new consuming class in emerging countries long relegated to the periphery of the global economy.

The two shifts bear comparison. The original Industrial Revolution, hatched in the mid-1700s, took two centuries to gain full force. Britain, the revolution's birthplace, required 150 years to double its economic output per person; in the United States, locus of the revolution's second stage, doubling GDP per capita took more than 50 years. A century later, when China and India industrialized, the two nations doubled their GDP per capita in 12 and 16 years, respectively. Moreover, Britain and the United States began industrialization with populations of about ten million, whereas China and India began their economic takeoffs with populations of roughly one billion. Thus, the two leading emerging economies are experiencing roughly ten times the economic acceleration of the Industrial Revolution, on 100 times the scale—resulting in an economic force that is more than 1,000 times as big.

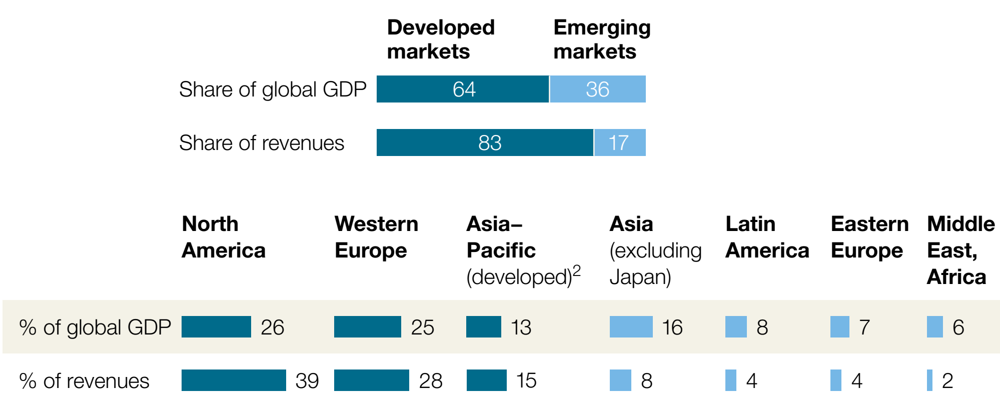
CEOs at most large multinational firms say they are well aware that emerging markets hold the key to long-term success. Yet those same executives tell us they are vexed by the complexity of seizing this opportunity. Many acknowledge that despite greater size, larger capital bases, superior product technology, and more sophisticated marketing tools, they are struggling to hold their own against local competitors. That anxiety is reflected in their companies' performance in emerging markets. In 2010, 100 of the world's largest companies headquartered in developed economies derived just 17 percent of their total revenue from emerging markets—though those markets accounted for 36 percent of global GDP (Exhibit 1) and are likely to contribute more than 70 percent of global GDP growth between now and 2025.

We wish there were a secret formula or key capability that could easily transform a company's emerging-market efforts. In fact, our experience suggests the challenge in emerging markets more closely resembles a decathlon, where success comes from all-around excellence across multiple sports. Sitting out an event isn't an option; competing effectively means mastering a variety of different capabilities in a balanced way. As with a decathlon, there's no single path to victory. In emerging markets, companies, like athletes, must learn to make trade-offs, taking into account their own capabilities and those of competitors. They must choose where it makes sense to differentiate themselves through world-class

Exhibit 1

Leading companies in the developed world earn just 17% of total revenues from emerging markets even though these markets represent 36% of global GDP.

Markets' contribution to global GDP vs leading global companies' share of total revenues[1] from given markets, 2010, %



[1] For 100 of the world's largest companies headquartered in developed economies; figures for GDP do not sum to 100%, because of rounding.
[2] Asia–Pacific includes Australia, Japan, New Zealand, and South Korea.

Source: Company financials; McKinsey analysis performance and where it is wiser to run with—or, ideally, a little ahead of—the pack. Both the rewards for success and the costs of failure will be large.

The $30 trillion opportunity

For centuries, less than 1 percent of the world's population enjoyed sufficient income to spend it on anything beyond basic daily needs. As recently as 1990, the number of people earning more than $10 a day,[1] roughly the level at which households can contemplate discretionary purchases of products such as refrigerators or televisions, was around one billion, out of a total world population of roughly five billion. The vast majority of those consumers lived in developed economies of North America, Western Europe, or Japan.

But over the past two decades, the urbanization of emerging markets—supported by long-term trends such as the integration of peripheral nations into the global economy, the removal of trade barriers, and the spread of market-oriented economic policies—has powered growth in emerging economies and more than doubled the ranks of the consuming class, to 2.4 billion people. By 2025, McKinsey Global Institute (MGI) research suggests, that number will nearly double again, to 4.2 billion consumers out of a global population of 7.9 billion people.[2] For the first time in history, the number of people in the consuming class will exceed the number still struggling to meet their most basic needs.

By 2025, MGI estimates, annual consumption in emerging markets will rise to $30 trillion, up from $12 trillion in 2010, and account for nearly 50 percent of the world's total, up from 32 percent in 2010 (Exhibit 2).[3] As a result, emerging-market consumers will become the dominant force in the global economy. In 15 years' time, almost 60 percent of the roughly one billion households with earnings greater than $20,000 a year[4] will live in the developing world. In many product categories, such as white goods and electronics,

[1] On a purchasing-power-parity basis.

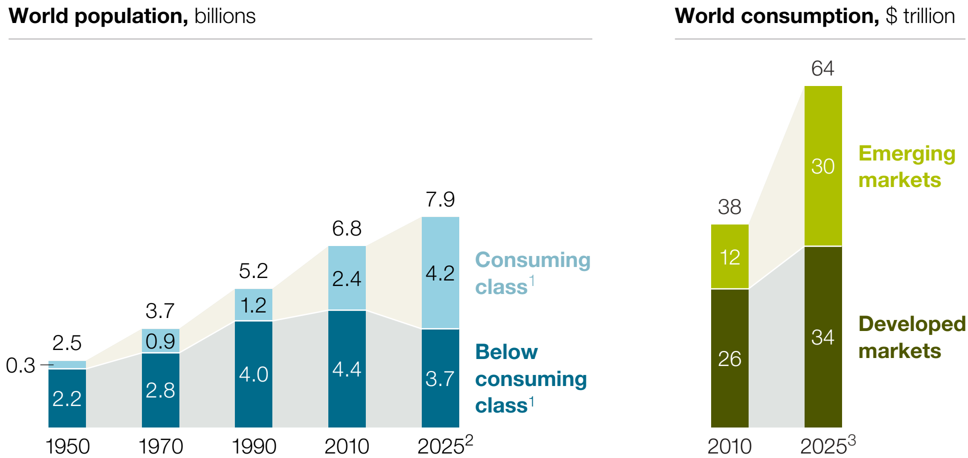
[2] For more, see the full MGI report, *Urban world: Cities and the rise of the consuming class* (June 2012), on mckinsey.com.

[3] Our estimate of $30 trillion reflects private consumption in emerging-market regions in 2025. We define these regions to include Africa, Central Asia, China (with Hong Kong and Taiwan), Eastern Europe, Latin America, the Middle East, and South and Southeast Asia.

[4] On a purchasing-power-parity basis.

Exhibit 2

By 2025, the consuming class will swell to 4.2 billion people. Consumption in emerging markets will account for $30 trillion—nearly half of the global total.



[1]Consuming class: daily disposable income is ≥$10; below consuming class, <$10; incomes adjusted for purchasing-power parity.
[2]Projected.
[3]Estimate based on 2010 private-consumption share of GDP per country and GDP estimates for 2010 and 2025; assumes private consumption's share of GDP will remain constant.

Source: Angus Maddison, founder of Groningen Growth and Development Center, University of Groningen; Homi Kharas, senior fellow at Wolfensohn Center for Development at Brookings Institution; McKinsey Global Institute analysis

emerging-market consumers will account for the overwhelming majority of global demand. China already has overtaken the United States as the world's largest market for auto sales. Even under the most pessimistic scenarios for global growth, emerging markets are likely to outperform developed economies significantly for decades.

Leading the way is a generation of consumers, in their 20s and early 30s, who are confident their incomes will rise, have high aspirations, and are willing to spend to realize them. These new consumers have come of age in the digital era. Already, more than half of all global Internet users are in emerging markets. Brazilian social-network penetration, as early as 2010, was the second highest in the world. And a recent McKinsey survey of urban African consumers in 15 cities in ten different countries found that almost 60 percent owned Internet-capable phones or smartphones. As e-commerce and mobile-payment systems spread to even the most remote hamlets, emerging consumers are shaping, not just participating in, the digital revolution and leapfrogging developed-market norms, creating new champions like Baidu, mPesa, and Tencent.

The preferences of emerging-market consumers also will drive global innovation in product design, manufacturing, distribution channels, and supply chain management, to name just a few areas. Companies failing to pursue consumers in these new markets will squander crucial opportunities to build positions of strength that, history suggests, could be long lasting. In 17 major product categories in the United States, the market leader in 1925 remained the number-one or number-two player for the rest of the century.[5]

Ten crucial capabilities

For developed-market companies, winning consumers in these new high-growth markets requires a radical change in mind-set, capabilities, and allocation of resources. The value consciousness of emerging-market consumers, the diversity of their preferences, and their sheer numbers mean companies must rethink every aspect of operations, including product portfolios, research and development, marketing, supply chain management, and talent development. They must learn to place big bets on new markets and technologies, invest with speed and at scale, and manage risk and cultural diversity at a whole new level.

Changes of such magnitude must be implemented in a thoughtful, systematic way. With the help of colleagues, we've distilled a set of ten capabilities global corporations need in emerging markets. Just as winning a decathlon requires an athlete to master ten events, we believe winning in emerging markets requires companies to master the ten capabilities. And as in a decathlon, companies must sharpen their skills in all these areas at the same time.

1 Surgically target urban growth clusters.

The scale of the modern exodus from farms to urban areas has no precedent. As we describe in more detail in “Unlocking the potential of emerging-market cities” (on page 41), the population of cities in developing economies grows by 65 million people a year—the equivalent of seven cities the size of Chicago. Over the next 15 years, just 440 emerging-market cities will generate nearly half of global GDP growth and 40 percent of global consumption growth.

[5]These companies include Kraft Foods (Nabisco), which led in biscuits; Del Monte Foods, in canned fruit; and Wrigley, in chewing gum.

Midsize cities, as opposed to tier-one megacities, frequently offer the best opportunities. In Brazil, the big metro market is São Paulo state, with a GDP larger than Argentina's. But competition in São Paulo is brutal and retail margins razor thin. For new entrants to the Brazilian market, there might be better options in the northeast, Brazil's populous but historically poorest region, where boomtowns like Parauapebas are growing by as much as 20 percent a year. Of course, the notion that smaller cities can offer bigger opportunities isn't new. Fifty years ago, Wal-Mart opened its first store, in Rogers, Arkansas, and proceeded to build one of the world's largest businesses by avoiding highly competitive metropolitan markets.

Many multinationals nonetheless pursue country-based approaches or hybrid ones that include tweaks for megacities. They assume that efforts to develop local strategies for "middleweight" cities can come only at the expense of economies of scale. To minimize that trade-off, global companies should group multiple smaller cities into clusters with common demographics, income distributions, cultural characteristics, media regions, and transportation links. By running operations through a common management hub and pursuing a strategy of gradual, cluster-by-cluster expansion, companies can gain scale efficiencies in all aspects of their operations, including marketing, logistics, supply chain management, and distribution. For all but a handful of high-end product and service categories, the emphasis should be on "going deep" before "going wide."

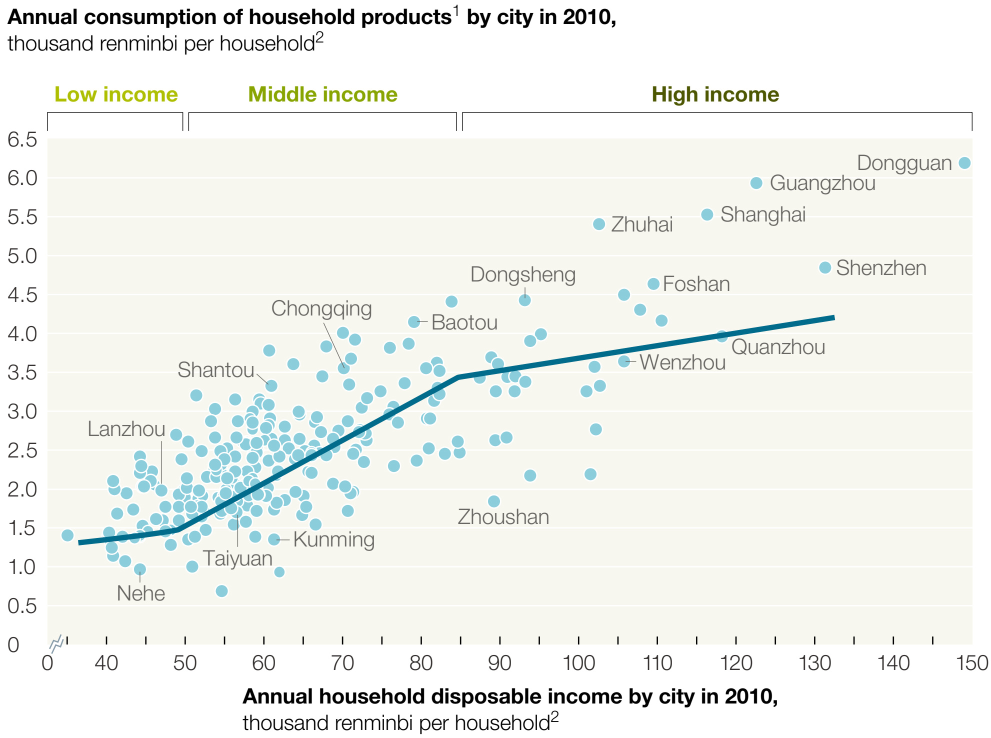
2 Anticipate moments of explosive growth.

In emerging markets, timing matters as much as geography in choosing where to compete. Demand for a particular product or category of products typically follows an S-curve rather than a straight line: there is a "warm-up zone" as growth gathers steam and consumer incomes begin to rise, a "hot zone" where consumers have enough money to buy a product, and a "chill-out zone" in which demand eases (Exhibit 3).

In plotting consumption S-curves, per capita income is the critical variable. But the takeoff point and shape of consumption curves will vary by product or service. Purchases of products with low unit costs, such as snacks and bottled drinks, accelerate at a relatively early stage of the income curve, beauty products somewhat later, and luxury products, such as fashion and fine wines, later still. Services

Exhibit 3

Per capita income is the critical variable in consumption S-curves, but the takeoff point and shape of the curve will vary by product.



[1] Includes white goods, furniture, and home accessories.
[2] In 2010 real renminbi; 6.77 renminbi = $1 in 2010.

Source: National Bureau of Statistics of China; McKinsey analysis

tend to take off at higher income levels. Refrigerators tend to have a steep adoption curve that flattens out as the market reaches saturation, while spending on clothing displays a more sustained growth pattern. The adoption patterns of products within the same general category can vary widely.

While refrigerators and washing machines are often lumped together as white goods, consumption data show that in Beijing, purchases of the former start to take off at annual incomes of $2,500 a year and slow above $6,000, while the take-up for the latter doesn't begin until incomes approach $10,000 a year.

Predicting when and where consumers will move into the hot zone also requires a granular understanding of technological, demographic, cultural, geographic, and regulatory trends, as well as a thorough knowledge of local distribution networks. Because many of India's households are vegetarian, for example, meat consumption in that country is much lower than the global average. In Nigeria, where more than one-third of the population is 14 years of age or younger, sales of baby food are far above the global average at similar income levels.

3 Devise segmentation strategies for local relevance and global scale.

Identifying high-growth hot spots and anticipating when consumers there will be ready to buy isn't enough. Multinationals also must determine how to refine product or service offerings so that they will appeal to (or even shape) local tastes, be affordable, and give the company an opportunity to achieve reasonable scale in a timely way.

Too often, multinationals attempt to make sense of the diversity of emerging-market consumers by ordering them in polar caricatures: at one extreme, the nouveau riche, eager to flaunt their wealth and emulate the West; at the other, the penny-pinching poor at the bottom of the pyramid, for whom the overriding purchase criterion is getting the lowest price. With the number of mainstream consumers on the rise in emerging markets—more than half of all Chinese urban households, for example, will be solidly middle class by 2020, up from 6 percent in 2010—companies are learning to craft more nuanced product strategies that balance scale and local relevance.[6]

A careful segmentation strategy helped Frito-Lay, for example, to capture more than 40 percent of the branded-snack market in India. Besides tailoring global products, such as Lays and Cheetos, to local tastes, Frito-Lay created Kurkure, a cross between traditional Indian-style street food and Western-style potato chips. Kukure represented a new category in India and is now being sold in other countries. Critical to Kurkure's success: attractive pricing and local feel combined with scalable international packaging. In China, Audi introduced A6 models with a longer wheelbase for extra legroom, while adding backseat entertainment systems and extendable tray tables.

[6]We define mainstream consumers in China as members of relatively well-to-do households with annual disposable incomes of $16,000 to $34,000. For more on China's mainstream consumers, see Yuval Atsmon and Max Magni, "Meet the Chinese consumer of 2020," mckinseyquarterly.com, March 2012.

Leading companies also look for opportunities to scale ideas across emerging markets. Unilever, for example, has begun marketing its Pureit water filter, first launched in India in 2005, to consumers in Asia, Eastern Europe, and South Africa. Telecommunications providers operating in emerging markets have learned to replicate successful marketing programs across multiple geographies.

Radically redeploy resources for the long term.

To win in emerging markets, developed-market companies must be willing to embrace big changes fast; those unable to reallocate resources radically risk a drubbing by local competitors. Our research shows that emerging-market companies redeploy investment across business units at much higher rates than companies domiciled in developed markets. Emerging-market firms are growing faster than their developed-market counterparts, even when both operate in neutral third markets where neither is based. The emerging players' growth advantage persists even after we controlled for the smaller base from which they start, and it also exists in developed markets.[7]

In part, the agility of emerging-market companies reflects the fact that majority shareholders tend to have more power in them than in their developed-market counterparts. But it also reflects different management mind-sets. Emerging-market companies are built for speed. They are designed to serve the rapidly changing needs of middle-class consumers in their home markets and other emerging societies. They know that they must innovate or die.

It helps, too, that these emerging-market companies aren't burdened by legacy issues; they can focus on what works in emerging markets without having to straddle both the rich and developing worlds. By contrast, CEOs at many developed-market companies, who live in fear that even a fleeting dip in domestic earnings, market shares, or stock prices could put their jobs at risk, must protect their flank at home as they pursue emerging markets that carry significant near-term risks.

[7] For example, in emerging economies where both categories of companies are off their home turf, the growth advantage for emerging-market companies is 18.1 percent. In neutral developed markets, the advantage is 10.7 percent. The smaller size of emerging-market businesses accounts for, on average, no more than a quarter of the overall growth differential. For more on this research, see Yuval Atsmon, Michael Kloss, and Sven Smit, "Parsing the growth advantage of emerging-market companies," mckinseyquarterly.com, May 2011.

Yet there's no escaping the importance in emerging markets of making big bets and riding them for the long term. The investment profile of global consumer product giants that have established a successful presence in emerging markets indicates an interval of approximately four or five years until investments pay off. M&A can accelerate progress. Consider Danone's purchase in Russia of Unimilk, which allowed the French food giant to offer more competitive products at a wider variety of prices. Similarly, Diageo's acquisition of a majority stake in China's Shuijing-fang boosted the British beverage company's distribution reach and ability to supply Chinese consumers with the white liquor that is so popular there.

5 Innovate to deliver value across the price spectrum.

Emerging markets offer greenfield opportunities to design and build products and services with innovative twists on best-in-class equivalents in established markets. South Korea's LG Electronics, for instance, struggled in India until the 1990s, when a change in foreign-investment rules enabled the company to invest in local design and manufacturing facilities. Local employees, recognizing that many Indians used their TVs to listen to music, urged LG to introduce new models with better speakers. To keep prices competitive, the company swapped expensive flat-panel displays for less costly conventional cathode ray tubes. (For more on making cost-effective design and production trade-offs, see "Designing products for value in emerging markets," on page 46.)

Today, LG markets many other original products in India, including appliances with programming menus in local languages, refrigerators with brighter colors and smaller freezers, large washing machines for India's big families, and microwaves with one-touch "Indian menu" functions. LG's product innovation center in Bangalore is its largest outside South Korea, and the company is India's market leader in air conditioners, refrigerators, TVs, and washing machines. Other global firms, in India and elsewhere, are following LG's lead; over the past 12 years, the number of multinational firms with major research centers in China has risen to nearly 1,000, from fewer than 20.

Local players, too, are proving nimble innovators. For rural customers, China's Haier makes extra-durable washing machines that can wash vegetables as well as clothes, and refrigerators with protective metal plates and bite-proof wiring to ward off mice. The company is no less ingenious in developing products for urban users, such as smaller washing machines and refrigerators designed for tiny, cramped apartments. Dabur, an Indian consumer health company, is combining Western science with Indian Ayurvedic medicine to offer innovative consumer health products in India and Africa. Meanwhile, Tanishq, part of the Tata Group, has built a fast-growing jewelry business with heavily localized design and payment options that cater to the needs of different Indian communities and regions.

Whether a company sells basic products or services to challenge low-cost local players or seeks to entice consumers to adopt new products and services comparable to global offerings, competing effectively often requires innovating and localizing, while redesigning product lines, service operations, and supply chains.

6 Build brands that resonate and inspire trust.

The outlook of consumers in emerging and developed markets differs in many ways. On average, emerging consumers are younger—with 63 percent aged 35 or under in 2010, versus 43 percent in developed countries—and more optimistic than their better-off counterparts. And unlike developed-market consumers, whose purchases are informed by a lifetime of exposure to products and brands, emerging consumers are novice shoppers for whom buying a car, a television, or even a box of diapers may be a first-time experience.

Emerging consumers wrestle with these new choices in a cluttered marketing environment and highly fragmented retail landscape offering little consistency in how products are presented or promoted. As these consumers move from rural villages to cities, they embrace new ideas and ways of living, placing in flux not just their buying preferences but also their very identities. They are highly receptive to effective branding efforts but also far more likely than developed-market consumers to dump one brand for the next new thing. These characteristics have significant implications for brand and marketing strategies, which we explore in more detail in “Building brands in emerging markets,” on page 50.

7 Control the route to market.

Our research underscores the importance of managing how consumers in emerging markets encounter products at the point of sale. In China, 45 percent of consumers make purchasing decisions inside shops, compared with just 24 percent in the United States. Almost a quarter of the Chinese consumers we surveyed said in-store promoters or salespeople greatly influenced their decisions. In one study, we found that Chinese who purchased high-end consumer electronics items visited stores up to ten times before deciding what to buy.

Managing the consumer's in-store experience is an enormous challenge, especially in middleweight cities where the biggest growth opportunities lie. Part of the problem is the fragmented nature of the retail landscape in emerging markets; e-commerce penetration currently lags behind Western levels, supermarkets remain a relative novelty, and consumers still make most purchases from ubiquitous mom-and-pop shops. In China, the 50 largest retailers have only a tenth of the market share of the 50 largest US retailers.

Often, reaching these small outlets means negotiating bad roads and a byzantine, multitiered network of distributors and wholesalers. In such places, local champions have clear advantages, including long-standing alliances with distributors and armies of low-paid salesmen. Multinationals—many of which now struggle just to get products into emerging-market stores—should be prepared to build a much larger in-house sales operation in these countries than they have in their home markets. They should also devote far more time and energy to categorizing and segmenting sales outlets and to devising precise routines and checklists for monitoring the quality of the in-store experience. (For more on these approaches, see "From oxcart to Wal-Mart: Four keys to reaching emerging-market consumers," on page 58.)

8 Organize today for the markets of tomorrow.

In theory, global players should enjoy substantial advantages over local rivals in emerging markets, including shared infrastructure and the protection that a more geographically diverse business portfolio offers against country and currency risks. In practice, however, as global companies grow bigger and more diverse, the costs of coping with complexity rise sharply. Less than 40 percent of the executives at global firms surveyed recently by McKinsey's organization practice said they were better than local competitors at understanding the operating environment and customers' needs. Furthermore, adhering to globally standard policies and risk-management practices sometimes hinders managers of global companies in emerging markets from moving quickly to lock in early opportunities.

As our colleagues reported in the previous issue of the *Quarterly*, there's no definitive solution to these challenges, but some important principles are emerging.[8] For example, we've found that multinationals can boost their effectiveness by focusing on a few key management processes for which global consistency is advantageous, while allowing variability and local tailoring in others. It may be useful to group high-growth countries together (even when not geographically proximate) to help top management assess their needs. Clarifying the role of the corporate center is critical; too often headquarters assumes functions that add complexity but little value. New communications technologies can help, but management must ensure that they do not ensnare employees in an ever-expanding web of teleconferences in disorienting time slots, with hazy agendas and ill-defined decision rights. The farther flung the organization, the greater the virtue of simplicity.

9 Turbocharge the drive for emerging-market talent.

Unskilled workers may be plentiful in emerging societies, but skilled managers are scarce and hard to retain. Global firms must develop clear talent value propositions—an employer brand, if you will—to differentiate themselves from local competitors, as our colleagues noted in the previous issue of the *Quarterly*.[9] In South Korea, L'Oréal established itself as a top choice for female sales and marketing talent by creating greater opportunities for brand managers, improving working hours, expanding the child care infrastructure, and adopting a more open communication style.

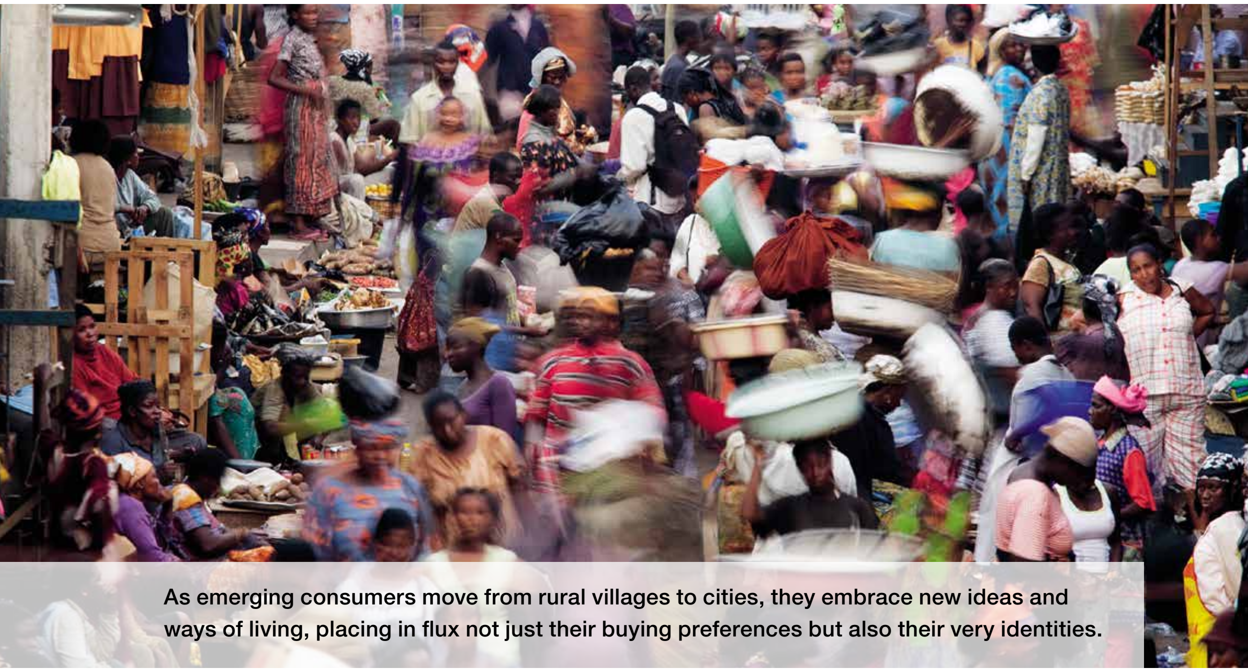
Deepening ties between key corporate functions and emerging markets can create opportunities for local talent while enhancing

[8] See Toby Gibbs, Suzanne Heywood, and Leigh Weiss, "Organizing for an emerging world," mckinseyquarterly.com, June 2012.

[9] Martin Dewhurst, Matthew Pettigrew, and Ramesh Srinivasan, "How multinationals can attract the talent they need," mckinseyquarterly.com, June 2012.

organizational effectiveness. Western firms, including Cisco, HSBC, and Schneider Electric, have benefited from strengthening links between headquarters and high-growth regions and offering emerging-market managers global career paths and mobility programs. Similarly, in 2010 about 200 managers from Unilever's Indian subsidiary were assigned global roles with the parent company; indeed, two former senior executives in its Indian operations now are members of the global parent company's core leadership team. At Yum Brands, the India head reports directly to the global CEO.

Given the leadership requirements of emerging markets, global companies need bold talent-development targets. We think many players should aspire to multiply the number of leaders in emerging markets tenfold—and to do that in one-tenth of the time they would take back home. The strategies of emerging-market players merit careful study. In India, Reliance Group, the largest private employer, faced a leadership gap: a need for as many as 200 new functional leaders to support growth initiatives. It addressed the problem by recruiting a new wave of 28- to 34-year-old managers and enlisting help from local business schools and management experts to design new development programs. For an inside look at the leadership approach of one CEO, see "Leading in emerging markets: An interview with ICICI's Chanda Kochhar," on page 36.



As emerging consumers move from rural villages to cities, they embrace new ideas and ways of living, placing in flux not just their buying preferences but also their very identities.

10 Lock in the support of key stakeholders.

No matter where successful businesses operate, they need the support of key stakeholders in government, civil society, and the local media (increasingly shaped by online commentators). Managing these relationships effectively can have a huge impact on a company's market access, ability to engage in merger or acquisition activity, and broader reputation. We believe global companies must devote far more time and effort to building such support in emerging markets than they would in developed ones. Such efforts should include cultivating relationships with local business allies—customers, joint-venture partners, investors, and suppliers.

Amway's success in China illustrates the benefits of effective stakeholder management. In the early 2000s, the US-based direct-sales giant was almost declared an illegal business in China for violating a 1998 ban on direct selling. Amway's senior executives visited Beijing frequently to get to know senior leaders and explain the company's business model. Amway also demonstrated its commitment to China by opening stores countrywide, while investing more than $200 million in China-based manufacturing and R&D centers. In 2006, the Chinese government reshaped the regulation of direct sales. Today, Amway is China's second-largest consumer product business.

Leading the charge

The multidimensional challenge presented by emerging markets, and the redeployment of global resources it implies, cannot be adequately addressed by managers of individual regions or business units. These issues require commitment and leadership from CEOs and their top teams.

At most large Western multinationals, it's taken for granted that senior executives must command detailed knowledge of market conditions in the 20 largest European and US cities. Yet in these same firms, many senior executives have failed even to visit more than a dozen of the largest cities in the emerging world. Few top executives can offer credible explanations of what drives growth in crucial high-growth clusters in China, India, or Brazil or describe the features of a typical household in those markets with the specificity they can summon up for cities in the home market. Similarly, chief executives of many large Western companies have convened board meetings in China or India, but few pay regular visits to key regulators or business partners in emerging-market target cities. Few have taken the time to understand how their businesses operate on the front line in those cities with anywhere near the level of detail they would demand in scrutinizing operations at home.

As senior leaders take steps to build knowledge in and commit themselves fully to priority emerging markets, they also must reassure board members, shareholders, market analysts, and employees that their push into high-growth markets is worth the risk and won't come at the expense of domestic performance. One thing that can help is developing clear, meaningful metrics for tracking the success of efforts in emerging markets. Such metrics might include the ratio of revenue from developed markets versus high-growth emerging ones and year-on-year comparisons of market share in critical urban clusters or other priority growth markets. Although metrics can help leaders paint a picture of the future and reveal any need for quick course corrections, setbacks are inevitable; not even the most gifted athlete can become a successful decathlete overnight.

Shirking the challenge, though, would be a terrible mistake. Over the past 100 years, the title of "world's greatest athlete" has been given to the winner of the Olympic decathlon. This has been true since the Stockholm Olympics, in 1912, when King Gustav V of Sweden used those words to describe Jim Thorpe, winner of the newly reintroduced decathlon competition. The rise of the emerging world's new consumer class is the greatest business competition of our age. For all the complexity of emerging markets, they offer multinationals and their shareholders the best hope for future prosperity. During the next 100 years, the title of "world's greatest companies" will surely be given to those that win in emerging markets. Business leaders and their boards need to ask themselves whether they are making the changes required to win or risk being overtaken by competitors with bolder ambitions.

The authors would like to thank Sambit Sathapathy and Jeongmin Seong for their contributions to the development of this article.

Yuval Atsmon, who was based in McKinsey's Shanghai office from 2006 to 2012, is a principal in the London office, where **Peter Child** is a director; **Richard Dobbs** is a director of the McKinsey Global Institute and a director in the Seoul office; **Laxman Narasimhan** was a director in the Delhi office until September 2012.

Leading in emerging markets:

An interview with ICICI's Chanda Kochhar

This interview with Chanda Kochhar, managing director and CEO of India's ambitious and fast-growing ICICI Bank (the country's second largest), underscores how rapidly the competitive landscape can—and will—shift in today's emerging economies. Her account of an almost-missed opportunity in the Indian State of Goa is a reminder to senior leaders everywhere of the need to develop a fine-grained view of local markets, customers, and even employees.

The *Quarterly*: *You're still primarily an India-focused operation. How closely do you, as CEO, feel you have to be in touch with what's happening in Europe or elsewhere in Asia?*

Chanda Kochhar: I have to follow events beyond India very closely. In a globalized world, change from almost anywhere can affect us, whether directly or indirectly. At the same time, our organization itself has become far more global. Ten years ago, we were a purely domestic Indian bank. Today, we're present in 18 countries outside India, and our international operations account for about 25 percent of our assets. While a large part of this is business with Indian clients, their operations are spread all over the world. We have a large number of

Chanda Kochhar is the CEO and managing director of ICICI Bank. She was ranked 11th in the list of Top 50 Women in World Business by the *Financial Times* (2010) and was the first woman to be named Business Leader of the Year by the *Economic Times* (2011).

non-Indian retail customers. And anything that happens in the global economy has the potential to affect our Indian clients.

The *Quarterly*: *Do you see your role as more of a big-picture strategist or a hands-on manager?*

Chanda Kochhar: Well, of course, I must be both. In today's world, leaders must have one eye on the broad trends—what is happening in the world? what is the next volatile thing that can hit you?—and at the same time have a very clear view of day-to-day operations. I think one of the big challenges for leaders today is that windows for effective execution have gotten smaller. The world today is so volatile that just about anything you need to implement has to be done in 90 days, and sometimes in 60 days or even 30 days, or it risks becoming irrelevant.

So as CEO I have to be very close to reality, while at the same time keeping the big picture in mind. Getting that mix right—thinking strategically and staying close to execution—is the essence of the CEO's job. You don't want to micromanage every little thing and constrain the people on your team. But at the same time, you can't get so preoccupied with a vision or dream that you forget about your next product launch or technology initiative. It's essential that I get right into the nitty-gritty of how decisions are being executed and make sure things are moving as fast as I want.

The *Quarterly*: *Do you have a formal mechanism for making sure you stay in touch with employees and customers on the organization's front line?*

Chanda Kochhar: I make regular visits to all our branches. I go almost unannounced, and at the branch I make an effort to talk to the people there. And for the past two years I have been holding regularly scheduled employee discussion meetings. These are not performance reviews or meetings with a particular business segment—with a boss and his subordinate and the next subordinate and the next. These are just meetings with different sets of about 20 employees picked on a random basis at various levels of the organization. We do them once a month. I promise people who participate that whatever they say is just for me to absorb and will not go out of the room. Sometimes we talk about the work environment in the branches. Sometimes we talk about what customers are feeling. Sometimes we talk about gender issues. Sometimes we talk about our transfer policies. And over time, people have learned that they can speak to me and they do; no one outside the room knows who spoke.

The *Quarterly*: *That's a big time commitment. What do you get from those interactions?*

Chanda Kochhar: I learn a lot. One of my most meaningful encounters was in a branch at a time when we were changing many of our customer processes. I spent an entire day not just visiting the branch but standing in the reception area watching the person who greeted and directed customers as they came through the door. This was supposed to be a fairly junior position, someone who basically just said, "Hello, may I help you?" and steered customers to other counters. But standing behind this person—watching the interactions, hearing for myself what kinds of questions customers had, observing directly the ability of our staff to react—was a very powerful learning experience for me.

I realized that what we had thought was a very simple job that could be left to someone junior was actually a very complicated job that should be done by someone with training and experience. I saw that this person had to know how to deal with all sorts of things. How do you handle cash? How do you handle the sale of a life insurance policy? Now, you might think taking cash deposits—how hard could that be? You send the customer to the cashier. Well, what about a case when the transaction has been prompted by a death in the family and the customer doesn't know how to file the claims? I realized that not only was this desk getting all the most complicated and unstructured queries but that it was our very first point of interaction with our customers.

The *Quarterly*: *It sounds like the visits generate useful insights about your people. Do the interactions ever teach you more about your customers?*

Chanda Kochhar: Absolutely. At one of our branches in Goa recently, a loan officer pointed out to me that we still kept a policy in place against making auto loans in a particular part of the state because there had been a lot of defaults on those loans four years earlier. “But now the whole customer profile has changed,” he argued, going on to explain to me exactly how it had changed and how competitors were moving in. “I’m dying here. The other banks have started,” he said. “Why haven’t we?”

It was a fair question. We had been the early movers, but we had a bad experience and stopped. In one sense, it was insignificant for the organization’s business in car loans. It wasn’t the whole Goa State in question; it was a small part of the location.

But it was very significant for the loan officer because for him that’s 100 percent of his area. Why, then, didn’t we listen to this guy? He may not have been the most senior guy, but he was close to reality. He knew his stuff, but he didn’t know how to filter what he knew through our system. Ultimately, stories like his reinforce for me the point that every business is significant because while it may not even be 1 percent of the total business that we are doing in car loans across India, why not add that fraction of a percent?

The *Quarterly*: *Your bank must collect oceans of data about customers and various financial products. Why didn’t your data-gathering processes highlight the change in Goa customer profiles observed by your loan officer on the ground?*

Chanda Kochhar: I think we do very well with data. I have my own dashboard of daily indicators, things I want to see every morning before I’m at my desk. But having good data isn’t enough. Data can tell you about the things you are doing already. It can’t tell you about things you’re not doing. If this had been a location where we were doing business and things were going badly, we’d have spotted that. Or if it was a location where the business was doing very well, the data would have flagged that too.

The *Quarterly*: *How much of your time do you spend developing leaders within your organization?*

Chanda Kochhar: I put a lot of time into that because, ultimately, the success of your strategy depends on the ability of your team to execute it. And you can’t just stop at developing the first level of leaders—the ones who report to the CEO. It's equally important to look at the next few levels down. I also put a premium on teamwork; all my leaders ought to be able to work together.

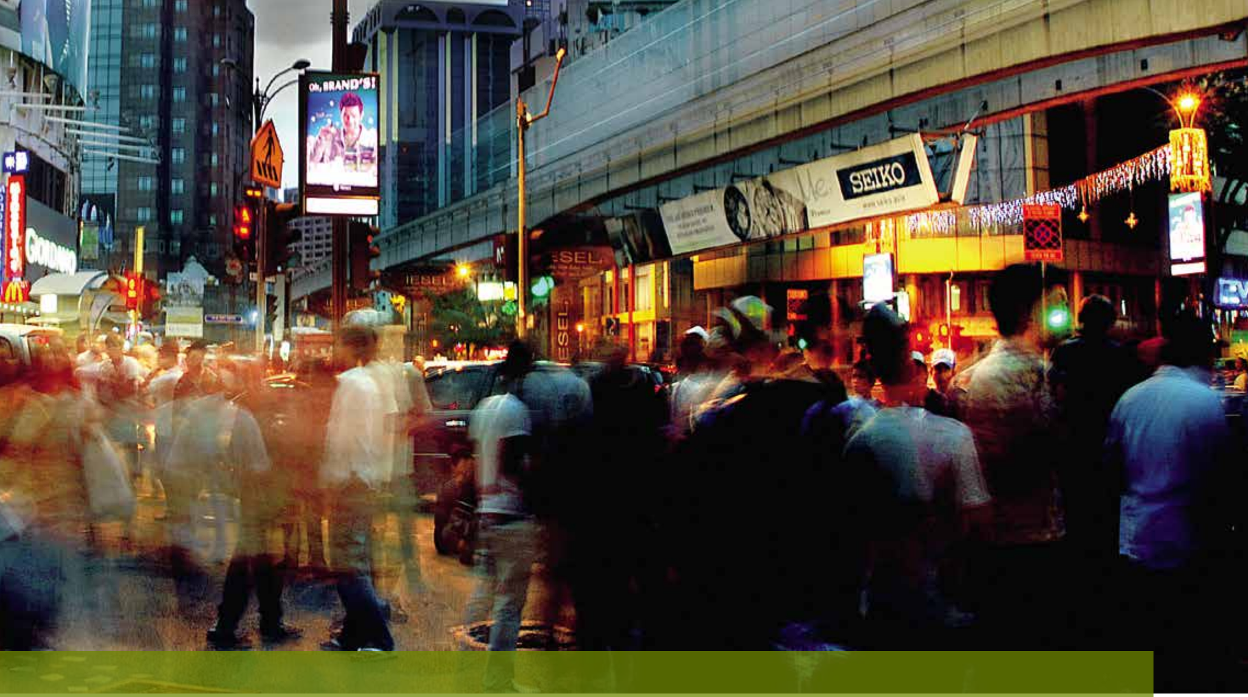
In India, as leaders and as CEOs, we have to get accustomed to working with young talent. This is a young country. And we all have been young, compared with earlier generations, in moving to various roles. We have to be comfortable with younger leaders and able to believe that those leaders can handle the next level of responsibility and allow them to evolve.

The *Quarterly*: *Are there particular challenges that you face as a woman leader in India?*

Chanda Kochhar: No, frankly, when it comes to women in leadership roles, I think India is more evolved than is generally recognized. Things have changed substantially here over the last 30 years. When I started my career, I think the whole perspective toward women leaders was definitely different from what it is today. Many Indian corporations, in fact, are going out of their way to attract more and more women in the workforce. And women are becoming much more open and conscious about the fact that they need to have a career of their own. The jury is still out on whether so many women will be able to balance their personal and professional lives through the middle-management stages of their careers and on how many will emerge from that as senior leaders. But I would say that as a whole, the outlook of the Indian corporate sector has improved substantially. ICICI has always been gender neutral, and I see that across many more companies today. o

This interview was conducted by **Clay Chandler,** a member of McKinsey Publishing who is based in McKinsey's Hong Kong office.

For the full version of this interview, see "Leading in the 21st century: An interview with ICICI's Chanda Kochhar," on mckinsey.com.



Unlocking the potential of emerging-market cities

Richard Dobbs, Jaana Remes, and Fabian Schaer

Most companies still take a national or regional view when allocating resources for global growth. They should shift their focus to fast-growing cities.

A massive wave of urbanization is propelling growth across the emerging world. This urbanization wave is shifting the world's economic balance toward the east and south at unprecedented speed and scale. It will create an over-four-billion-strong global "consumer class" by 2025, up from around one billion in 1990. And nearly two billion will be in emerging-market cities. These cities will inject nearly $25 trillion into the global economy through a combination of consumption and investment in physical capital. This is a very significant shot in the arm for a global economy that continues to suffer from pockets of acute fragility.

Yet few business leaders focus on the importance of cities when establishing growth priorities. In a recent survey, we found that fewer than one in five executives makes location decisions at the city (rather than country) level. Few executives expected this approach to change over the next five years, and more than 60 percent regarded cities as "an irrelevant unit of strategic planning."[1] As these new

[1] "McKinsey Global Survey results: Relocating for growth" was conducted in February 2012. The survey received responses from 2,962 executives, representing the full range of regions, industries, and company sizes. To adjust for differences in response rates, we weighted the data by the contribution of each respondent's nation to global GDP.

Exhibit 1

Approximately 440 emerging-market cities are poised to deliver close to half of global GDP growth.

Cities' contribution to global GDP and GDP growth[1]

Emerging-market cities

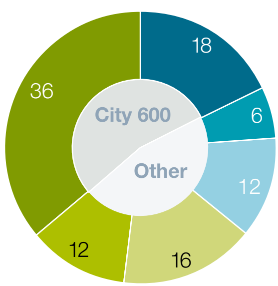
443 cities in the City 600[2] | Other large cities | Small cities and rural areas

Developed-market cities

157 cities in the City 600[2] | Other large cities | Small cities and rural areas

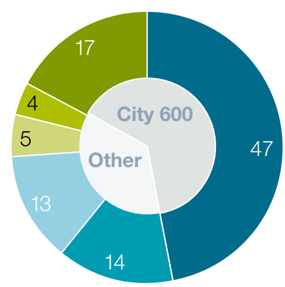
Global GDP, 2010, %

100% = $63 trillion (real exchange rate[3])



Global GDP growth, 2010–25, %

100% = $50 trillion (real exchange rate[4])



[1]2,600+ cities, including large cities as well as smaller cities and rural areas.
[2]The top 600 cities by their contribution to global GDP growth 2010–25.
[3]Reflects market exchange rate.
[4]Prediction based on differences in per capita GDP growth rates of countries relative to the growth of US per capita GDP.

Source: McKinsey Global Institute Cityscope 2.0

urban-growth zones flourish, there's a cost to companies that lack a clear view of the emerging landscape—chiefly in the potential for resource misallocation.

Shifting investment away from established markets to more promising areas can be difficult, as our colleagues have shown in separate research.[2] Budgets are often "sticky" because companies lock into current rather than future opportunities. And many middle-tier emerging-market cities, however attractive, may be unfamiliar. Take Foshan, Porto Allegre, and Surat—cities that are unlikely to be high on the priority lists of global executives, though each has more than four million inhabitants, fast growth, and a vibrant base of consumers. Indeed, each of these cities will contribute more to global growth than Madrid, Milan, or Zurich.

And they are far from isolated examples. Our research indicates that 440 emerging-market cities, very few of them "megacities," will

[2]See Stephen Hall, Dan Lovallo, and Reinier Musters, "How to put your money where your strategy is," mckinseyquarterly.com, March 2012.

Exhibit 2

A city-specific lens can reveal urban areas with the highest growth potential in a given market.

Top cities by growth in given market, 2010–25

Emerging region
Developed region

Rank	Elderly higher-income consumers[1] (aged 65+)	Young entry-level consumers[2] (aged 14 or under)	Consumer spending on laundry care products[3]	Demand for commercial floor space[4]	Municipal water demand
1	Shanghai	Lagos	São Paulo	New York	Mumbai
2	Beijing	Dar es Salaam	Beijing	Beijing	Delhi
3	Tokyo	Dhaka	Rio de Janeiro	Shanghai	Shanghai
4	Tianjin	Ouagadougou	Shanghai	Los Angeles	Guangzhou
5	Mumbai	Khartoum	Mexico City	Tokyo	Beijing
6	São Paulo	Ghaziabad	Moscow	Washington, DC	Buenos Aires
7	Osaka	Sanaa	Bangkok	Dallas	Kolkata
8	Chongqing	Nairobi	Istanbul	São Paulo	Khartoum
9	Delhi	Luanda	Manila	Guangzhou	Dhaka
10	Nanjing	Baghdad	Johannesburg	Chicago	Istanbul

[1]With household income >$20,000 at purchasing-power parity.
[2]With household income of $7,500–$20,000 at purchasing-power parity.
[3]Based on city-level market-demand-growth model.
[4]Includes replacement floor space.

Source: McKinsey Global Institute analysis

account for close to half of expected global GDP growth between 2010 and 2025 (Exhibit 1). Crafting and implementing strategies that emphasize such cities will require new attention from senior leaders, new organizational structures that take account of urban rather than just regional or national markets, and potentially difficult choices about which activities to scale back elsewhere to free up resources for new thrusts.

Companies that adopt such a strategic approach may gain early-mover benefits. For some, developing better insights into demographic and income trends—such as an understanding of the urban areas where the population of older, wealthier consumers is growing most rapidly—will be sufficient. Others may need to dig deeper, learning the market dynamics of specific products in target cities. To illustrate the different panoramas of opportunity that appear when companies use a city-specific lens, we looked at five business sectors, each with different demand profiles. We then ranked cities with the highest growth potential for each of the sectors (Exhibit 2). Among the takeaways:

- Companies marketing health care products to seniors would find Shanghai and Beijing topping the list of cities with growing populations of older consumers whose incomes are sufficiently high (above $20,000 on a purchasing-power-parity basis) to afford these products. Tokyo and Osaka are the only developed-world cities among the top ten—a sign that well-off, aging consumers no longer are found exclusively in developed markets.

- Baby food is at the other end of the age spectrum. Combining income and demographic data—in particular, the numbers of households with young children—we found that cities in Africa offer great potential. More than half of the top ten cities enjoying rapid growth in the number of children[3] who live in households with incomes from $7,500 to $20,000 (on a purchasing-power-parity basis) are in Africa.

- São Paulo, Beijing, Rio de Janeiro, and Shanghai rank highest in a targeted analysis of market growth for laundry products. In fact, over the next decade, São Paulo will experience more growth in the sale of detergents and related cleaning products than the national markets of France or Malaysia will. That's just a small shard in the global-consumption mosaic for emerging cities. We project that urban consumers in developing countries will spend an additional $14 trillion annually by 2025.

- By 2025, cities worldwide will need to spend at least $10 trillion more per year on physical capital—everything from office towers to new port facilities—than they do today. In building construction, the new floor space required will be equivalent to 85 percent of today's entire residential and commercial building stock; 40 percent of that growth will be in Chinese cities.

- Urban water-related infrastructure, another pressing need, will require $480 billion in global investment by 2025, with 80 percent of that flowing to emerging-market cities. Mumbai and Delhi will be the leaders in that spending.

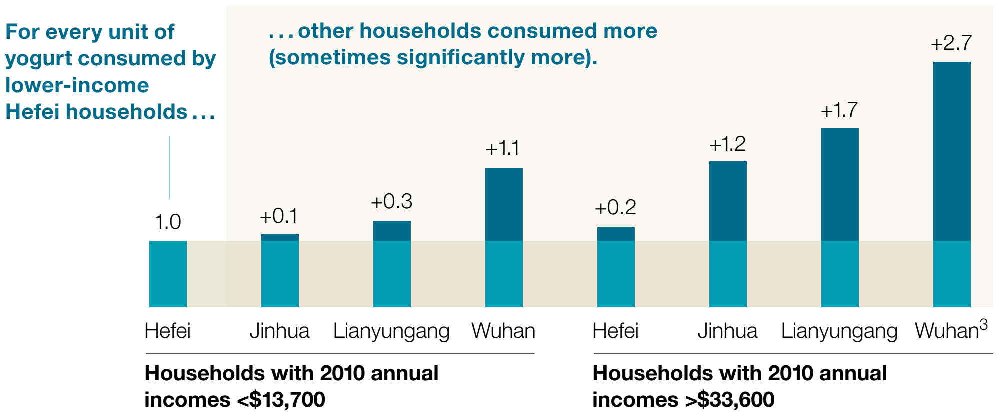
In addition to supporting geographic priority-setting, a city-level view can help companies sharpen their marketing strategies. Product adoption rates often are tied to local preferences that can vary across different cities within the same country—preferences that marketers

[3] For the purposes of this analysis, individuals aged 14 and under qualify as children.

Exhibit 3

Awareness of cities' different spending patterns across products can sharpen a company's marketing focus.

Example: average yogurt consumption per household in 2010, by cities in China[1]; index: consumption in Hefei households with incomes <$13,700 = 1.0[2]



[1]With 2010 populations between 1.1 million (Lianyungang) and 9.7 million (Wuhan).
[2]Income levels adjusted for purchasing-power parity (PPP); $1 at PPP = 3.9 renminbi.
[3]For households earning >$51,900, since data for households earning $33,600–$51,900 not available.

Source: 2010 McKinsey survey of 15,000 Chinese consumers; McKinsey Global Institute analysis

may miss when they follow the time-honored approach of plotting adoption curves that trace purchases by levels of household income and by product types within categories. Yogurt consumption shows the types of variations that a national view might not pick up: we found, even after adjusting for income levels, that typical households in Wuhan spent significantly more on yogurt than their counterparts in three comparable Chinese cities did (Exhibit 3). Awareness of different spending patterns by city across products should give companies a better basis for allocating marketing and distribution resources.

• • •

As the locus of global economic activity shifts to developing nations, companies should be aware of the growth dynamic that's playing out in cities. Leaders who give their strategies an urban dimension could find themselves positioned to allocate investments more effectively and to seize more readily the many opportunities at hand. o

Richard Dobbs is a director of the McKinsey Global Institute (MGI) and a director in McKinsey's Seoul office; **Jaana Remes** is a senior fellow at MGI and is based in the San Francisco office; **Fabian Schaer** is a consultant in the Zurich office.

Designing products for value in emerging markets

Ananth Narayanan, Asutosh Padhi, and Jim Williams

Leading companies combine insights about customers, competitors, and costs to develop innovative, cost-effective products across a wide slice of the price spectrum.

As global companies strive to create products that will appeal to the rapidly swelling ranks of emerging-market consumers, many take a bimodal approach: wealthier customers get the standard, global version of a product, low-income shoppers a bare-bones, low-cost variant. Only too late do these companies learn that what seems appealing and affordable in Chicago may be irrelevant in Chengdu or Chennai.

By contrast, the most successful product-development organizations we've studied embrace the diversity of emerging markets to develop innovative, cost-effective products across a greater slice of the price spectrum. The key is the ability to combine deep insights about customers, competitors, and supply bases to strip out excess costs while retaining—and amplifying—what customers truly value. Unsurprisingly, perhaps, some of the most exciting examples hail from emerging markets themselves (though a number of Western multinational companies also think in this way). A closer look at one developing-market company's experiences suggests how companies anywhere might better position themselves for improved margins and growth in emerging markets.

Case in point: Appliance manufacturer

The challenge

Senior executives at a large, low-cost manufacturer of appliances and white goods were concerned about the sluggish performance of the company's household fan business. It had long been among the top local players in the company's home country, an emerging market, but was now losing domestic share in two important—and fiercely competitive—product categories.

The company's leaders suspected that a stagnant product portfolio was partly to blame. They had been focusing a considerable amount of attention on operations and had neglected to revisit fan designs for a couple of years. Meanwhile, an innovative upstart, also from an emerging market, had begun competing with the manufacturer, both at home and in developed markets. The threat served as a wake-up call: establishing a stronger platform for growth, the executives realized, would require the company to step up its product-development capabilities while maintaining—or even improving upon—its low-cost edge.

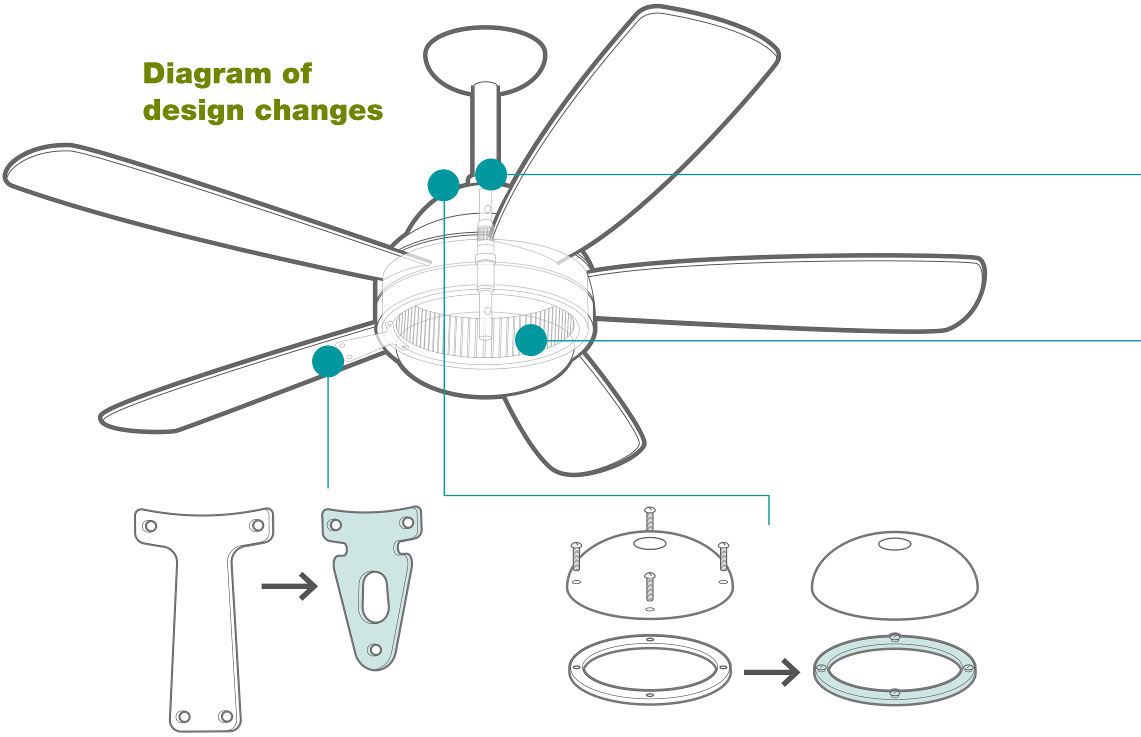
Focus on the customer

The company started by conducting focus groups and ethnographic research aimed at identifying unmet needs among middle-income (and aspiring middle-income) families in emerging markets. As these approaches started generating concepts for new products, the company ran surveys that forced consumers to choose between various product features and price points and then used conjoint analysis to discern how much customers were willing to pay for various options.

Its results were intriguing. For example, the ethnographers observed that middle-class aspirants in urban areas hated how dirty the blades of typical ceiling fans became after prolonged use. Conjoint analysis showed that some of these consumers were willing to pay a premium for models that were easier to clean.

Similarly, the work identified profitable niches for fans with built-in, rechargeable batteries (to be used in case of power outages), as well as portable models for families that wanted one fan to serve several purposes—say, venting cooking odors in the kitchen and personal use elsewhere in the house. The company began actively pursuing these and other designs, including concepts tailored for consumers in developed countries.

Diagram of design changes



Blade
Using smaller shank lowers cost by 3.7%.

Cover
Replacing screws with snap-fit attachments lowers cost by 0.2%.

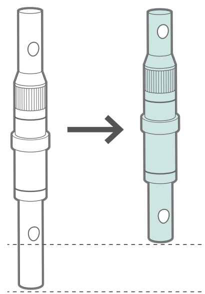
Study the competition

Next, the executives brought together a group of designers, purchasers, marketers, product engineers, and others to conduct a series of product teardowns involving the company's—and the competitor's—fans. By seeing how different models stacked up, the executives hoped to spark fresh thinking from the team that would improve the new designs and to help determine whether competing products had unexpected cost or technological advantages.

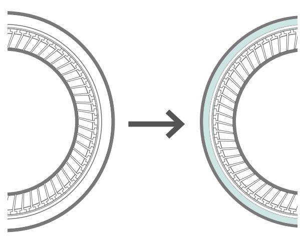
The exercise helped the company to meet both its goals. Purchasers and product engineers, for instance, believed that the company was already striking the right balance between quality and price in its materials and components. Yet the teardown showed that as compared with competitors, the company was "overbuilding" its products significantly and that identical—or even better—product performance was possible at a lower cost if the team was willing to rethink its design approaches.

Some of the resulting design changes were quite straightforward and even, in retrospect, obvious. Yet the team acknowledged that the new ideas didn't click until the teardown, when

For the full version of this article, see "Designing products for value," on mckinseyquarterly.com.

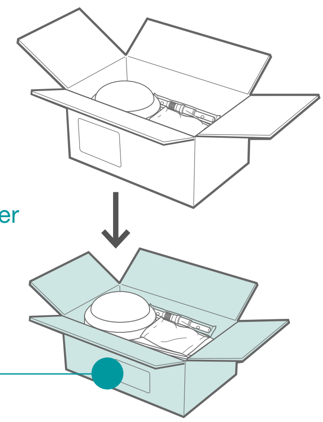


Motor
Shortening spindle lowers cost by 0.7%.

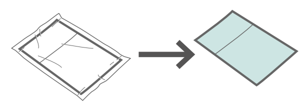


Motor
Redesigning rotor using less aluminum lowers cost by 2.8%.

Packaging
Redesigning box to use less cardboard lowers cost by 3.0%.



Smaller routing sticker lowers cost by 1.1%.



Eliminating polybag for warranty/ instructions lowers costs by 0.5%.

Diagram by Vic Kulihin

the evidence was spread out on the table for discussion. By modifying the cover of one type of household fan, for example, the team made it unnecessary to include an internal bracket assembly that had supported the original cover—a savings of 7 percent per unit. This change, like most cost-saving opportunities the team identified, was invisible to customers and didn't matter to them.

Outcome

Many of the individual cost-saving opportunities the team identified were small (for an example of one model, see diagram). But the collective impact was huge—helping the company to reduce the total cost of manufacturing its fans by more than 10 percent, against a cost base that was already quite competitive. Meanwhile, consumers received the new designs well, which contributed to a 50 percent operating-profit jump during the first year of their introduction and helped to put the company in the market's number-two spot (up from number three) over that time span. o

The authors wish to acknowledge the contributions of Shivanshu Gupta, Vivek Khemka, Amresh Kumar, and Ashish Tuteja to the development of this article.

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Building brands in emerging markets

Yuval Atsmon, Jean-Frederic Kuentz, and Jeongmin Seong

Companies that harness word-of-mouth effects, emphasize in-store execution, and get their brands onto shoppers' short lists for initial consideration are more likely to capture the loyalty of emerging-market consumers.

As the rapid growth of emerging markets gives millions of consumers new spending power, those consumers are encountering a marketing environment every bit as complex and swiftly evolving as its counterpart in developed countries. Product choices and communication channels are exploding; so is the potential of digital platforms; and, as everywhere, consumer empowerment is on the rise.

The impact of these changes has been so profound in developed markets that three years ago, our colleague David Court and his coauthors proposed a new approach for understanding consumer behavior.[1] On the basis of research involving 20,000 consumers across five industries and three continents, our colleagues suggested replacing the traditional metaphor of a "funnel" in which consumers start at the wide end, with a number of potential brands in mind, before narrowing their choices down to a final purchase.

[1]See David Court, Dave Elzinga, Susan Mulder, and Ole Jørgen Vetvik, "The consumer decision journey," mckinseyquarterly.com, June 2009.

Envisioning consumer behavior as less of a linear march and more of a winding voyage with multiple feedback loops, our colleagues put forward an iterative framework, which they called the *consumer decision journey*, and identified four critical battlegrounds where marketers can win or lose.

These four battlegrounds are initial consideration, when a consumer first decides to buy a product or service and thinks of a few brands; active evaluation, when the consumer researches potential purchases; closure, when the consumer selects a brand at the moment of purchase; and postpurchase, when the consumer experiences the product or service selected. They are as relevant for emerging markets as they are elsewhere. As in developed markets, technology is unleashing the possibility of increasingly deep customer engagement at each phase of the journey, but with some important twists reflecting differences in the characteristics of emerging-market consumers, who generally don't have the same level of experience with brands and product categories as their developed-market counterparts do. Many are still looking to buy their first car, first television, or first package of diapers, for example.

In this article, we highlight the implications of three key differences between emerging- and developed-market consumers that we've uncovered in our research (Exhibit 1). First, harnessing the power of word of mouth is invaluable, as it seems to play a disproportionate role in the decision journeys of emerging-market consumers. Second, getting brands into a consumer's initial consideration set is even more important in emerging markets, because that phase of the journey appears to have an outsized impact on purchase decisions. Finally, companies need to place special emphasis on what happens when products reach the shelves of retailers, because the in-store phase of the consumer decision journey tends to be longer and more important in emerging markets than in developed ones.

Harnessing word of mouth through geographic focus

Word of mouth plays a more central role in the decision journeys of emerging-market consumers than for those in developed markets. When we surveyed food and beverage consumers in a range of developed and emerging markets, roughly 30 to 40 percent of the

Exhibit 1

Three factors in the consumer decision journey take on greater importance in emerging markets than in developed markets.

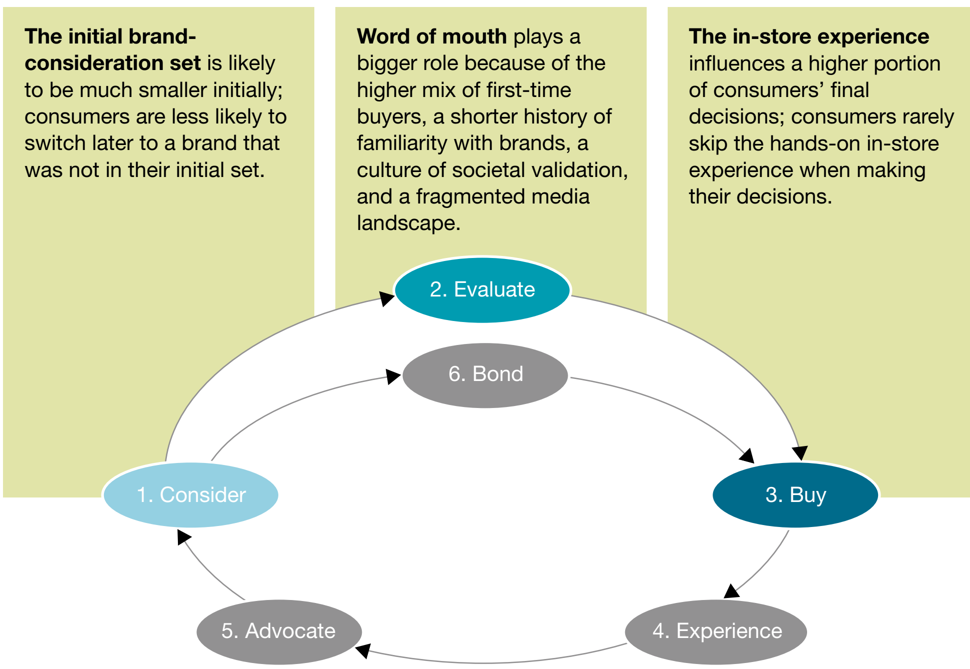
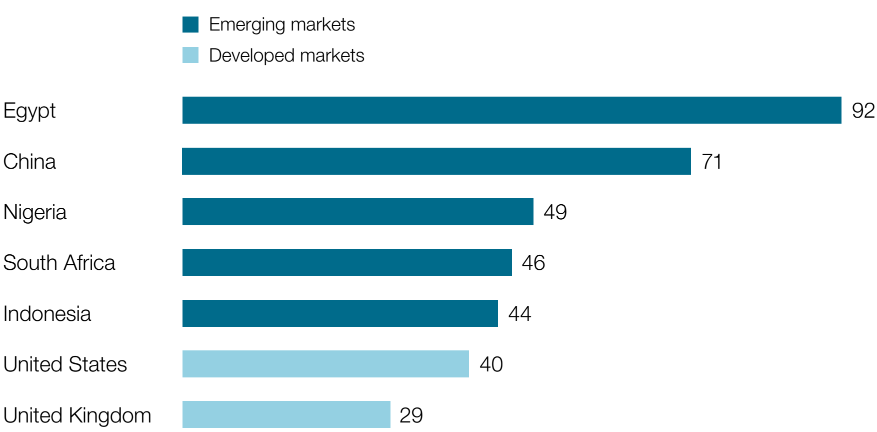


Exhibit 2

Purchase decisions of emerging-market consumers are heavily influenced by recommendations from friends and family members.

% of respondents who have received recommendations on food and beverage products from family and/or friends before purchasing



Source: McKinsey 2011 surveys of 512 South African, 4,244 Chinese, and 1,198 Indonesian consumers; McKinsey 2011 online benchmark survey of 150 UK and 250 US consumers respondents in the United Kingdom and the United States said they received recommendations from friends or family members before making purchases. Consumers in Africa and Asia reported higher, sometimes dramatically higher, figures: more than 70 percent in China and 90 percent in Egypt, for example (Exhibit 2). Similarly, 64 percent of the Chinese respondents said they would consider recommendations from friends and family for moisturizer, compared with less than 40 percent of respondents in the United States and the United Kingdom.

An important explanation for word of mouth's outsized role is that in a land of consumer "firsts"—more than 60 percent of Chinese auto purchasers are buying their first car, and the comparable figure for laptops is 30 to 40 percent—few brands have been around long enough to ensure loyalty. Seeing a friend use a product is reassuring. Indeed, the less a consumer knows about a product and the more conspicuous the choice, the more the consumer is likely to care about the opinions of others. "The more people I know who are using a product," consumers reason, "the more confident I can be that it will not fall apart, malfunction, or otherwise embarrass me." The presence (or absence) of that confidence shapes the group of brands that consumers choose to evaluate. It is particularly influenced by the postpurchase experience of friends and family, along with their loyalty to a brand.

Often, word of mouth is a local phenomenon in emerging markets, partly because of the simple reality that emerging-market consumers generally live close to friends and family. In addition, word of mouth's digital forms, which transcend geography and are growing rapidly in emerging markets, still have more limited reach and credibility there than in developed ones. According to our annual survey of Chinese consumers, just 53 percent found online recommendations credible—a far cry from the 93 percent who trusted recommendations from friends and family. That same survey showed that only 23 percent of Chinese consumers acquired information from the Internet about products they bought. For food, beverage, and consumer electronics consumers in the United States and the United Kingdom, that figure is around 60 percent.

Word of mouth's relatively local nature means that companies in emerging markets are likely to reap higher returns if they pursue a strategy of geographic focus than if they spread marketing resources around thinly (targeting all big cities nationwide, for example). By attaining substantial market share in a cluster of cities in close proximity, a company can unleash a virtuous cycle: once a brand reaches a tipping point—usually at least a 10 to 15 percent market share—word of mouth from additional users quickly boosts its reputation, helping it to win yet more market share, without necessarily requiring higher marketing expenditures.

In China, the bottled water brand C'estbon has a very small national share, but a 25 to 30 percent market share, on average, in the southern part of the country. Most of the brand's sales are to small stores and restaurants, where it has a dominant 45 to 50 percent share in that region. In India, this approach worked for P&G, with its Whisper brand of sanitary napkins, which the company introduced in targeted local communities by offering training and free samples to adolescent girls in schools. After successfully creating word of mouth in those communities, P&G gradually expanded the campaign to reach more than two million girls at 150,000 schools. The result was a drastic reduction in the use of cloth-based protection—to 6 percent, from 66 percent, among the targeted group, according to the company's assessment.

Emerging-market consumers have a penchant for visiting multiple stores multiple times and for collecting information methodically, especially when they purchase big-ticket items.

Building brands that get considered

Emerging-market consumers tend to consider smaller sets of brands initially and, compared with consumers elsewhere, are less likely to switch later to a brand that was not in their initial set. For example, research we conducted in nine product categories (including food and beverages, consumer electronics, and home and personal-care products), indicated that Chinese consumers initially consider an average of three brands and purchase one of them about 60 percent of the time. The comparable figures in the United States and Europe are four brands, with a purchase rate of 30 to 40 percent.

To include a brand in the initial consideration set, consumers must obviously be aware of it, so achieving visibility through advertising on TV and other media is an essential first step. Here again, geographic focus is critical. Emerging-market consumers not only generally live close to friends and family but also tend to view local TV channels and read local newspapers rather than national ones. (China, for example, has about 3,000 mostly local TV stations.) Gaining a high share of voice through local outlets in targeted geographies can help create a sense that a company's priority brands are in the forefront—which is valuable, because status-conscious, relatively inexperienced emerging-market consumers tend to prefer brands they perceive as leaders.

But spending heavily on advertising alone is not sufficient to ensure consideration. Companies also need to reach these consumers with messages that have been tailored to suit local market preferences and concerns, and are likely to be trusted. Testing messages—even those that have delivered powerful results in developed markets—is a key part of that equation. When Acer China tested its slogan "Simplify my life" in China, as part of a campaign emphasizing the low cost of its PCs, the message didn't resonate. For typical Chinese consumers, a PC is a very big-ticket purchase, so they care chiefly about durability. Chinese purchasers of PCs also tend to be entertainment rather than productivity oriented. In focus groups, it became clear that Acer's intended message of "great value for money" was arousing suspicion that the company's products might not perform reliably. A change in Acer's message to stress reliability rather than simplicity and productivity helped the company to build a more relevant and trusted brand, to get onto the short lists of more consumers, and to double its market share in less than two years.

Winning the in-store battle

The in-store phase of the consumer decision journey tends to be longer and more important in emerging markets than in developed ones. Emerging-market consumers have a penchant for visiting multiple stores multiple times and for collecting information methodically, especially when they purchase big-ticket items. The typical Chinese decision journey in one major consumer electronics category takes at least two months and involves more than four store visits. These consumers like to test products, interact with sales reps to collect product information, and negotiate with retailers to get the best deal.

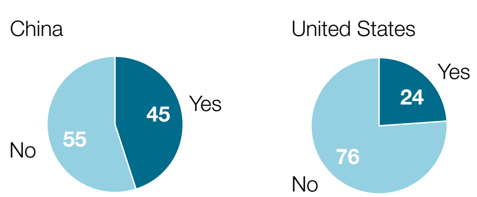
Exhibit 3

In-store execution heavily influences consumer decisions in China.

% of respondents[1]

China compared with United States

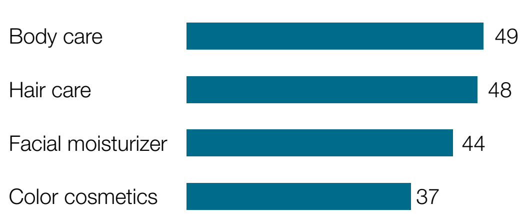
"I find myself leaving the store with a different brand/product than I planned because of the suggestion of the in-store salesman."



% of respondents

Comparison of various products within China

"I consider several brands and make the final decision in the store among a set of predetermined brands."



[1]Yes = respondents who strongly or somewhat agree; no = respondents who strongly or somewhat disagree.

Source: 2008 McKinsey survey of 5,372 Chinese consumers and ~300 US consumers

As a result, in emerging markets there is significantly more room to influence and shape consumer decisions at the moment of purchase. We first quantified this distinction in 2008 (Exhibit 3). This finding has been reinforced by subsequent research revealing, for example, that the in-store experience is by far the biggest factor in finalizing emerging-market consumers' flat-screen-TV purchase decisions and that Chinese consumers are almost two times more likely to switch brand preferences while shopping for fast-moving consumer goods than US consumers are.

Important as it is to control the in-store experience, the challenge can hardly be overstated. Products may be sold in tens of thousands of retail outlets after going through two or three layers of distributors. Companies often have limited visibility into what happens at the moment of purchase. Inconsistent merchandising, packaging, and in-store promotions can easily overshadow superior products and carefully crafted advertising strategies.

The first step in avoiding such waste is gaining a clear view of the retail landscape—how it is segmented and where the priority outlets are. Companies must then develop tailored control systems based on incentive schemes, collaboration with distributors, and retail-management programs. For priority outlets, companies must often deploy a heavy-control model using supervisors and mystery shoppers with supporting IT infrastructure to ensure that the performance of stores is visible enough to assess.

Unilever deploys massive resources in India to cover 1.5 million stores in tens of thousands of villages. Many of the salespeople carry a handheld device so that they can book replenishment orders anywhere, anytime, and synch their data with distributors. In Indonesia, Coca-Cola sells 40 percent of its volume directly to local retailers, with whom it collaborates closely. The lion's share of Coke's remaining Indonesian volume is sold to wholesalers with fewer than five employees and less than $100,000 in annual revenues. These wholesalers, in turn, distribute Coke products to small retailers. To improve in-store execution in the many outlets Coca-Cola doesn't serve directly, the company deploys additional support, including supplying them with free coolers and dispensers and providing sales effectiveness training for merchants (for more on the in-store battle, see "From oxcart to Wal-Mart: Four keys to reaching emerging-market consumers," on page 58).

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Although these principles—harnessing word of mouth, getting brands into a consumer's initial consideration set, and emphasizing in-store execution—may sound obvious, acting on them is not easy. It requires bold investment decisions, efforts to build the skills of local teams, and the courage to operate in ways that are fundamentally different from what headquarters might regard as normal. Fortunately, the potential rewards are commensurate. When emerging-market consumers perceive a brand consistently and positively across the major touch points, including friends and family and the in-store experience, they are far more likely to choose that brand, profiting companies that spend smartly rather than heavily. ○

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From oxcart to Wal-Mart:

Four keys to reaching emerging-market consumers

Alejandro Diaz, Max Magni, and Felix Poh

To get products to customers in emerging markets, global manufacturers need strategies for navigating both the traditional and the modern retail landscapes.

In emerging markets the world over, multinationals struggling to get their products to consumers confront a bewildering kaleidoscope of strategic and operational challenges. At one extreme, they must grapple with traditional retailers: the chaotic array of shops, kiosks, street vendors, and other small proprietors who seem to offer neighborhood customers a little of everything, whether it be groceries or branded goods, such as beverages, small electronic devices, and personal-care products. At the other, multinationals must deal with modern retailers—global giants, including Carrefour, Tesco, and Wal-Mart, as well as local leaders, such as CR Vanguard, in China, or Grupo Pão de Açúcar, in Brazil—that have become a powerful force in the emerging world's fast-growing cities.

This duality has become more pronounced since we last wrote about reaching consumers in emerging markets, five years ago; our emphasis then was largely on the ubiquitous mom-and-pop shop.[1] Today, retail landscapes in emerging markets can be divided into three broad categories (see exhibit, which focuses on grocery sales):

[1] See Alejandro Diaz, Jorge A. Lacayo, and Luis Salcedo, "Selling to 'mom-and-pop' stores in emerging markets," mckinseyquarterly.com, March 2007.

- *predominantly traditional* markets, such as India, Nigeria, and Indonesia, where small proprietors account for 98 percent, 97 percent, and 85 percent of the market, respectively[2]

- *predominantly modern* markets, such as China, Mexico, and South Africa, where modern trade already accounts for more than half of sales

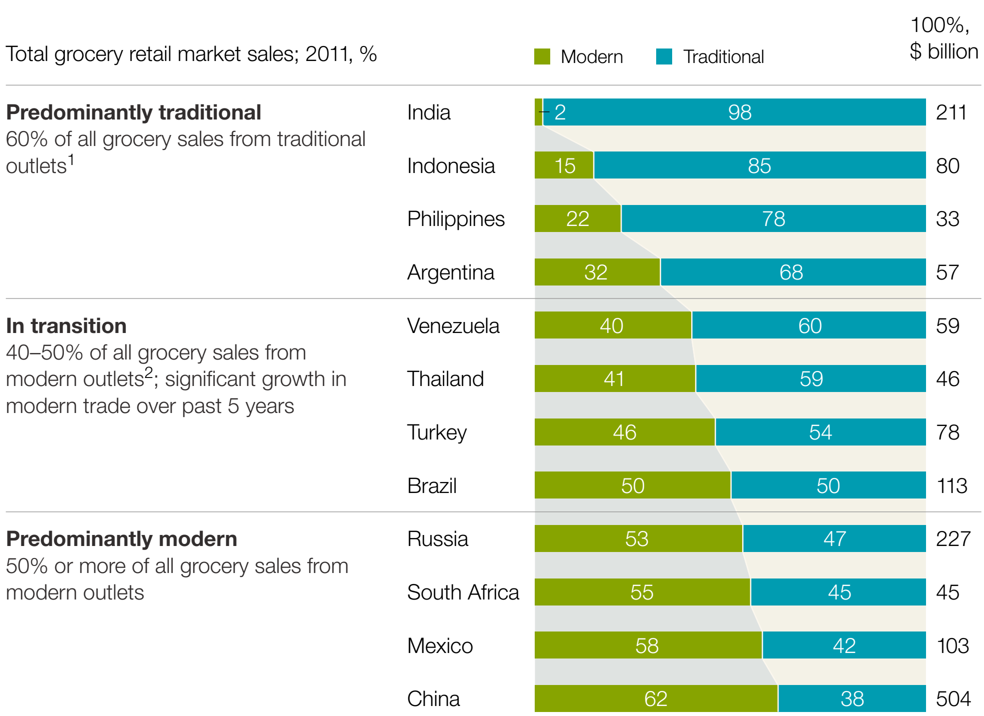
- *transitional* markets, where small proprietors currently prevail but are being rapidly elbowed aside by modern retailers; in Turkey, for example, their share of sales has shot up to 46 percent in 2011, from 26 percent in 2005

As multinational manufacturers look beyond countries as their unit of strategic planning, they will discover stark variations within regions,

[2] All market share figures are the latest available (typically, 2011) estimates from reports produced by Euromonitor and Planet Retail.

Exhibit

Emerging markets present a mix of retailing on a range from predominantly traditional to predominantly modern trade.



[1] Includes cooperatives, independent grocers, free markets, and food specialists.
[2] Includes hypermarkets, supermarkets, discounters, department stores, and convenience stores.

Source: Euromonitor

cities, and neighborhoods. (For more on city-based strategy setting, see "Unlocking the potential of emerging-market cities," on page 41.) In Malad, a western suburb of Mumbai, the most important outlets for grocery sales are mom-and-pop stores, known as *kirana*, and the suburb's giant fruit and vegetable *mandi*, or outdoor market. But as business-processing centers and new residences spring up in the district, modern retailers are muscling in. Malad now boasts ten supermarkets and three large hypermarts.

Even in predominantly modern retailing markets, such as China, where modern outlets account for nearly two-thirds of sales nationwide, traditional and modern stores live cheek by jowl. China's ten largest grocery retailers, though growing fast, account for only 11 percent of total sales—far less than the ten largest US players, which account for 51 percent of sales in that market. China's biggest retailer, China Resources Enterprise, commands a market share of 2.3 percent of total grocery retailing and 3.8 percent of modern grocery retailing. In a host of leading Chinese cities—among them Chengdu, Chongqing, Dailian, Shenyang, and Wuhan—modern retail outlets account for only about 50 percent of sales. By contrast, modern retailing represents more than 75 percent of sales in Beijing and Guangzhou, 80 percent in Shenzhen, and 77 percent in Shanghai, where residents can choose to buy their groceries at more than 100 hypermarkets.

Across the emerging world, in short, the retail terrain is diverse and unfamiliar. This article offers four road rules for companies to follow as they navigate it.

1. Embrace the duality of emerging markets

The starting point for any successful strategy is a recognition that manufacturers must engage effectively with traditional *and* modern trade outlets—and be prepared to live with that reality for the foreseeable future. In some emerging markets, notably India, regulations against big-box competitors explicitly protect small proprietors. Cultural preferences, poor infrastructure, and the geographic dispersal of emerging-market populations also assure a significant role for traditional outlets.

In our experience, companies that craft nuanced strategies embracing the traditional retailer can raise their revenues from emerging markets by 5 to 15 percent and their profits by as much as 10 to 20 percent. That's because for all the appeal that large-format retailers hold for global manufacturers—big chains are familiar, easy to deal with, and can free manufacturers to focus on issues like strategy, product development, or recruiting—these retailers can command high listing fees and big discounts, as well as impose many conditions small proprietors cannot. They also are quick to weed out products that don't sell briskly.

Some manufacturers have opted to focus on large retail chains to build a position of strength and then gradually developed the capacity to work with traditional outlets. Prantalay Marketing, a Thai seafood processor, increased sales of its ready-to-eat meals, launched in 2004, to more than $30 million within six years, in part by concentrating on Thailand's large retail chains, including Siam Makro, Big C, and Tesco Lotus. The focus on modern retailing made sense because Prantalay's prepared meals were frozen and required a reliable cold chain. Now the company is turning its attention to traditional channels and expanding its product lineup to include offerings, such as instant noodles, that do not require freezing.

Similarly, South Africa's Tiger Brands worked through large retailers to consolidate its position in its home market. A consumer product giant whose brand portfolio includes everything from Purity baby food to Doom insecticide, Tiger accounts for close to 15 percent of sales at every major South African retailer. But as the company looks for future growth, it has begun acquiring businesses in other African markets. Given the greater importance of small proprietors in those economies, Tiger's emergence as a regional player will force it to develop new capabilities for working through traditional retailers.

Other manufacturers have moved in the opposite direction, securing market position through traditional retail outlets, then turning to larger establishments in the quest to expand. Consider the case of Wanglaoji, a 184-year-old herbal tea transformed by JDB Group, a Hong Kong soft drink marketer, into China's best-selling beverage. Until 1995, when JDB acquired the rights to the Wanglaoji trademark from state-owned Guangzhou Pharmaceutical,[3] the drink was primarily seen as an herbal elixir for cooling "overheated" internal organs.

[3] Zhang Zhao, "Arbitration ends long tempest in a tea can," *China Daily*, May 23, 2012.

JDB launched a rebranding effort whose masterstroke was a decision to market the drink through restaurants specializing in spicy Sichuanese cuisine. JDB pitched Wanglaoji as a healthy and refreshing antidote to Sichuan's famously fiery hot-pot dishes, forged partnerships with select restaurants, and gave "Wanglaoji-trusted outlets" lavish incentives, including product discounts, free promotional materials, and generous contributions to holiday marketing campaigns. The results of the repositioning were dramatic: between 2002 and 2008, sales soared from less than $30 million to more than $1.5 billion.[4] With consumers clamoring for the drink in shops as well as restaurants, JDB found modern retailers eager to carry its red cans. Today, the brand boasts sales of roughly $3 billion in China, topping sales of that other popular red-can beverage, Coke.[5] It is widely available in a variety of hypermarkets, minimarts, and convenience stores, as well as in hot-pot restaurants.

2. Segment and conquer

Because multinationals can't be everywhere at once, it is essential for manufacturers to pick their shots by segmenting and prioritizing sales outlets carefully. Sophisticated segmentation strategies are especially crucial in targeting traditional trade channels, for a single country may have millions of outlets. (China, for example, has anywhere from 3 million to 8 million sales outlets, depending on what kind are counted, while India has 8 million to 15 million.) In mapping routes to market in emerging economies, we urge manufacturers to focus on a geographic region or cluster of cities and to achieve complete coverage at outlets with significant potential before going on to the next market. (For more on the advantages of creating a stronghold in one area before moving to the next, see "Building brands in emerging markets," on page 50.)

To navigate these markets effectively, manufacturers should look beyond the current sales of priority outlets. Sales data for traditional stores in emerging markets are notoriously unreliable; even when accurate, they often reflect little more than how much effort the

[4] Huang Daohen, "Lost rights—Wanglaoji's case spells war for the herbal tea market," *Beijing Today*, May 25, 2012.

[5] Whether the Wanglaoji brand can sustain the past decade's rapid growth is uncertain. A series of recent court rulings invalidated an effort by JDB to extend its rights to use the Wanglaoji trademark to 2020. A 2001 agreement that, according to JDB, provided for this was thrown out by mainland courts after a 2005 investigation discovered that the chairman of JDB's parent company secured the signature of Guangzhou Pharmaceutical's vice chairman on this deal by paying him a $600,000 bribe.

manufacturer has expended to date in supporting the store in question. It's far better to estimate potential sales by using forward-looking parameters, such as store size, proximity to workplaces or schools, traffic volumes, neighborhood wealth, or shelf space.

One leading global food company used census and publicly available transportation data to classify sales outlets in the Middle East according to outlet size (six segments, ranging from more than 130 square meters to 30 square meters or less) and a mix between traffic volumes (high, medium, and low) and incomes of surrounding households (high, medium, and low). The result was a grid with 36 cells, which were then aggregated into six distinct segments, enabling managers to make strategic choices about which outlets merited greater investment and which should get only basic maintenance.

The next step is to specify precisely the combination of service, support, and incentives each outlet segment merits. Coca-Cola refers to this process as defining the "picture of success." What should a store look like? How should Coca-Cola products be displayed, stored, priced, and promoted? Big stores in rich, high-traffic areas will get more attention than small shops in poor, low-traffic areas—but there are numerous variations in between. For each segment, managers tailor a specific set of value propositions. Should the company supply coolers and, if so, how many? What kind of signage and other promotional materials should it provide? Which Coca-Cola products should be supplied and in how many variations of packaging? How frequently should sales staff visit? (See illustration on page 64.)

In emerging markets, manufacturers must go to great lengths to craft a combination of retailer incentives ensuring that the picture of success comes out right. Big chains, of course, care most about discounts and fatter profit margins, together with better merchandising, more expensive displays, more frequent deliveries, and more frequent visits by salespeople. Some traditional retailers may value these things too. Smaller retailers, however, may prefer free equipment, brand promotions, flashier displays, and outside signage to help them stand out from the crowd. In many cases, manufacturers can win the loyalty of small proprietors by paying electricity bills or providing health insurance for the owner, employees, and members of their families. In some cities in Mexico and India, where shopkeepers take special pride in their establishments' appearance, offering to pay for a new paint job every six months may be the lowest-cost way to secure a partnership.

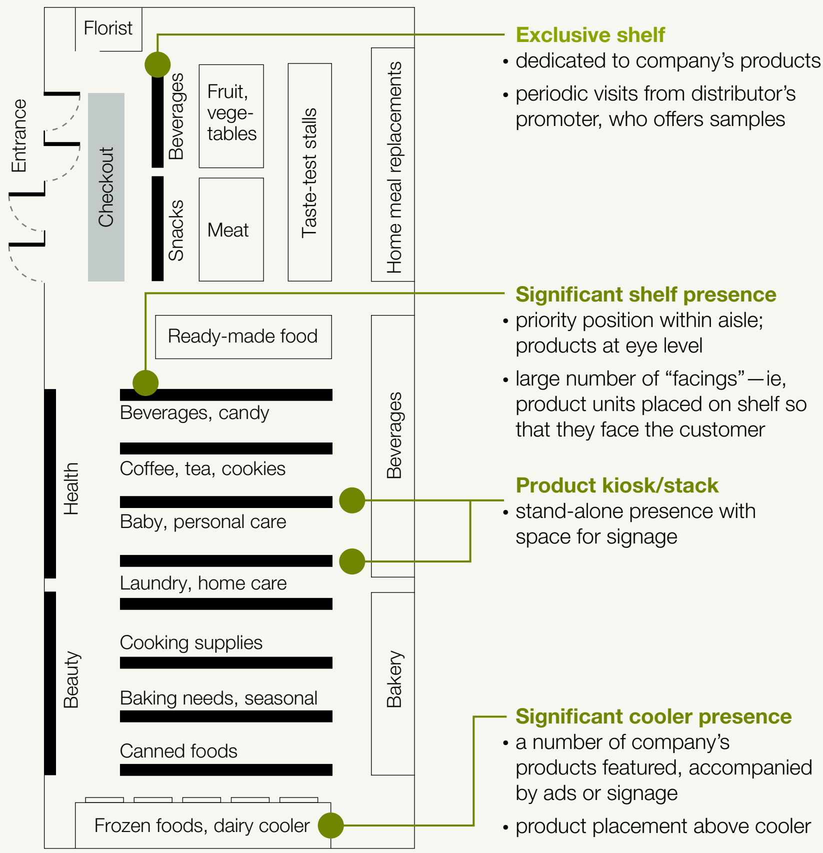
Creating a 'picture of success' involves tailoring the retail value proposition to different types of outlets.

Example of large Chinese dairy player's store presence (floor plans not drawn to scale)

● Customer activation elements

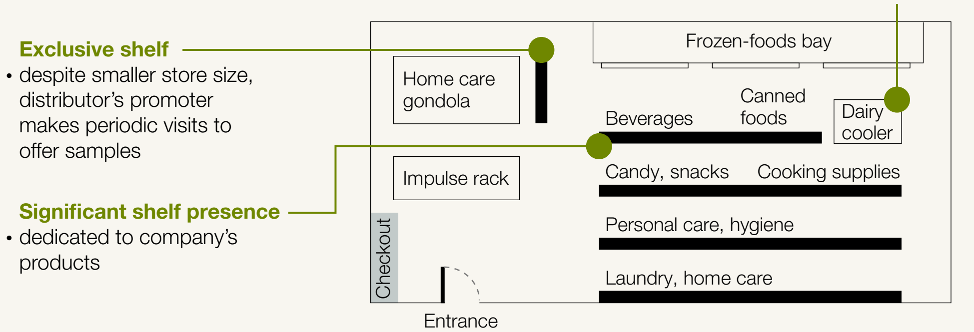
Urban hypermarket (45,000–55,000 sq ft)

Potential incentives offered to stores in exchange for commitments include discounts, fatter profit margins, expensive displays, frequent deliveries/sales visits, and free equipment.



Small convenience store (1,500–2,000 sq ft)

Potential incentives include free equipment, brand promotions, flashier displays, and outside signage to stand out from the crowd.



Source: Field visits; McKinsey analysis

Manufacturers must calibrate their concessions carefully. All "gives" to retailers should be compensated by "gets"—for example, requirements that retailers guarantee certain sales volumes or provide superior shelf space. One leading multicategory food company in Mexico offers to install high-end shelves and displays in smaller stores in exchange for a retailer's commitment to display its products prominently. The degree to which retailers actually deliver these "gets" provides valuable information to manufacturers as they periodically reevaluate the potential of outlets.

3. Balance cost and control in your route to market

Even the most sophisticated segmentation strategy can be undone by flawed models for transporting goods and serving retailers. Direct delivery with a manufacturer's own trucks and trained employees is the preferred option for modern trade. But such costly support must be confined to outlets that really matter. Often, "basic availability"—with products delivered, say, by wholesalers—will suffice.

In Indonesia, Unilever, for example, services supermarkets and hypermarkets with its own vehicle fleet. But because the archipelago has thousands of islands, Unilever reaches minimarts through a network of distributors who work solely for the company in the categories it carries and serves independent small retailers and chains through another network. For ice cream vendors, who sell from freezer-equipped tricycles, Unilever relies on ice cream concessionaires. In India, Unilever has used a similar multiple-channel approach to gain access to more than half of the country's population—all urban centers and 85,000 villages, which in some cases it serves with bullock carts and tractors.

Coca-Cola prefers direct delivery wherever possible. But in Kenya, where rural and urban roads alike are often too rough for Coca-Cola delivery trucks, the company delivers on bicycles and pushcarts to microdistributors, which in turn can reach retail outlets covering 90 percent of the country's population. This vast network of small vendors has not only generated enormous goodwill for Coca-Cola but has also been cited by the International Finance Corporation as a model of how global companies can foster local entrepreneurs.

In many of these markets, companies must deal with thousands of distributors and wholesalers, which often struggle to realize the manufacturer's brand goals or strategies for influencing the behavior of retailers. Executives at many leading global consumer companies argue that segmenting and prioritizing distributors is as important as segmenting and prioritizing sales outlets. The goal is to build the skills of reliable, high-priority distributors so they can help manufacturers achieve their strategic goals for different kinds of outlets—which sometimes means consolidating distribution networks.

In India, for example, Hindustan Unilever consolidated its distributors for the Mumbai market from 21 firms to just four megadistributors.[6] Similarly, more than a decade ago Procter & Gamble shrank the number of its distributors in China. Acquisitions can be an excellent opportunity to reevaluate distributors; over three years, a leading fast-moving consumer goods company in Russia did exactly that, transforming a tangle of 300 overlapping players of widely varying capabilities into a core of 100 focused, high-performance stars.

4. Arm the front line with skills and technology

The many moving pieces in these sales and distribution networks demand a relentless focus on frontline execution. Xian-Janssen OTC, Johnson & Johnson's consumer health care arm in China, requires its sales personnel to undergo five formal training modules over five years to master professional skills, such as salesmanship and team management. The company also coaches employees informally (with sales visit "shadowing") and conducts weekly "education meetings" where difficult sales situations encountered during the week are reenacted and analyzed. What's more, high-performing companies recognize that "what gets measured gets done," so they set targets and offer incentives aimed not just at raising sales volumes but also at promoting proper retail execution, such as the quality of in-store product displays.

At the same time, companies are well advised to recognize the varying capabilities of their emerging-market sales forces and to find simple ways of standardizing the quality of sales visits as far as possible. For instance, Kang Shi Fu, a successful Chinese manufacturer of beverages and noodles, provides its salespeople with checklists that are

[6] Sudha Menon, "HUL set to streamline distribution network," LiveMint.com, January 9, 2009.

tailored for each outlet segment and must be completed during every visit. Guidelines for Pepsi salespeople cover a host of specific duties, from greeting the retailer to checking inventory levels. Checklists and standardized approaches are useful both when manufacturers hire and manage their own sales forces and when they rely on (and closely supervise) those of distributors. "Shadow management" of this sort has proved effective for several leading global companies in China. Often, sales managers are "embedded" with distributors to train staff and offer advice on how to execute different strategies for different store types. Embedded managers also join visits with distributors' sales teams to monitor performance and provide on-site coaching.

Technology is an increasingly important tool, with handheld devices for salespeople proving especially useful. A snack company in the Middle East uses satellite-linked devices, so their geo-coordinates can be tracked. If outlets aren't visited in the right order, the devices are disabled, preventing the salespeople from completing their tasks. A central team can also periodically monitor the location of individual salespeople, to ensure that they truly are on sales visits and not engaged in side jobs. These handhelds come preloaded with detailed instructions on each outlet the salespeople are about to visit—for instance, its outlet segment, historical sales information, specific products to sell, and key action steps to complete from the last sales visit. Not long ago, such functions involved a specialized mobile device and high hardware costs. Today, an app on a low-cost smartphone can perform many of these tasks.

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Eventually, mom-and-pop stores may go the way of buggy whips, and the descendants of today's village children in countries such as China and India may scoff at the idea of buying products and services anywhere but in climate-controlled malls or online sites. For now, though, manufacturers staking their futures on these booming economies must forge lasting relationships with a diverse set of retailers—before competitors do.

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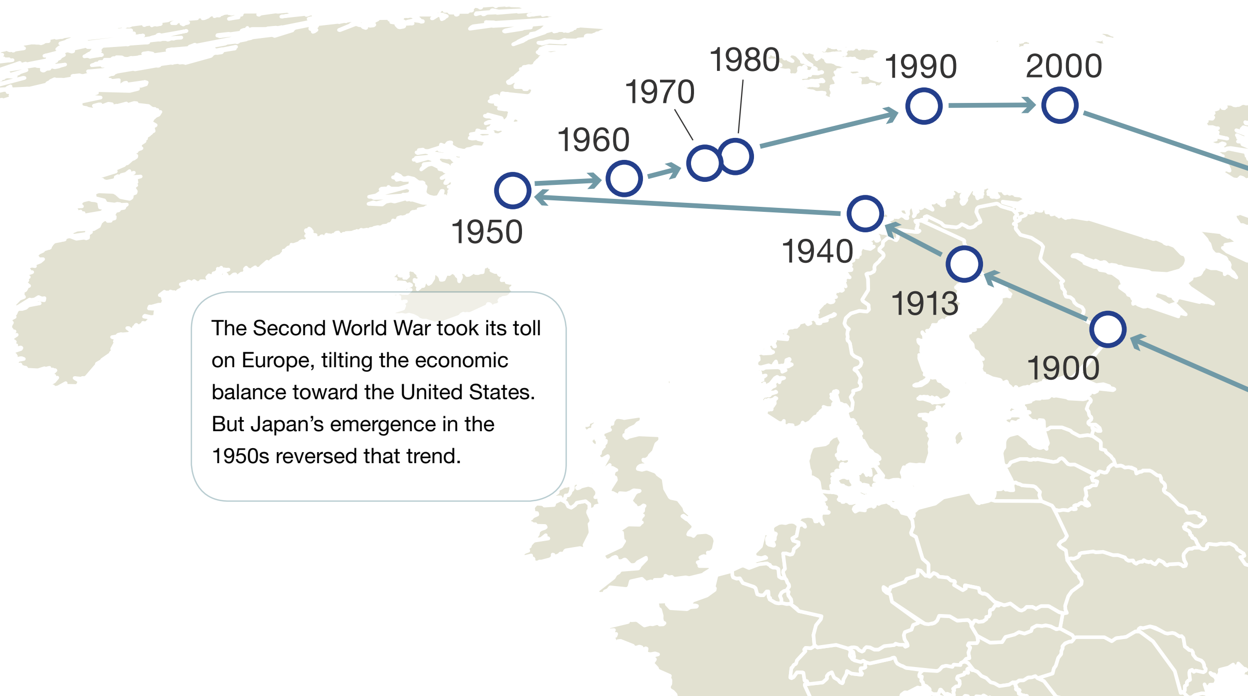
Picture This

Mapping economic change

Jaana Remes and Fabian Schaer



A picture, they say, is worth a thousand words—or, in this case, perhaps 2,000 years. The map on these pages tracks big shifts over time in the world's economic balance. For each year highlighted, we have plotted a point that represents the earth's "economic center of gravity," calculated by weighting individual countries' share of global GDP according to their geographic center.

The world's economic center of gravity was relatively stable for many centuries. But after 1600, it started moving north and west, reversing direction suddenly after the Second World War and speeding up dramatically in the 21st century. Today, with China urbanizing at 100 times the scale of Britain in the 18th century—and at more than ten times the speed—the global economic balance is almost back to where it began.

Jaana Remes is a senior fellow at the McKinsey Global Institute and is based in McKinsey's San Francisco office; **Fabian Schaer** is a consultant in the Zurich office.

Historical data from former University of Groningen professor Angus Maddison underlies this mapping. For a full explanation of the methodology, see page 67 in the McKinsey Global Institute report *Urban world: Cities and the rise of the consuming class*.

Taking

social networks

beyond marketing

Social technologies have dramatically changed how individuals interact, so it's natural that they should play a greater role in how companies organize and manage themselves. In our first article, research from the McKinsey Global Institute sizes up the tremendous new value companies can capture by applying social technologies—for instance, increasing the productivity of knowledge workers by 25 percent. While marketers have been the first movers, our second article shows that social media can play a vital role across functions: transforming the way companies gather competitive intelligence, by tracking and analyzing vast new pools of socially generated information.

Illustrations by Bill Butcher

Capturing business value with social technologies

Jacques Bughin, Michael Chui, and James Manyika

As these powerful technologies shake up productivity and growth across industries, they will create new organizational imperatives.

Social technologies, in their relatively brief period of existence, have found favor with consumers faster than previous technologies did.[1] It took 13 years for commercial television to reach 50 million households and 3 years for Internet service providers to sign their 50 millionth subscriber. Facebook hit the 50 million–user mark in just a year and Twitter in nine months. Sweeping cultural, economic, and social changes have accompanied this accelerated pace of adoption by the world's consumers.

Companies, too, have adopted these technologies but have generated only a small fraction of the potential value they can create. An in-depth analysis of four industry sectors that represent almost 20 percent of global industry sales suggests that social platforms can unlock $900 billion to $1.3 trillion in value[2] in those sectors alone. Two-thirds of this value creation opportunity lies in improving communication and collaboration within and across enterprises. Frequently, these improvements will go well beyond the areas many companies have focused on to date in their social-media efforts: connecting with consumers, deriving customer insights for marketing and product development, and providing customer service.

[1] We define social technologies as products and services that enable social interactions in the digital realm and provide distributed rights to communicate and add, modify, or consume content. They include social media, Web 2.0, and enterprise collaboration technologies.

[2] In this article, value means economic surplus, not net present value.

Since “social” features can be added to almost any digital application that involves interactions among people, the range of uses is immense and measurement correspondingly challenging. Thus, we cast a wide net. We studied several hundred cases of organizations using social technologies around the globe. In addition, we examined the patterns of knowledge work within organizations and drew insights from data covering several years of surveys involving thousands of global executives on the ways their companies use social technologies. Our analysis of successful uses served as a basis for modeling potential improvements across the value chain.

Of late, some bearish sentiments surround social technologies after disappointments for several companies in the capital markets. It’s worth noting, however, that today only 5 percent of communications occur on social networks. Moreover, almost all digital human interactions can ultimately become “social,” and jobs involving physical labor and the processing of transactions are giving way, across the globe, to work requiring complex interactions with other people, independent judgment, and the analysis of information.[3] As a result, we believe social technologies are destined to play a much larger role not only in individual interactions but also in how companies are organized and managed.

Productivity possibilities

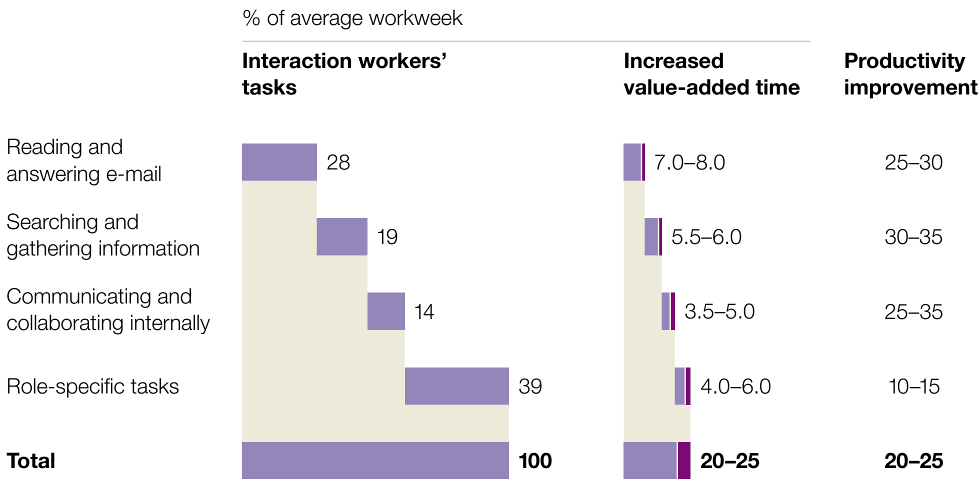
We estimate that using social technologies to improve collaboration and communication within and across companies could raise the productivity of interaction workers by 20 to 25 percent (Exhibit 1). These dramatic gains would occur thanks to shifts in the way these workers communicate—from using channels designed for one-to-one communication, such as e-mail and phone calls, to social channels, which allow “many-to-many” communication.

Specifically, our research indicates that interaction workers typically spend 28 percent of each day (13 hours a week) reading, writing, and responding to e-mails. A huge amount of valuable company knowledge is locked up in them. As companies adopt social platforms, communication becomes a new form of content, and more enterprise

[3] See Scott Beardsley, Bradford C. Johnson, and James Manyika, “Competitive advantage from better interactions,” mckinseyquarterly.com, May 2006.

Exhibit 1

Improved communication and collaboration through social technologies could raise the productivity of interaction workers by 20 to 25 percent.



Source: International Data Corporation (IDC); McKinsey Global Institute analysis

information can become readily accessible and easily searchable rather than sequestered as inbox "dark matter." Employees will be able to find knowledge in the organization more readily and to identify experts on various topics, given the expertise implied by their patterns of social communication. We estimate that 25 to 30 percent of total e-mail time could be repurposed if the default channel for communication were shifted to social platforms.

E-mail is just the beginning. Companies could also raise the efficiency of the large part of the day—roughly 20 percent—that knowledge workers spend searching for and gathering information. In fact, our analysis suggests that a searchable store of social messages could allow employees to repurpose 30 to 35 percent of their information search time.[4] Unisys, for instance, has started along the path to capturing value in this way: 16,000 employees around the world have joined a company-wide social network, and ten social communities provide ready access to specialized expertise from around the company to resolve technical problems.

[4]Estimates of the number of hours interaction workers spend on various tasks are based on McKinsey proprietary data and on International Data Corporation survey results. For methodological details and for more on the research underlying this article, see the full McKinsey Global Institute report, *The social economy: Unlocking value and productivity through social technologies*, on mckinsey.com.

Capturing these technologies' full potential to improve collaboration and communication, however, will require organizational change and new management approaches, which often take time to implement.

Adding up the business benefits

Besides these productivity opportunities from improved collaboration, social technologies offer a wide range of business benefits in additional areas—including consumer marketing (for instance, in industries such as consumer packaged goods and automotive), customer service, and even fraud detection (in sectors like insurance). To understand the full company-level potential of social media, we examined four major sectors: consumer packaged goods (CPG), advanced manufacturing, professional services, and consumer-facing financial services. Within each sector, we quantified the value potential in five functional areas—R&D, operations and distribution, marketing and sales, customer service, and business support[5]—as well as uses that cut across the enterprise and its functions (Exhibits 2 and 3).

Consumer packaged goods

CPG companies have been among the early adopters of consumer social media, both to engage customers and to derive insights. However, substantial gains could arise from additional applications, particularly in marketing and sales, where these companies spend an average of 15 to 20 percent of their revenues. Some leading companies have gained the same level of consumer insight, at only 60 to 80 percent of the previous cost, by substituting insights from extensive online communities for more traditional marketing panels and focus groups. Interactive product campaigns that deploy social technologies, our research further shows, can increase the productivity of advertising expenditures by as much as 30 to 60 percent. New, collaborative forms of engagement with customers too can improve product development, both in speed and level of understanding. Kraft, for instance, discovered key consumer insights and significantly reduced times to market for 48 new South Beach Diet products by enlisting communities of nutrition experts and potential consumers.

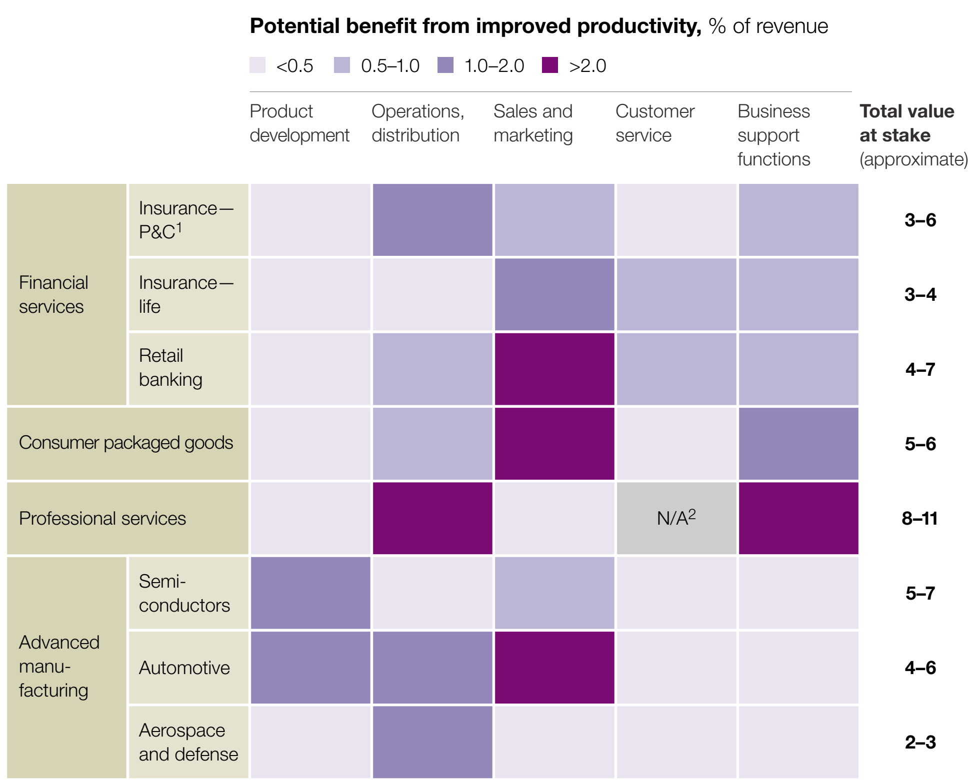
[5] Business support functions are corporate or administrative activities, such as human resources or finance and accounting.

Advanced manufacturing

We found significant opportunities for tighter collaboration in the three advanced-manufacturing industries we studied—semiconductors, aerospace, and automotive. Highly educated knowledge workers, though central to R&D operations in these industries, often remain "siloed" in their specific units within sprawling global operations. Collaboration among such employees across organizational boundaries could increase their effectiveness. Supply chain operations in semiconductors and aerospace frequently require a high degree of collaboration and knowledge sharing within and beyond company boundaries in the manufacture of specialized components and complex subsystems. Pre- and postsales customer support in these industries often involves ecosystems where information can be exchanged among knowledgeable customers and company personnel,

Exhibit 2

Social technologies promise to unlock value in major sectors of the economy and across a range of functional areas.



[1]Property and casualty.
[2]The activities associated with providing direct services to customers are captured under "Operations, distribution."

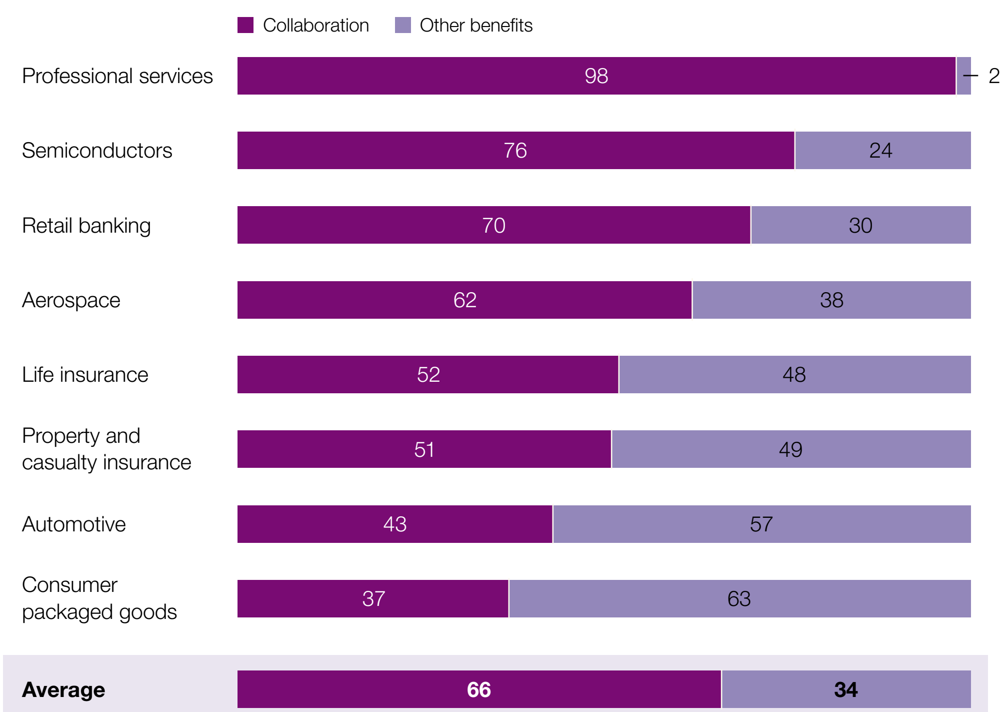
Source: McKinsey Global Institute analysis and collaboration tools can facilitate this sharing. Texas Instruments, for example, uses social platforms to share design information with engineers at client companies, tailoring products to their needs while avoiding costly overdesign.

Automotive is a somewhat special case of advanced manufacturing, in that the end customers for finished products are consumers. Consequently, companies have a significant opportunity to use social technologies for marketing and for deriving consumer insights. Kia Motors, for example, designed more comfortable seats and increased the space of the cabin in one of its models after learning that consumers in social forums found the cabin cramped and uncomfortable.

Exhibit 3

The potential for social technologies to create value through collaboration varies by industry and is greatest for professional services.

Share of total benefits, %



Source: McKinsey Global Institute analysis

Professional services

Interactions with colleagues and clients lie at the heart of how professional-service firms, such as advertising, accounting, engineering, and consulting businesses, create value. Productivity gains from the effective use of social technologies could be correspondingly significant, principally by reforming internal work flows and by providing meaningful real-time interactions with customers. Management resistance and legitimate fears of breaching client confidentiality are factors limiting the potential of social technologies, executives say. Of course, this resistance comes at a cost: service providers risk failing to satisfy the rising demands of clients, some of which could be further along the social-leaning curve than they are.

Innovations are emerging, however. Some entrepreneurial firms are experimenting with social networks to cocreate new services with their clients, speeding up knowledge access and implementation. One London engineering firm uses social platforms to manage project communications with road contractors. Disruptive new business models are appearing as well. At Choosa, a global design firm, clients post requests for proposals on a company social platform. The work is crowdsourced to contractors, who submit competing design proposals.

Consumer-facing financial services

In the retail-banking, life insurance, and property and casualty insurance industries, social technologies can help improve service delivery, reduce costs, and enhance the customer experience. Consumers are increasingly open to using these channels for easier, more transparent interactions with their financial institutions. New processes are surfacing across a sector often typified by organizational complexity, siloed personnel, and fragmented processes that stymie collaboration, innovation, and efficiency.

To improve collaboration and communication not only across an extensive branch network but also with headquarters, TD bank, for example, deployed a social platform for 85,000 employees. One result: a reduction in the number of phone calls, meetings, and unwanted e-mails. Insurance broker Friendsurance has launched a social platform that allows potential customers to form insurance groups (think Facebook friends) that lower costs. (The groups themselves insure lower-cost claims and crowdsource administrative tasks.) Movenbank has targeted 50,000 customers in a novel Facebook-based institution that will be branchless, as well as paper and plastic free. Clients will use the bank's Web site and their own mobile devices for transactions, and an intelligent system called CRED will advise on financial matters and analyze customer information for credit decisions.

'Next practices'

Because the landscape is evolving swiftly and remains largely uncharted, a universal set of prescriptions for business leaders to follow in exploiting these opportunities has yet to emerge. Furthermore, there are risks to be managed, including concerns about productivity-dampening distractions, privacy, the potential loss of proprietary information, and reputational issues.

Some companies have begun to develop a body of knowledge on how to use social technologies for applications such as marketing.[6] However, for most applications of social technologies—particularly enhancing collaboration and communication—we recommend that instead of focusing on *best* practices in the early stages of the journey, executives should be open to discovering *next* practices, to which broader principles apply:

- Since these are *social* technologies, the decisions that will make the most difference often won't be about the choice of the technologies themselves but about how to encourage interactions among people. Social technologies can bring the scope, scale, and economics of the Internet to human interactions, but a successful transformation will ultimately rest on practices and culture. The companies that have the greatest successes will be those with cultures conducive to broad collaboration and sharing.

- Activities appropriate to one organization may not succeed in another with a different workforce, competitive context, or customer base. Purposeful experimentation that tests an array of practices and technologies will therefore be crucial. Testing

[6] See Roxane Divol, David Edelman, and Hugo Sarrazin, "Demystifying social media," mckinseyquarterly.com, April 2012.

"minimal viable products" to determine what works should help companies learn and implement the right practices for them while they develop new "muscles" that allow the organization to pivot quickly and opportunistically to new models.[7]

- Creating a critical mass of participation is crucial, and companies will need to nurture self-reinforcing cycles of adoption. Bottom-up use of technologies is essential, but our research also has shown that role modeling and vocal support by leaders can be decisive. In addition, technologies should be baked into employees' day-to-day work flows, or usage will probably decline after an initial burst of interest.[8]

While the adoption of social technologies is growing rapidly, a huge untapped potential for them to create value remains. Companies open to the principles and practices we have outlined here can begin to exploit these possibilities and may find that the resulting gains form the basis of a competitive edge over their rivals. ○

[7] Eric Ries, *The Lean Startup: How Today's Entrepreneurs Use Continuous Innovation to Create Radically Successful Businesses*, Crown Business, 2011.

[8] See Michael Chui, Andy Miller, and Roger P. Roberts, "Six ways to make Web 2.0 work," mckinseyquarterly.com, February 2009.

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For the full MGI report on which this article is based, see *The social economy: Unlocking value and productivity through social technologies*, on mckinsey.com.

How ‘social intelligence’ can guide decisions

Martin Harrysson, Estelle Metayer, and Hugo Sarrazin

By offering decision makers rich real-time data, social media is giving some companies fresh strategic insight.

In many companies, marketers have been first movers in social media, tapping into it for insights on how consumers think and behave. As social technologies mature and organizations become convinced of their power, we believe they will take on a broader role: informing competitive strategy. In particular, social media should help companies overcome some limits of old-school intelligence gathering, which typically involves collecting information from a range of public and propriety sources, distilling insights using time-tested analytic methods, and creating reports for internal company “clients” often “siloed” by function or business unit.

Today, many people who have expert knowledge and shape perceptions about markets are freely exchanging data and viewpoints through social platforms. By identifying and engaging these players, employing potent Web-focused analytics to draw strategic meaning from social-media data, and channeling this information to people within the organization who need and *want* it, companies can develop a “social intelligence” that is forward looking, global in scope, and capable of playing out in real time.

This isn’t to suggest that “social” will entirely displace current methods of intelligence gathering. But it should emerge as a strong complement. As it does, social-intelligence literacy will become a critical asset for C-level executives and board members seeking the best possible basis for their decisions.

In this article, we explore four distinct ways social technologies can augment the intelligence-gathering approaches of companies. As Exhibit 1 makes clear, social media has little effect on some aspects of the intelligence cycle—in particular, the need to identify priorities for exploration and decision making over the next 6 to 12 months, as well as the use of assembled information to make unbiased decisions. But social technologies can play a surprisingly central role in how information is sourced, collected, analyzed, and distributed.[1]

From identifying data to mapping people and conversations

Social media creates a new information map. Competitive analysts today differentiate between primary sources of information (from experts, competitors, employees, and suppliers), on the one hand, and secondary sources (such as published data, articles, and market research), on the other. Social intelligence operates on a different plane, identifying people and their conversations in social spaces. Its logic is that if you can find the right "curators" and experts collecting and channeling vital, accurate information, that eliminates the need for extensive searches of traditional databases and published information. Identifying the right people ultimately should induce companies to join existing online conversations and even shape them. This real-time information may help preempt key actions of competitors or lead to adjustments of strategy.

The costs of navigating without a social-intelligence map can be substantial. Servier, a French pharmaceutical company, is a case in point. Its licensed diabetes drug, Mediator, was also used extensively off-label for weight loss. The drug was withdrawn from the French market in November 2009 after questions arose about its safety, including its role in a number of deaths. For years after Mediator's launch, in 1976, there had been little news in the press, let alone medical data, that pointed to problems. By 2003, though, online forums were hosting hundreds of conversations among concerned patients. Not long afterward, doctors and nutritionists began weighing in with their concerns about the drug's safety. These early signals were too weak for traditional Web analysis to spot by simple keyword scanning. But if the analysis had shifted to deeper "argument mining," diabetes-related conversations among experts would have

[1]The analysis in this article relies in part upon data and research provided by NM Incite, a joint venture between Nielsen and McKinsey.

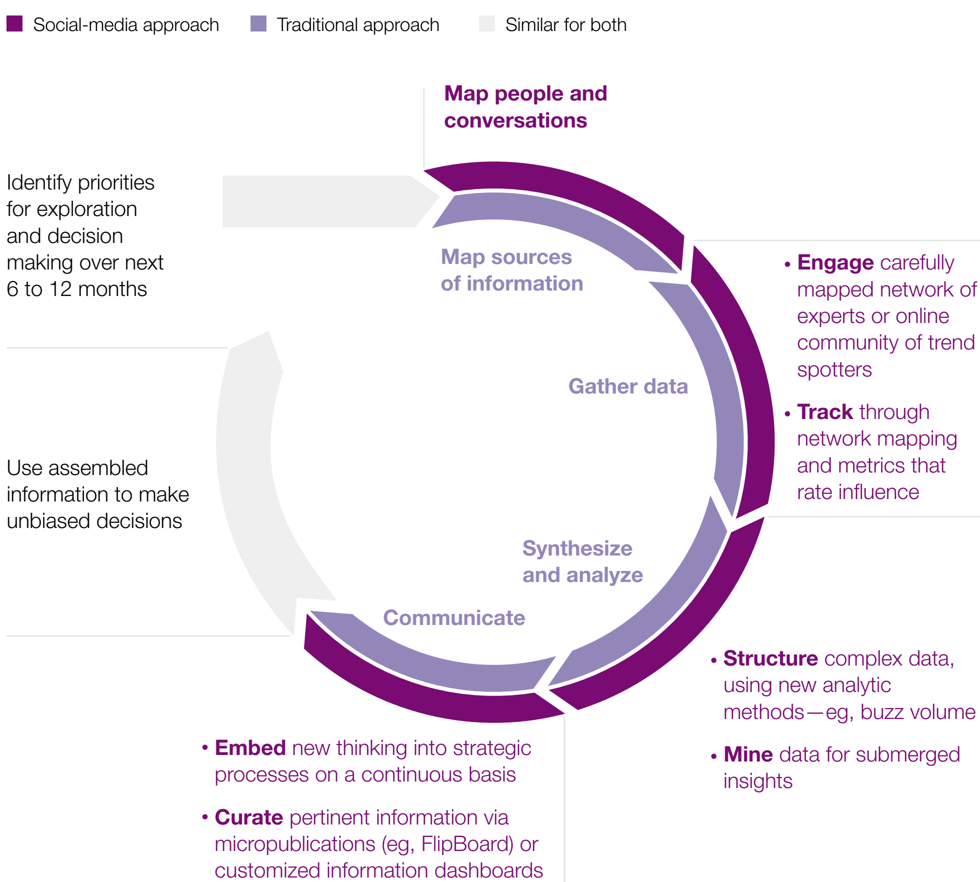
appeared, perhaps prompting action by the company. A retrospective analysis from French social-media researchers found that by 2006 the conversations mapped though argument mining had shifted heavily to discussions of the drug’s risks.[2]

The case of Mediator, while perhaps extreme, hints at structural constraints that lurk within many organizations and hinder efforts to identify or act on key information—particularly when it runs against the organizational grain. Intelligence analysts often report exclusively to a single department, such as communications, marketing, or strategy. That can make analysts gravitate toward the approved pattern of thinking within their function, potentially limiting the breadth of insight they distill and sometimes even

[2]See a case study published, in French, by Agence Conversationnel: *L’Argument Mining: Une Technique D’Investigation Online Pour Anticiper Les Risques*, 2011.

Exhibit 1

Social media is enhancing the intelligence cycle.



interfering with their judgment. Curating a variety of perspectives from multiple social-media sources should help internal checks and balances play out more freely and, in some cases, lead to necessary whistle-blowing. To reinforce this diversity of thought, companies can embed analysts across the organization in functions ranging from strategic planning and product development to R&D, customer service, and M&A planning.

As companies make such moves, they will probably need to update the profiles of their competitive-intelligence analysts. Recruitment from outside the company or even the industry can improve the odds that analysts will pick up a variety of signals that now may be missed. Leaders, too, will need to understand that decrypting weak signals may offer better strategic insights than the familiar patterns traditional intelligence sometimes serves up.

From data gathering to engaging and tracking

Analysts typically spend 80 percent of their time gathering information before they begin to analyze it. Social intelligence radically alters this process. Numerous tools allow analysts to create dynamic maps that pinpoint where information and expertise reside and to track new data in real time. The most effective way of obtaining new information is to engage a carefully mapped network of experts on specific subjects.

General Electric employed this proactive approach last year in an effort to gather ideas about what it called a "social" airplane, offering prizes with Virgin Airlines for the best insights. The company enlisted a community of more than 90,000 people who follow its @ecomagination Twitter account and organized conversations around key topics using hashtags.[3] Over the course of only two hours, this global network produced thousands of ideas that had not been discussed or published elsewhere. Some focused on green topics, such as the use of solar panels and electric vehicles in engine-manufacturing operations and of LED lighting on aircraft. Participants also suggested giving each flight its own hashtag for conversations or allowing airlines to send messages directly to passengers

[3] A word or phrase used in microblogging and social-networking services, such as Twitter, that is preceded by a hash mark (#) and identifies a category of interest and facilitates a search for it.

when their rows were boarding. GE used the information to fine-tune its understanding of airline passengers' expectations and to create new processes for injecting stakeholder input into strategic planning and product development.

Social media can also provide windows into the plans of competitors, suppliers, and customers. Consider, for example, how competitive analysts from one organization used LinkedIn to piece together, virtually, an advanced look at new features a major technology company was planning as part of a product upgrade. Because the company's software developers were publicly sharing information about their work projects, it was possible to produce a surprisingly accurate view of the new product, with significant implications for the R&D and marketing strategies of suppliers within the major player's ecosystem.

Companies today normally hire people with outstanding research and analytical skills. But socially astute analysts will need more, such as the ability to manage and engage an online community of trend spotters and, above all, the curiosity to reach out for novel sources of expertise. In effect, they must become *hunters* of information rather than *gatherers*. Companies will need to invest in the tools, such as network-mapping and influence-rating metrics, that analysts need to manage these new networks—for example, by helping to assess the expertise and relevance of community members. An obvious corollary is that companies should also be trying to reduce the odds of competitors "hunting" them in social spaces by making their people aware of how easy it is to inadvertently divulge valuable information.

From analysis and synthesis to structuring and mining

Few analysts deploy tools robust enough to draw useful insights from the turbulent new streams of social data. Most use older-line approaches taught in business schools—such as standard SWOT[4] analyses or those employing Porter's five forces—and often find themselves improvising. Even analysts who have dipped in the waters of social media often find themselves swimming upstream. Most of today's techniques simply extract conversation flows found on the "usual suspects": Facebook and Twitter.

[4] An acronym for a strategy-planning method used to identify the *strengths*, *weaknesses*, *opportunities*, and *threats* of a new venture, project, or process.

Yet the availability of vast quantities of social-media data points has spawned an array of new analytic methods that can structure and derive insight from complex information. Earlier this year, executives at a major telecom company launched a social-research effort to get a detailed picture of consumer conversations about the company on social media. The results of that initiative were surprising and significant: a realization that 4G data speeds and new devices attracted the most discussion, fresh consumer perspectives on the strengths and weaknesses of the company's major competitors, and the realization that the success of its growth strategy would depend on a more thorough education of customers.

Equally interesting, for our purposes, was the range of sources surveyed—more than 120 million blog entries, 10,000-plus discussion boards, and 90,000 Usenet groups, as well as CNET, Facebook, Twitter, and YouTube. We were also interested in the half-dozen new analytic techniques employed, including "buzz volume," to isolate relevant messages about the company's brand and those of competitors; "discussion topics," which distilled a random sample of messages about the company and each competitor and arranged them by the topics that arose in discussions; "qualitative insights," targeting notable quotes from the messages; and "consumer sentiment," categorizing messages as positive, negative, mixed, or neutral (Exhibit 2).

As this list indicates, the range of analytical techniques has exploded, and to stay ahead of the game companies must tap new areas of expertise. Some may have to seek talented people from outside the organization who are familiar with the new methods or to invest heavily in upgrading the skills of current intelligence analysts. Central to this quest will be convincing senior leaders that the new methodologies are sound and the insights they provide will improve decision making. With little history and few case studies demonstrating their impact, this is often an uphill battle.

From reporting to curating and embedding

One complaint we often hear from analysts is that senior managers don't act on the information channeled their way. There are good reasons for this inattention: intelligence reports often are formal documents sent by e-mail, broadcast by corporate newsletters, or posted on intranets. Content sometimes covers the waterfront of

Exhibit 2

An explosion in new analytical tools gives companies new ways to tap expertise.

Objective	Traditional tool kit	Social-intelligence tool kit
Industry dynamics	• Porter's five forces (analysis of forces at work) • Structure, conduct, performance (SCP) • Value chain analysis • Analysis of consolidation/fragmentation	• Network intelligence: analyzing real-time reactions across industry players, responses to changes • Examples: Alterian, TweetReach
Competitive landscape	• War game and game theory analysis • Benchmarking • Cost structure comparison • Psychological profiling	• Real-time competitive intelligence: tracking revenue growth and product usage, marketing success, brand mentions • Examples: BoardReader, Radian6, Socialbakers
Future trends	• Trend interaction analysis • Granular opportunities • Scenario planning • Competitive trend exposure (benchmarking exposure to trends vis-à-vis peers)	• Crowd intelligence: tapping into followers and fans for new insights and innovations • Weak-signal analysis: identifying emerging trends early • Examples: Facebook, LinkedIn, Glassdoor.com
Opportunity/ market sizing	• Market sizing by triangulation • Estimation of achievable customer base in a previously undefined market • Penetration of addressable market	• Live testing: getting direct feedback from users on new products/ideas • Data mining: using text-analytics to estimate market size • Examples: Attensity, Autonomy
Customer insights	• Focus groups and customer interviews/surveys • Observing consumer behavior in field, "shadowing" • Customer segmentation	• Sentiment analysis: estimating buzz around product or service • Influencer intelligence: identifying key influencers and targeting for marketing/insights • Examples: NM Incite, Social Mention, SocMetrics, Traackr, Tweepi

competitive topics, and information can be dated by the time it gets into decision makers' hands.

By contrast, new social software now on the market lets companies rapidly, even automatically, curate highly pertinent information—from news sources, Web discussions by experts and influencers, freshly minted market data, and customer feedback. This software allows companies to produce "micropublications" that can be dispatched to decision makers instantly. External sources, such as paper.li and Flipboard, automatically generate targeted newsletters on a particular subject in attractive and intuitive formats.

Almost any user within a company can therefore create a personalized information dashboard, which "democratizes" intelligence and embeds relevant data deep within the organization.

Desjardins, a large Canadian financial cooperative, has crafted such an approach, using Flipboard to deliver data and information that users can tailor to departmental needs. To do so, analysts at the company first identify online curators—experts, from outside the company, who are rated highly for their ability to scan and interpret information on financial services and financial technology. The list of experts evolves over time to account for new directions in the company's strategy. To support an effort to enhance the customer experience, for example, a team of analysts could expand the network of experts to include people with best-practice knowledge outside the financial-services industry. The company aims to embed new thinking into its strategic processes continuously. Armed with a customized roster of experts, executives and managers throughout the organization can design their own narrowcast newsletters, selecting the curators who bring the most value to the company's business goals. Previously, analysts had controlled the sources of information and distribution channels.

In an example of this approach at work, Desjardins recently tapped into cutting-edge trials of new electronic currencies being offered in the United States by start-ups such as Bitcoin. In the United Kingdom, to explore new forms of consumer and company finance, Desjardins tracked a community dedicated to crowdsourced funding. In Africa, it sought local experts on mobile-payment practices. The company has found that, particularly in fast-evolving markets, information-gathering approaches like these are more cost effective and better able to deliver timely data than the traditional alternative of relying on market research firms.

The Desjardins experience underscores the leverage companies gain when they distribute intelligence socially. Often, we find, one analyst within a company can identify a network of experts and curators. With this model in place, companies in effect "outsource" their data gathering—freeing up intelligence resources for other tasks, such as comprehensive data analysis and trend mapping. The organization's information base becomes ever more granular as more and more committed executives learn social data skills. Next steps at Desjardins include moving beyond curation to a more targeted and structured analysis of competitors by deploying advanced tools to crunch the company's increasingly granular social data.

Looking forward, more sophisticated users of social media, such as Desjardins, should be able to rate the relevance of information they receive, by using Web conventions such as "liking" or "+1 ing." That permits analysts to track the ripple effects of information bursts as individuals virally propagate those they find most useful. Visual-mapping techniques also let analysts chart these new information flows, which may appear as nodes and connectors across a company's geography. Such information maps highlight particularly strong knowledge relationships within companies and may provide clues for new organizational designs that optimize intelligence.

• • •

The information that companies need to meet competitive challenges is moving quickly from published and proprietary sources to the open, chaotic world of social platforms. Navigating this new environment effectively will require new skills and a willingness to engage in social conversations rather than merely assemble information. This is a mission that should extend across the organization. Senior executives can't leave such important work to specialists. Social intelligence will sharpen strategic insights, and leaders must be immersed in the new information currents.

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The changing
world of work

Illustration by Christopher Corr

Talented employees are the lifeblood of successful organizations, but analysis from the McKinsey Global Institute suggests that disquieting imbalances in global labor pools could soon make it harder for companies to find skilled workers—and for less-skilled workers to find jobs. Therefore, a second article in this package argues, companies must use their top talent more effectively and revamp how, where, and by whom knowledge work is performed. Finally, Symantec executive Rebecca Ranninger reflects on the security software company's preparations for the new world of work.

Talent tensions ahead: A CEO briefing

Richard Dobbs, Susan Lund, and Anu Madgavkar

Looming imbalances in global labor pools could make it harder for some companies to find enough skilled workers and for some less-skilled workers to find jobs.

Technological advances, industrialization, and liberalized trade have created a staggering 900 million nonfarm jobs in developing countries since 1980, lifting hundreds of millions of people out of poverty. As global companies have tapped (and helped fuel the growth of) low-cost labor sources, they also have created high-wage jobs for more than 50 million high-skill workers, while boosting productivity in developed and emerging markets alike.

This virtuous cycle appears to be reaching its limits, however, and there is a growing sense that something has gone wrong with the machinery that, for decades, delivered GDP growth, higher productivity, rising wages, and better standards of living. Indeed, new research from the McKinsey Global Institute (MGI) suggests that by 2020, the world could have 40 million too few college-educated workers and that developing economies may face a shortfall of 45 million workers with secondary-school educations and vocational training. In advanced economies, up to 95 million workers could lack the skills needed for employment.[1]

The projected gaps we identified are notional, and global labor markets will adjust in response to them. But their consequences

[1]According to a 2011 survey by employment-services company Manpower, 34 percent of employers around the world had difficulty filling jobs as a result of a lack of available talent, up from 30 percent in 2009.

would be serious: higher levels of unemployment (even as companies struggle to fill select vacancies), rising income inequality, and heightened social tensions testing political stability in countries around the world.

Senior executives and policy makers should study these imbalances closely because together they outline where dangers and opportunities will arise, and they provide a framework that business leaders and policy makers can use to guide their decisions. In this article, we'll look at the most significant labor imbalances by geography and then discuss the moves companies can begin making now to prepare for the talent tensions to come.

A new world for work

To better understand the evolving global labor market, we analyzed 70 countries, representing 87 percent of global population and 96 percent of GDP. Segmenting these countries by educational achievement (a rough proxy for skill), median age, and GDP per capita highlighted clusters of countries sharing similar attributes (Exhibit 1). Using these clusters as a starting-off point, we modeled a "momentum" base case that combines current trajectories in demographics, GDP, educational attainment, and the supply of and demand for labor by skill level, all with the intention of highlighting potential labor imbalances that companies around the world might soon face. Four areas deserve close scrutiny from senior executives.

China's high-skill gap

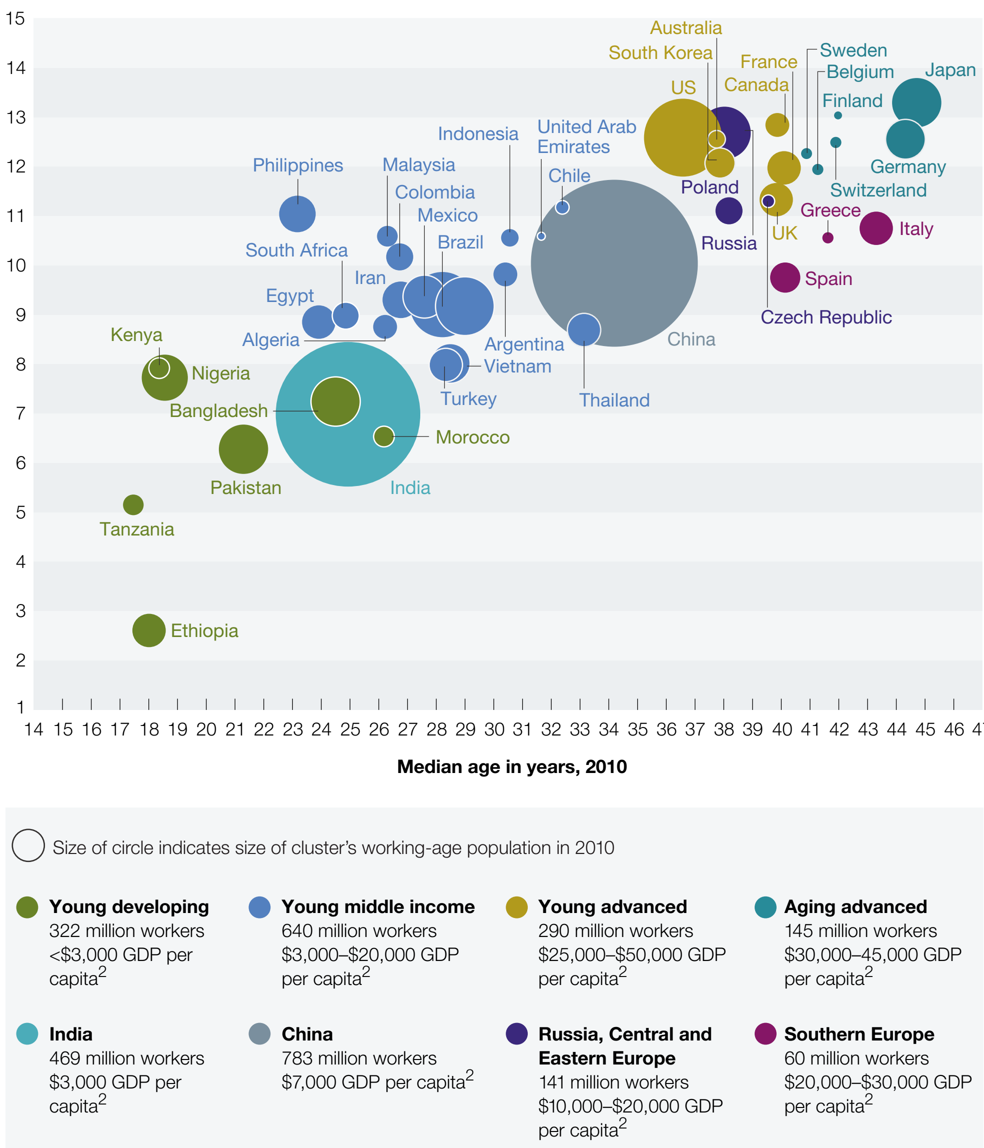
In recent decades, China's industrialization has moved hundreds of millions of workers from farms into urban manufacturing and services. These changes boosted the country's GDP per capita and productivity, while providing the developed world with a massive source of low-cost labor. More recently, China has expanded beyond its role as "workshop to the world" and become a vital growth market for global companies operating there.

Yet a confluence of factors—including China's aging population, the rapid growth of the country's service sectors, and the move into more skill-intensive manufacturing—means that by 2020 the economy will probably need 23 million more college-educated workers than

Exhibit 1

An analysis of the global labor market reveals countries that share similar attributes.

Education index for selected countries[1]



[1]Education-attainment levels weighted by years of schooling and by working-age population; median age weighted by total population.
[2]All GDP per capita expressed at 2005 purchasing-power parity; exceptions to ranges noted for GDP per capita: for "young developing," Morocco ($7,100); for "young middle income," United Arab Emirates ($28,500); for "young advanced," South Korea ($23,500); for "Russia, Central and Eastern Europe," Czech Republic ($22,300) and Ukraine ($6,000).

Source: International Institute for Applied Systems Analysis (IIASA); UN International Labour Organization (ILO); UN Population Division (2010 revision); McKinsey Global Institute analysis

For an interactive chart featuring all 70 countries MGI studied, see *The world at work: Jobs, pay, and skills for 3.5 billion people*, on mckinsey.com.

it can supply (Exhibit 2). This gap, equivalent to 16 percent of estimated labor demand, will probably emerge despite massive investments, already made or planned, in education. (China, for example, is already on track to add more than 50 million workers with a college education by 2020.) The implications of the gap are huge, as an adequate supply of highly educated workers will be critical to securing the growth of higher-value-added industries and the productivity gains needed to sustain China's GDP trajectory, not to mention realizing the growth aspirations of companies around the world.

Boosting the share of college graduates in the labor force would help—it currently stands at 11 percent—but that will be tough. Getting to 17 percent by 2020 would require more than 85 percent of China's secondary-school graduates to complete a college education, compared with about 50 percent at present.

What's more, the country already has one of the world's highest female labor-participation rates, at 82 percent; increasing that level won't be easy.

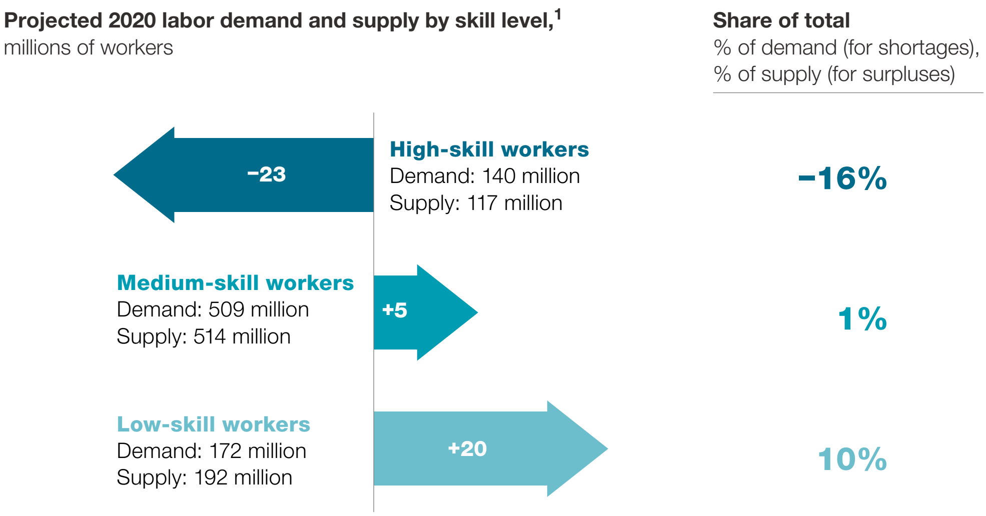
India's missing middle

India is a much younger country than China, and its shift out of agriculture and up the value curve is proceeding more slowly. From 2000 to 2010, India created just enough nonfarm jobs (about 67 million) to keep pace with the growth of its labor force, but not enough to move workers out of agriculture in substantial numbers. Consequently, India faces a unique set of labor market imbalances. In fact, it could be among the few countries with a *surplus* of highly skilled workers: in our momentum case, 36 million college graduates will join its labor force in the coming decade, about 6 million more than its domestic industries can employ.

Nonetheless, the share of India's working-age population with a secondary education is less than half that of China and many other developing economies. Further, India's relatively low secondary-school graduation rate could mean a shortage of medium-skill workers, such as plumbers and welders, to fill the jobs created by the country's burgeoning construction, manufacturing, retail- and wholesale-trade, and service sectors. All told, we project a gap in medium-skill workers of 13 million, or about 10 percent of demand in 2020 (Exhibit 3). India already faces a shortage of medium-skill workers,

Exhibit 2

In China, demand for high-skill labor will probably grow faster than supply over the next decade.



[1]High-skill workers = college degree or higher; medium-skill workers = high school or vocational training only; low-skill workers = primary school or no education.

Source: National Bureau of Statistics of China; McKinsey Global Institute analysis

a fact reflected in high wage growth for vocationally trained people in sectors such as construction and mining.

Finally, if current population and education trends persist, India could have 27 million too many low-skill workers by 2020. This growing surplus of low-skill workers implies adverse social outcomes: millions of people trapped in low-productivity, low-income jobs. India would need an unprecedented increase in job creation and education levels (including vocational education) to address these labor market challenges.[2]

From surplus to shortage

As China's labor force growth slows in coming decades, the young developing countries we studied, a group that includes Bangladesh,

[2]For more about the approaches India's manufacturers are taking to develop these skills, see Rajat Dhawan, Gautam Swaroop, and Adil Zainulbhai, "Fulfilling the promise of India's manufacturing sector," mckinseyquarterly.com, March 2012.

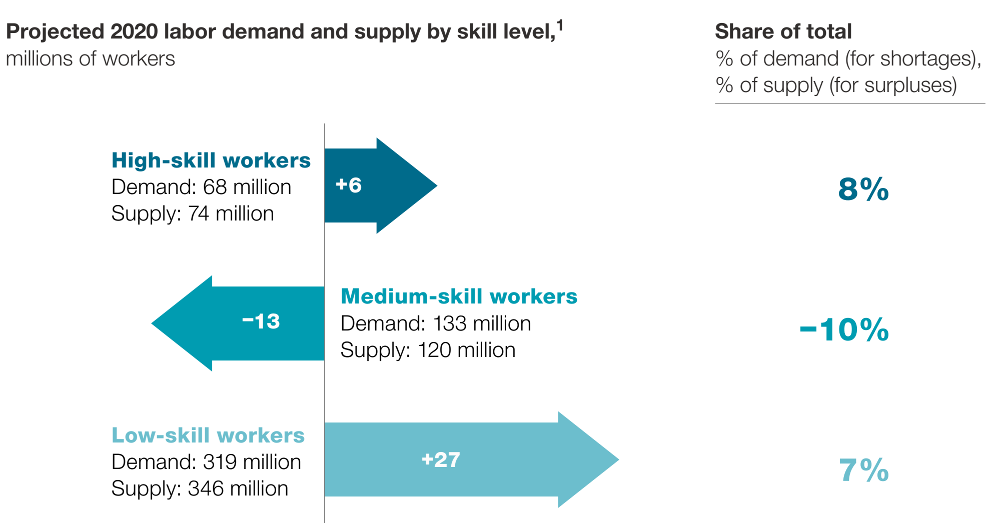
Kenya, Morocco, and Nigeria,[3] will contribute about one-third of the growth in the global labor force. Today, these countries have ample numbers of college-educated workers—often more than their industries are ready to employ. In North African countries, for example, unemployment among highly educated workers is 20 percent, which is worse than the 8 percent rate for workers with only a primary education. (This difference reflects the fact that lower-skill workers engage in subsistence activities to survive in the absence of social safety nets.)

The labor surplus many of these countries have won't last forever, because their economies are growing much faster than those of the developed world and represent important markets for multinational companies. African countries, in particular, have garnered significant attention in recent years as destinations for investment, and

[3]The other countries in this category are Ethiopia, Ghana, Ivory Coast, Mozambique, Pakistan, Tanzania, and Uganda.

Exhibit 3

India may soon have too few workers with a secondary education and too few jobs for low-skill workers.



[1]High-skill workers = college degree or higher; medium-skill workers = high school or vocational training only; low-skill workers = primary school or no education.

Source: India census; India's Ministry of Human Resource Development; National Sample Survey Organisation, India's Ministry of Statistics and Programme Implementation; McKinsey Global Institute analysis new research from MGI finds the continent has large untapped job potential in agriculture, manufacturing, and the retail and hospitality industries.[4]

Nonetheless, if current growth, population, and education trends persist, we conservatively project that the countries of sub-Saharan Africa and South Asia (excluding India) could have a shortage of 31 million workers with a secondary education by 2030 (Exhibit 4). Furthermore, young developing countries will need to find work for about 30 million low-skill workers with no education or only primary schooling. By 2020, the surpluses will represent 14 percent of the supply of such workers in these countries.

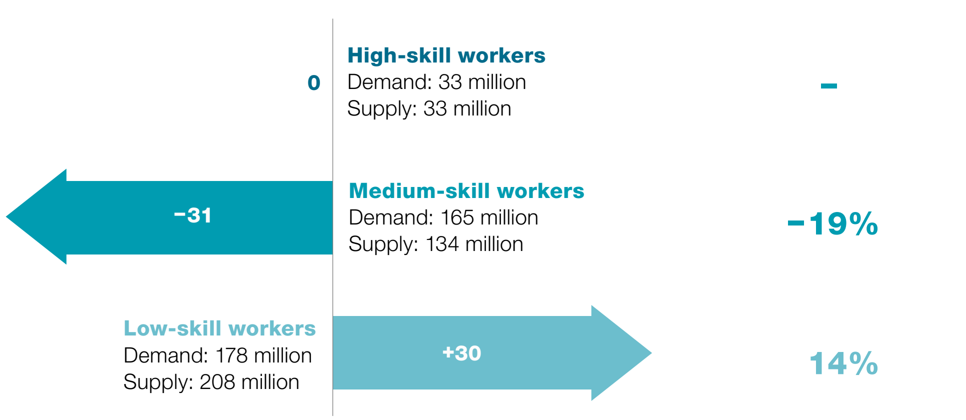
[4]For more, see the full MGI report, *Africa at work: Job creation and inclusive growth*, on mckinsey.com.

Exhibit 4

Young developing economies face a shortage of medium-skill workers along with an excess supply of low-skill workers.

Projected 2020 labor demand and supply by skill level,[1]
millions of workers

Share of total
% of demand (for shortages),
% of supply (for surpluses)



[1]High-skill workers = college degree or higher; medium-skill workers = high school or vocational training only; low-skill workers = primary school or no education; young developing countries include Bangladesh, Côte d'Ivoire, Ethiopia, Ghana, Kenya, Morocco, Mozambique, Nigeria, Pakistan, Tanzania, and Uganda.

Source: International Institute for Applied Systems Analysis (IIASA); UN International Labour Organization (ILO); UN Population Division (2010 revision); McKinsey Global Institute analysis

Addressing such imbalances will require young developing economies to more than double the growth of educational attainment and to raise their secondary-enrollment and -completion rates.

High-skill shortage, low-skill surplus

Advanced economies, including those in Europe and North America,[5] face daunting challenges, too. Trends in educational attainment and projected employment needs indicate that employers there will require 16 million to 18 million more college-educated workers than will be available in 2020, a gap representing 11 percent of demand (Exhibit 5).

The skill gap will be widest in Southern Europe, where educational attainment is lowest and populations are relatively old. These countries could have 3.5 million too few college graduates in 2020. Other advanced economies with high median ages—such as Germany—could face a shortage of college-educated workers equivalent to 10 to 11 percent of demand, despite relatively high college completion rates. In the United States, a demographically younger economy, the gaps will be less severe: perhaps 1.5 million too few workers with college or graduate degrees by 2020.

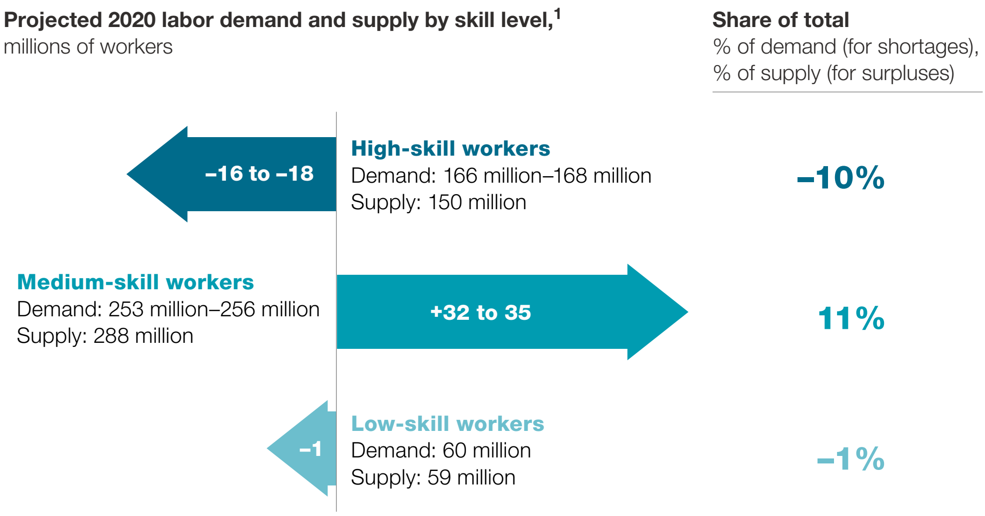
Meanwhile, the advanced economies are likely to face an excess supply of low- and medium-skill workers. Our analysis of demand patterns indicates that in 2020, there could be 32 million to 35 million more workers without postsecondary education than employers will need—a surplus equivalent to 10 percent of the supply of these workers. That surplus implies a range of adverse social and economic outcomes: higher unemployment rates (even during periods of economic expansion), rising numbers of discouraged workers who opt out of the labor force permanently, and more workers forced to accept marginal jobs, resulting in downward pressure on wages.

The oversupply of low-skill labor will be most acute where educational attainment is lowest. Current demand trends suggest that in 2020, as many as 16 percent of Southern Europe's roughly 50 million

[5] For the purposes of our study, we defined advanced economies as a set of 25 Organisation for Economic Co-operation and Development (OECD) countries with GDP per capita above $20,000 in 2010 (at 2005 levels of purchasing-power parity).

Exhibit 5

By 2020, advanced economies could have too few college-educated workers and too many workers with secondary degrees.



[1]High-skill workers = college degree or higher; medium-skill workers = high school or vocational training only; low-skill workers = primary school or no education. Advanced economies are defined as a set of 25 countries with GDP per capita >$20,000 in 2010 (at 2005 levels of purchasing-power parity); all are members of the Organisation for Economic Co-operation and Development (OECD) except for Hong Kong and Singapore.

Source: country sources for France and United States; GDP consensus estimates; Global Insight; International Institute for Applied Systems Analysis (IIASA); UN International Labour Organization (ILO); UN Population Division (2010 revision); McKinsey Global Institute analysis

workers without a postsecondary education could be unable to find employment.

Bridging the high-skill-worker gap would require raising young people's rate of college completion by 2.5 times the historical rate of increase, and simultaneously raising participation rates of college-educated women and older workers at over twice the historical rate of increase. Even this won't suffice to deal with the surplus of low-skill workers: the rate of job creation for them would need to be at least five times higher than it was in the past to create enough job opportunities.

What business can do

As we've said, labor markets are dynamic: wages will adjust in the face of imbalances; workers will relocate; and the nature of work itself will continue to evolve. Technology has a critical role to play—both helping workers perform higher-skill jobs than they otherwise could and serving as a powerful aggregator of skills. (Consider how 20,000 low-skill workers in southern India are using smartcards, mobile phones, and kiosks to disburse microloans or how Amazon's Internet marketplace, Mechanical Turk, enables businesses to outsource simple tasks, such as writing product descriptions.)

The uneven distribution of skills and needs means that business leaders must develop a finer-grained view of shifting labor dynamics. By anticipating trends in education, aging, and incomes, executives can better tune their recruitment, offshoring, and investment strategies. In addition to sizing pools of appropriately skilled workers, companies will need to assess the quality of educational systems and the market forces that determine—often at the level of individual cities—the wage differentials among employees.

And then companies will need to take action. For those competing at the high end of the labor market, a deficit of high-skill workers implies an intensifying global war for talent (see "Preparing for a new era of knowledge work," on page 103). Companies worried about losing the skills and institutional knowledge of older employees as they retire may need to provide them with more flexible options. In Japan, for example, Toyota Motor aggressively recruits among its retiring employees to bring workers back in half-time roles at the company or its affiliates.

Of course, business leaders will be establishing their labor strategies in an environment set by policy makers, who should focus on raising the output of educational systems and eliminating barriers to creating jobs for less-skilled workers. Looming labor market tensions suggest it would be unwise to take that context for granted. Particularly in high-demand STEM (science, technology, engineering, and math) disciplines, companies can play a larger role in shaping the educational content of colleges. The Great Minds in STEM initiative, for example, is committed to increasing attainment in these subjects among Hispanic students through an extensive community and school outreach program facilitated by corporate partners such as Boeing, Lockheed Martin, and Northrup Grumman. Some companies may even want to participate directly in the large and fast-growing market for education and training.

Companies also can influence the context by focusing their corporate-social-responsibility efforts on youth unemployment and helping to bring the long-term unemployed back into the workforce. Beverage-maker Diageo, for instance, set up Tomorrow's People, a UK-based charity that has helped more than 400,000 of the long-term unemployed find jobs, education, or training. Three-quarters of the people it helps to place remain employed after a year. Diageo supported the charity, now an independent entity, with operational and financial help, as well as access to jobs in businesses it owns.

By taking decisive action now, companies and policy makers can help ensure that over the next two decades a growing global labor market continues to provide the opportunities and benefits it did over the past 30 years. Companies would continue to access the talent they need to sustain growth and create opportunities. Workers, in advanced and developing economies alike, would enjoy clearer paths out of poverty, along with improved—and improving—living standards.

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Preparing for a new era of knowledge work

Susan Lund, James Manyika, and Sree Ramaswamy

Global competition, emerging skill shortages, and changing demographics will soon force companies to use their most highly paid talent more effectively.

The past three decades saw companies in developed economies make huge strides improving the productivity and organizational performance of an array of jobs. Aided by advances in technology and digital communications, companies automated, reengineered, and outsourced numerous tasks that had once required full-time, on-site employees. The trend, which began on production floors, moved next to offices, where a range of transaction-based jobs that could be standardized or scripted were automated, shifted to workers in low-wage countries, or both.

Through all such changes, a broad swath of employment remained largely untouched: work requiring extensive human interactions. Among these positions are the jobs held by knowledge workers—the doctors, engineers, lawyers, managers, sales representatives, teachers, and other skilled professionals who together serve as the engine of the knowledge economy. Research from McKinsey and others has shown that such interaction workers are vital to the competitive success of companies and countries alike.[1] Interaction work is the fastest-growing category of employment in developed countries, where it already accounts for a large proportion of jobs

[1] For example, see Bradford C. Johnson, James M. Manyika, and Lareina A. Yee, "The next revolution in interactions," mckinseyquarterly.com, November 2005.

(Exhibit 1).[2] Because technology has tended to complement, not replace, labor in interaction work, until recently many of these jobs had essentially been performed in the same ways for decades.

Not anymore. Today, interaction work is at an inflection point as global competition, emerging skill shortages, and changing demographics force companies to use their most highly paid talent more effectively. Employers in advanced economies may soon, for example, be unable to find as many college-educated workers as they require. Research from the McKinsey Global Institute finds that in the United States, the gap could reach 1.5 million graduates by decade's end. China, where many global companies have staked growth plans, faces a shortage of 23 million college-educated workers in 2020 (for more, see "Talent tensions ahead: A CEO briefing," on page 92).[3]

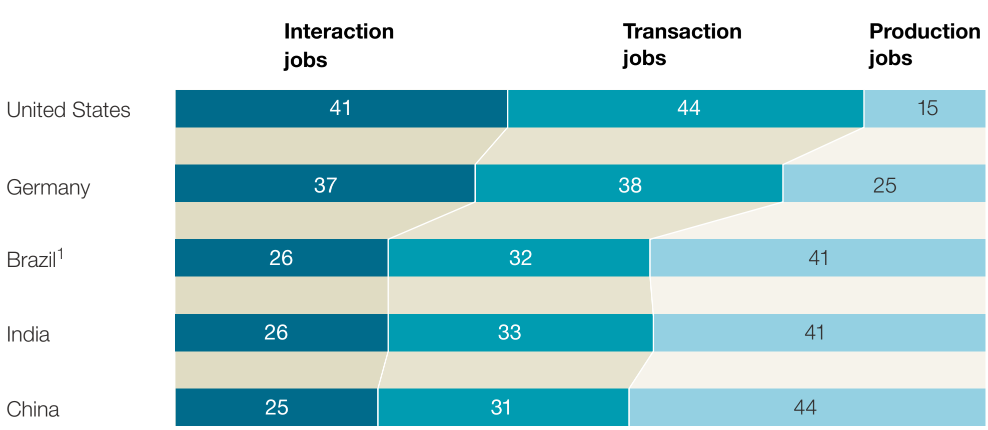
[2]In the United States, for example, interaction work accounted for nearly all net new job creation over the past decade and now characterizes more than 40 percent of all jobs.

[3]For the full McKinsey Global Institute report, see *The world at work: Jobs, pay, and skills for 3.5 billion people* (June 2012), on mckinsey.com.

Exhibit 1

Interaction-based work represents a significant proportion of jobs in developed and emerging markets alike.

% of workforce



[1]Figures do not sum to 100%, because of rounding.

The causes of this looming talent crunch are diverse. In some advanced economies, notably Japan, stagnant population growth means there soon won't be enough young workers to replace retirees. The underrepresentation of women, particularly in the ranks of managers and executives, remains a problem in some economies, notably Germany.[4] And despite technological advances in communications, geographic mismatches persist between the supply of workers and the demand for them. In the European Union, for example, different national systems of professional certification, as well as language and cultural barriers, make skills hard to transport. Mismatches occur within national borders as well: even in the traditionally more flexible United States (where labor mobility is at a 50-year low) the unemployment rate was 11.6 percent in Nevada in May 2012, versus 3.9 percent in Nebraska.

A changing world

Against this backdrop, leading companies we've studied—in aviation, business services, financial services, health care, high-tech manufacturing, and other industries—are exploring ways to revamp how, where, and by whom interaction work is performed. Companies that succeed in these efforts will enjoy productivity gains, greater flexibility in responding to opportunities, and better access to scarce talent. But to get there, they must rethink how they manage their workforces. Let's look at three approaches companies are taking, along with the implications for managers.

1. Break jobs down

Nearly all high-skill interaction jobs include tasks that can be hived off to allow the best-paid workers to focus on the most value-creating activities. A classic example was the introduction of paralegals into the legal profession, relieving attorneys of research and litigation-support tasks while allowing them to spend more time in the courtroom or serving clients. This shift created a middle-income profession that now employs more than one-quarter of a million people in the United States. Medicine is a field that is ripe for this type of

[4]Germany, for instance, could fill up to one-third of its coming talent shortage if it raised the share of women working full time to the level of countries such as Sweden.

job modification. In a study of primary health care clinics in the United Kingdom, for example, providers found that with a mix of 40 percent physicians and 60 percent nurses and other health providers—the opposite of the existing mix at the time—it was possible to improve patient satisfaction while delivering the same quality of care at much lower cost.

Traditional corporate line positions are also splintering. An obvious example of the disaggregation that's been under way for some time comes from the human-resources (HR) function, now being broken into disciplines such as compensation, recruiting, and benefits administration. Specialists (who may be full-time employees, contractors, or employees of service providers) can bring the expertise that generalists lack, often at a far lower cost. At the security software company Symantec, for example, call centers and an online portal support routine HR tasks. Specialists can therefore help business units with higher-value activities, such as hiring and training employees and developing long-term workforce strategies. (For more, see "The evolution of work: One company's story," on page 111.)

We believe the trend to disaggregate jobs will pick up speed as skill shortages take hold. The effects will be most strongly felt in corporate roles, such as marketing, that are quickly being transformed by digital technology. In such cases, breaking jobs down into more specialized tasks will not only help companies economize on scarce talent but also make it possible to perform those tasks more efficiently and effectively.

2. Go virtual

Employers first began ramping up their use of remote-work arrangements in the 1990s, in part to retain the services of mothers who preferred not to commute or who wanted to work part time. As technology evolved, companies such as IBM found they could eliminate permanent offices for sales reps and other customer-facing employees. Such moves yielded huge cost savings on real estate while increasing the time reps could spend with customers. Now, thanks to broadband, cloud computing, and a burgeoning market for online collaboration tools, many more jobs that once required in-person interactions can be performed anywhere. These jobs range from administrative assistants and insurance claims processors to law associates and corporate workers in functions such as finance or HR. In fact, by some estimates perhaps one-quarter of all US jobs could be performed remotely, and in our 2011 survey of 2,000 US businesses, one-quarter of them said they planned to use more remote workers in the future.[5]

Increasingly, new hires may not even come into the office for training, which is also delivered electronically. And because the rites of social media are so familiar to many employees, members of remote teams and their managers often establish relationships quickly. "It was a year before I ever even met one remote hire face to face," said a manager we talked to. "But I felt like we had been colleagues for years."

Virtual approaches to work are attractive to a wide array of employees, including working mothers, older workers, and younger, Generation Y professionals who want flexible lifestyles from the start. Younger workers are often particularly suited to work remotely, having grown up socializing and collaborating online. "They don't want to work 9 to 5," says Bonny Simi, vice president of talent at JetBlue, "and it doesn't matter to me if they work better from six at night until three in the morning or if they can do the work in six hours instead of eight."

3. Make work more flexible

By breaking some jobs into components and using technology to virtualize others, employers can engage labor far more efficiently. Some companies are already exploring a spectrum of mix-and-match work arrangements: traditional full-time workers in the office, part-time or temporary workers, and contingent, remote workers who can help meet spikes in demand. Companies that optimize such configurations and manage them effectively can begin engaging talent as needed, thereby lowering overhead costs and improving response times. The key to this talent-on-demand model is the availability of workers with specialized skills who are willing to work on a contingent basis.

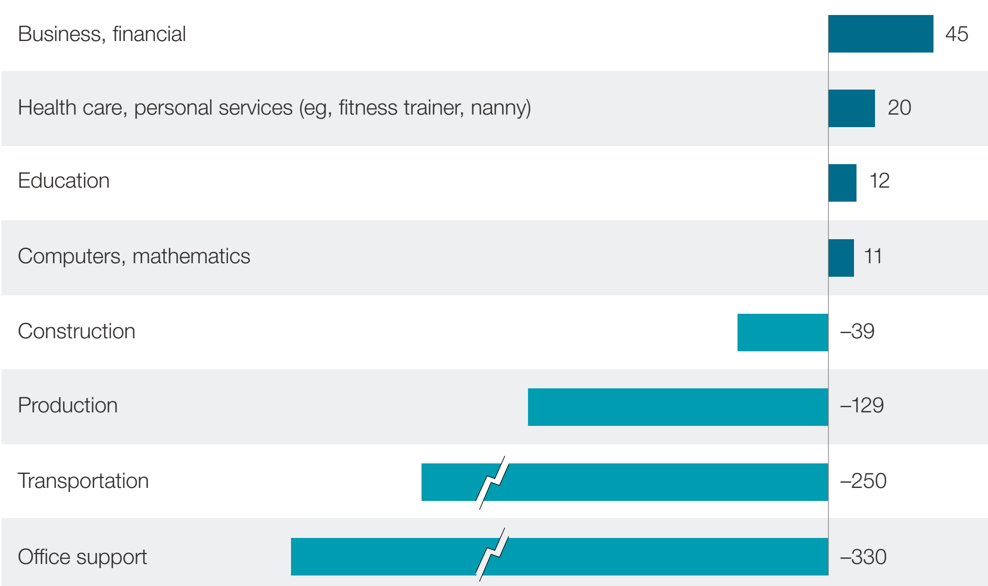
[5] For the full MGI report, see *An economy that works: Jobs creation and America's future* (June 2011), on mckinsey.com.

The workforce appears ready. An expanding industry of intermediaries and "talent aggregators" has cropped up to supply interaction workers ranging from drug-development scientists to advertising copywriters to investment bankers and attorneys. In the United States, 45 percent of temporary employees work in management, in IT or technical occupations, or in health care, and contract work has grown four times faster than total employment over the past decade. Moreover, while many less-skilled temporary workers were laid off during the recent recession, contingent work among more highly skilled professionals has continued to grow (Exhibit 2).

Exhibit 2

The mix of contract workers is shifting toward highly skilled professions.

4 largest job gains and 4 largest job losses out of 22 occupations in the employment-services industry, 2002–10, thousands of jobs



Source: American Staffing Association; US Bureau of Labor Statistics; McKinsey Global Institute analysis

Implications for senior executives

Savvy senior executives will recognize that managing the shift currently under way is analogous to leading a major change-management program and that managers, at all levels, will be the ones most keenly affected. The first priority for executives seeking to lead their organizations into the new world of work should be helping their management teams improve—or in some cases develop—abilities such as these:

- *Coordinate and sequence*. Managing diverse groups of on-site and remote employees will be challenging in a world where the composition of teams changes rapidly as project-based contractors and temporary staff come and go. Managers must become nimble coordinators and better coaches to ensure that all tasks, wherever they occur, mesh smoothly and that information is shared effectively among colleagues. Group interactions, in particular, will require more careful planning and structuring.

- *(Over)communicate*. Some companies require offsite workers to be available for a certain period each day to handle team catch-ups and check-ins with colleagues; other companies set aside regular times for in-person meetings. "You really have to over-communicate to make sure everyone understands their roles and when work will be handed off," said one manager we spoke with.

- *Observe and listen*. While some employees thrive in independent, remote work environments, others wither in the absence of daily contact with coworkers or the camaraderie of working in a traditional team. Likewise, some managers worry that remote workers will identify less fully with their companies. "You save money, but you lose control," warned one executive. "We're worried about loyalty, about identification with the company. If they work from home anyway, will they go to a competitor for just a small bump up in salary?" The best managers will vigilantly observe how their people adjust and respond accordingly.

- *Let go*. Some managers already struggle when they evaluate the performance of knowledge workers. It's a perennial challenge to judge employees on outcomes, not hours, since defining clear

> goals and determining reasonable time lines are difficult. Yet in an environment where some employees work in a central office and others are time zones away, managers have no choice but to define goals and step back. “Bosses need to just relax,” observes JetBlue’s Bonny Simi. “They don’t have to see the employee for the work to get done. That’s the hardest shift in mind-set for some managers.”

As with all change programs, the role of senior management will include communicating a clear rationale for any moves and creating a compelling vision of how they will help the company reach its goals. Managers must be convinced of the benefits—higher performance for their teams—if they are to become enthusiastic leaders of change. Above all, senior executives should encourage managers to think big: the new world of work opens up new possibilities for how companies define their boundaries and organize work. Distinctions among employers, employees, and customers are blurring. Innovation happens and tasks get done in new ways. Companies that take advantage of these trends—and indeed pioneer them—can lower their costs while significantly enhancing their value proposition to employees.

Susan Lund is director of research at the McKinsey Global Institute (MGI) and a principal in McKinsey’s Washington, DC, office; **Sree Ramaswamy** is an MGI fellow and a consultant in the Washington, DC, office; **James Manyika** is a director of MGI and a director in the San Francisco office.

Executive perspective

The evolution of work: One company's story

Symantec's chief human-resources officer, Rebecca Ranninger, describes the security software company's transition to a virtual workplace while reflecting on the promise—and perils—of new ways of working.

The physical part of work—where and how it's done—is shifting in big ways. We all recognize the signs: you'll schedule a meeting and you're the only person sitting in the conference room, with 20 people on the phone. You'll hear dogs barking in the background, babies crying. Yet all of these people have, in their heads, what they need for the meeting.

It seems as if it was just a few years ago that we were taking people out of offices and putting them into cubicles. From there, the trend went to open work spaces, then hoteling, and then shared hoteling "cubes"—all driven by the need to keep real-estate costs low in a very acquisitions-oriented industry that's always streamlining. Now, more and more of our employees are working remotely.

In many ways, that's a good thing. It gives people a lot more flexibility and freedom, and makes them happier about the job because they're able to put their lives together in ways that matter to them. This is true for men and women both. I think the additional flexibility makes Symantec more attractive to *all* employees and helps us get better people. I remember having discussions, eight or nine years ago, with my boss at the time about somebody who was just the perfect candidate but didn't want to move to our headquarters, in Mountain View, California. The answer was, "Nope, we need him here." That is much less likely to happen today.

But today's more virtual workplace also raises interesting psychological questions. I think it makes all of us less able to compartmentalize and separate the different elements of our lives as we used to. It's less linear—much more of a jumble—because we're always multi-tasking, we're always on. The technology enables that by taking away the limitations of time and space. I have seen people who stay up all night working with Europe, Australia, and India and then work the

Rebecca Ranninger is the executive vice president and chief human-resources officer at the security software company Symantec, where she manages global personnel programs and policies.

whole day in the United States. They burn themselves out because they're always available. It's a huge worry.

The new workplace also creates a very different ethos. Those 20 people in your phone meeting aren't sitting around a table together seeing the same presentation in front of them. The communal-experience piece of it—the camaraderie—is lost. These are concerns for us. How do we ensure that people have the same kind of experience they used to get sitting in a room when they're no longer even in the same hemisphere? We've got virtual teams all over the world, and I'm willing to bet there are many in which no team member has ever even met another team member. It's really easy to turn everybody into a voice on the phone and a line on a screen, and we don't want to do that.

Similarly, how do we make sure people learn from one another in a virtualized workplace? How do we make sure we're maintaining our company culture and values?

A new way

These are the kinds of questions we've grappled with as we implemented a home-based work program called Ways 2 Work, which we initially launched in parts of the United States and are now rolling out more broadly. The program's goal is to focus on employees' contributions and results rather than when—or where—work is done. There's a big technological component, of course: things like VoIP phones, social-networking tools, and other technologies can help people work efficiently from wherever they happen to be. But the program also relies heavily on the ability of managers to make sure their colleagues stay connected to work in a human way. A good example of success is our sales support unit in Shannon, Ireland, where our managers and employees are significantly changing how they work (see sidebar, "Close-up: Shannon, Ireland").

Here in the United States, an important aspect of the program involves moving away from paid time off. We started about a year and a half ago at the top of the company and have been working our way down, expanding the change to more and more groups. It's a big jump.

Basically, we're saying, you don't have a set amount of time off. Take your time off when you can—we're not going to record it but you need to get the job done.

The program is certainly a positive for the company because it takes a lot of money off the balance sheet, but it's had a really interesting effect on how people think of work time as well. I think it causes most people to look at time in the same way they did when they were students. Nobody cared if you studied five minutes or ten hours for the quiz. All they cared about was that you did well on it. The new policy has been a challenge for some employees, and we obviously have to beware of the extremes—say, people watching soap operas all afternoon, at one end, and completely burning themselves out with overwork, at the other. But it's been very successful overall, and I think our people appreciate the move. Our employee satisfaction scores *did* go up after the change, though I'm always leery of confusing correlation with causation when it comes to any single measure.

What the program means for managers

Ultimately, our managers have a lot of discretion in how they implement home-based work programs and define how work gets done in their own units. This is by necessity. Our products are so differentiated, and the types of work that our people do is so differentiated—and dispersed—that there can't be a "one size fits all" solution. We can tell our people what we want and what the outcome has to be, but the businesses need to have the autonomy to get that result in their own way.

This approach puts a lot of responsibility on our managers because it's really up to them to help their people determine the right balance. We spend a lot of time working with our managers on "remote management": training them in a whole gamut of skills and techniques to help bring together people from different cultures as a team. Those skills cover everything from the tactical, like clear and concise communication and follow-up skills, to those more in the realm of management philosophy, like the ability to base the evaluation of an employee on the fulfilment of a set of measurable deliverables, as opposed to putting in a certain number of hours a week. Remote management is now a core skill for managers—one reflected in our performance-management processes.

Yet even as these newer management skills grow in importance, I think it's more challenging than ever to ensure that our people have the general-management skills they need. In today's more specialized work environment, you have to know a whole lot more about a whole lot less to do a good job. This is certainly true at Symantec, where, for example, in recent years we've disaggregated all the various human-resources activities into specialist and generalist roles. Similarly, recruiting used to be handled by one or


Close-up: Shannon, Ireland

Sree Ramaswamy

The 50 or so employees of Symantec's sales support group in Shannon, Ireland, recently became the first of the company's international teams to "go virtual" as part of the Ways 2 Work program. By allowing employees to work from home, the unit supported the desire many of them had to strike a more satisfying balance between their work and personal lives. The company benefits too: in recent interviews with the local executives and managers responsible for the change, we learned that the group's productivity increased by 6 percent last year, with no employee attrition. A recent company survey found that 84 percent of the affected employees were happier working from home. What's more, the experience has prompted Symantec to develop a broader global strategy to consolidate its real estate and reduce the number of its physical offices. The company has even begun investigating more flexible work programs in functions such as product design.

Ensuring that technology was fully in place, on day one of the program, to support the changes was a key factor cited by managers explaining the program's success thus far. Another was acquiring a local executive suite where teammates can meet live once a week, which helps combat social isolation. "Managers need to make an extra effort to ensure that their employees feel connected and informed so that the team dynamic doesn't suffer," said Lloyd Nolan, senior director of support renewals. Finally, employees are advised to take frequent breaks, including exercise breaks, and to go out to lunch with coworkers whenever possible. And managers encourage their teams to disconnect completely when work is finished. "It's important," said Nolan, "that they walk away from their keyboard at day's end."

Sree Ramaswamy is a McKinsey Global Institute fellow and a consultant in McKinsey's Washington, DC, office.

two people; now there might be ten people contributing, but each of them handles specific tasks. I think that nearly all jobs are amenable to this trend, given the right talent and management skills.

Developing solid general-management skills requires helping people to think hard about what they want the map of their careers to look like. We also rotate people to give them more varied management opportunities. This is important because in a specialized world, people aren't as likely to get general-management skills the way they used to: by having responsibility for a whole bunch of things at once.

A more virtual and disaggregated workplace puts a lot of pressure on our senior leadership to connect the dots. The act of redefining jobs in a global company, for example, tends to highlight some of the age-old frictions about regional versus corporate-level control—and what you think about these issues often depends on where you sit. If you're in the corporate office, the push is always for more consistency, but if you're the head of Asia–Pacific, you're saying, "Wait a minute, what about India? We can't do it that way or we'll lose people." Talk of redefining jobs has sparked some big debates and serves as a great reminder to us that we have to be able to see multiple points of view simultaneously.

At the most basic level, working through these kinds of challenges comes down to building and strengthening trust. Ironically, perhaps, the act of building this kind of trust among senior managers is something I don't think we could have done virtually. There's a limit to virtualization in that respect. At some point, you have to get people together and sit around those tables and have those discussions. The meetings' content is important, but just as important is physically connecting in one place now and then, so you can work things out with each other. At the end of the day, we're still human beings. ○

This commentary is adapted from an interview with **Roxane Divol,** a principal in McKinsey's San Francisco office, and **Thomas Fleming,** a member of McKinsey Publishing who is based in the Chicago office.

Illustration by Eva Vázquez

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For a practitioner's perspective on gender, read W. L. Gore & Associates CEO Terri Kelly's commentary, 'We're at a tipping point,' on page 126.

The global gender agenda

Joanna Barsh, Sandrine Devillard, and Jin Wang

Women continue to be underrepresented at senior-management levels in Asia, Europe, and North America. McKinsey research suggests some answers.

The progress of women toward the upper echelons of business, government, and academia continues to provoke media attention and lively debate. Look, for instance, at the coverage of Marissa Mayer's July appointment as CEO of Yahoo! and the diverse reactions to an article ("Why women still can't have it all") published in the July/August issue of the *Atlantic* magazine.[1]

Coincidentally, this summer also marked the moment when we released the latest phase of a global research initiative on women in senior management across Asia, Europe, and North America. This effort involved assembling fresh data on the gender composition of boards, executive committees, and talent pipelines, as well as detailed surveys of leading businesses in each region.[2]

Encouragingly, the research shows that a growing number of women, both in senior roles and among the rank and file, are finding their voices and inspiring others to achieve progress. It also demonstrates that more companies are enjoying the benefits of gender diversity and that some have found ways to boost the representation of women at the highest levels of their organizations. From an admittedly low base, for instance, more women sit on European corporate boards (though not executive committees) than did so five years ago. Countries with a clear political commitment to change, in the form of specific quotas or targets, are achieving significant results. Several major corporations are emerging as inspirational role models.

[1] See Anne-Marie Slaughter, "Why women still can't have it all," the *Atlantic*, July/August 2012, Volume 310, Number 1, pp. 84–102.

[2] See *Women Matter: An Asian Perspective*, June 2012; *Unlocking the full potential of women in the US economy*, April 2012; and *Women Matter 2012: Making the Breakthrough*, March 2012 (all available on mckinsey.com).

Yet while the vast majority of organizations in developed economies are striving to unlock the potential of women in the workforce, many executives remain frustrated that they have not made more immediate and substantial progress. Firmly entrenched barriers continue to hinder the progress of high-potential women: many of those who start out with high ambitions, for instance, leave for greener pastures, settle for less demanding staff roles, or simply opt out of the workforce. In Asia, cultural attitudes toward child care and household tasks further complicate the challenges for corporate pioneers. And everywhere we look, despite numerous gender diversity initiatives, too few women reach the executive committee, and too few boards have more than a token number of women.

Our research also offered some clues about the characteristics of companies that make the greatest advances in gender diversity. Much depends on the stage of the journey companies have reached. The regional and cultural context matters, too. Still, we were struck by the global applicability of some core principles. Across geographies, we find that a wholly committed senior leadership, active talent management, and more effective efforts to shift mind-sets and change behavior can transform the gender agenda.

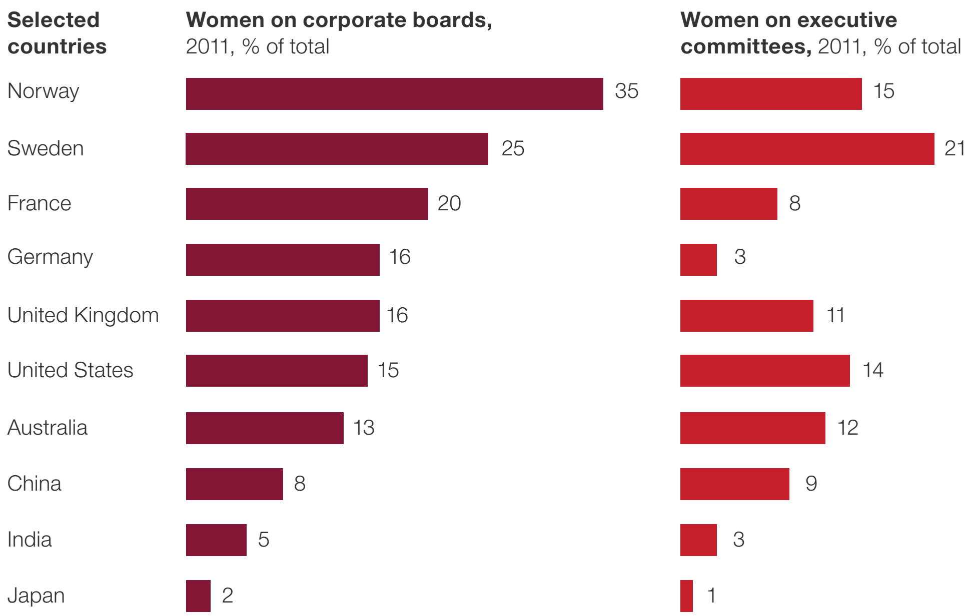
Global challenges

Women hold 15 percent of the seats on corporate boards and 14 percent of those on executive committees in the United States; 16 percent and 3 percent, respectively, in Germany; 20 percent and 8 percent, respectively, in France; and less than 10 percent on both boards and executive committees in China, India, and Japan. In Scandinavia, the numbers are higher: Norway's representation is currently at 35 percent and 15 percent, respectively; Sweden's at 25 percent and 21 percent, respectively (exhibit).

The representation of women in all regions, moreover, diminishes markedly at each higher management level. Some female executives, of course, leak out of the talent pipeline because they are headed for other or better jobs; others voluntarily draw back from promotions as part of conscious work–life decisions. But a significant number run into a succession of seemingly immovable barriers at key career intersections.

Exhibit

Women's representation on executive committees and corporate boards around the world remains small.



Source: Annual reports of companies listed on each country's main stock index; Italian data from Aliberti Governance Advisors; McKinsey analysis

We have long noted the combination of structural obstacles, lifestyle choices, and institutional and individual mind-sets that hinder the advancement of women. But only recently have we started to understand how deeply entwined they are. Men and women tend to be evenly distributed across line and staff roles early in their careers, for example, but women begin a steady and disproportionate shift into staff roles by the time they reach the director level. Lacking the sorts of networks that come more easily to men, many women miss out on discussions with sponsors who might encourage them to stay in the line. Line jobs tend to involve more pressure and less flexibility—less appealing to women forming families or opting for greater control over their lives. Some male executives, with good intent, do not even ask mothers to consider line assignments that involve travel and long hours.

Natural advantages or disadvantages do characterize some sectors, but the situation varies markedly even within them, and contradictions abound. In European financial services, for instance, the rate of attrition is particularly severe by the time women reach middle

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management. In contrast, our research indicated that some of the top US gender diversity performers were in financial services.

Finally, Asia stands out. The relatively low overall rate of female labor force participation in many Asian countries—though not all of them, for China is a notable exception—means that it is harder to fill the pipeline at the outset. Next, the double burden of Asia's working women, who must juggle families and jobs, is not only reinforced by cultural factors but also compounded by a lack of government support in areas such as childcare. In many markets, women wait until their children are older before returning to work or (in Taiwan, for example) drop out in their late 20s never to return. Exacerbating matters in much of Asia is an absence of urgency to change the equation. In our recent survey of the region's senior executives, just 30 percent of respondents said that gender diversity was currently a top priority for their corporations, and only a third saw it as being one of the top ten priorities on the corporate agenda in coming years.

From good to great

These challenges persist at a time when many companies, particularly in North America and Europe, are pursuing an arsenal of measures aimed at easing women's progress through the organization. Such measures include efforts to make appraisals objective and unbiased; the adoption of diversity targets; greater flexibility in remote working; smoother transitions before, during, and after maternity leave; and executive coaching for high-potential vice presidents. Of the 235 European companies we surveyed recently, for instance, more than 60 percent told us they have at least 20 gender diversity initiatives in place.

Motivations vary. A number of studies find a correlation between high-performing companies and those with strong female representation at the top,[3] though correlation does not prove causality. Many CEOs

[3]For more, see *Women Matter: Gender diversity, a corporate performance driver* (October 2007) and *Women Matter 2: Female leadership, a competitive edge for the future* (October 2008), on mckinsey.com.

are convinced that mixed boards and mixed executive teams perform better than those dominated by men. As one corporate leader put it, just about every company wants to "get the best brains to work on the problem." That said, successfully transforming gender attitudes and performance requires much greater leadership attention and dedication than even committed CEOs and top teams are currently giving to it. These goals also call for integrated management and monitoring of women in the talent pipeline from early on to the point when they become eligible to join the C-suite and for intervention to shift widely held beliefs holding back talented women.

Leadership 'obsession'

Every major cultural, operational, or strategic change in a business requires personal passion, "skin in the game," and role modeling from senior leaders, and gender diversity is no exception. When a CEO is the chief advocate and "storyteller," more people (including the often less committed male middle managers) believe that the story matters and begin to adopt the CEO's mind-set and behavior. Intensely committed CEOs make their goals clear and specific, tell everyone about them, get other leaders involved, and manage talent to help make things happen. CEOs who do not see gender diversity as a top issue fold "gender" into "diversity" and "diversity" into "talent," thereby losing focus as leadership of initiatives is delegated to others further down the line. CEOs who champion gender diversity, for example, participate in women's events and multiday talent discussions; less committed CEOs introduce them and leave, inadvertently signaling that other priorities take precedence.

In Europe, many executives tell us that the momentum for change took hold only when the top team made its commitment visible—for example, by appointing women to senior positions or taking measures to ensure that they were considered for certain jobs. Sponsorship is (and always has been) a critical part of an executive's path to the top. HR leaders tell us that these relationships are hard to institutionalize and that formal programs have mixed success. But we find it significant that one company did much better when the CEO and the diversity leader personally took charge of the sponsorship program, selected a group of high-potential women, and invited them to spend significant time with the top team. Women in the program really got to know the CEO and senior-team members, and vice versa, and most have since moved up the management ladder.

Managing—and cultivating—the pipeline

McKinsey's more general work on transforming the performance of companies shows that those with a clear understanding of their starting point are more than twice as likely to succeed as those that are less well prepared.[4] In a gender diversity context, this understanding means knowing the gender balance at every level of the organization; comprehending the numbers by level, function, business unit, and region; and then monitoring metrics such as pay levels, attrition rates, reasons women drop out, and the ratio between women promoted and women eligible for promotion.

Why go to this expense? Establishing the facts is the first step toward awareness, understanding, and dedication to improvement. Using a diagnostic tool, one company simulated how much hiring, promoting, and retaining of women it would require to increase the number of senior women managers. That approach helped it set an achievable and, just as important, sustainable target that would not compromise a highly meritocratic corporate culture. With an overall target—that 25 percent of managing directors and directors should be women by 2018—and a clear understanding that the bar for promotion could not be lowered, managers now look harder for high-potential women and start working with them earlier to develop that potential.

Incentives tied to managers' bonuses can help, though some companies fear that targets may undermine the credibility of women at the top. Those in favor of such targets believe that a radical mandate is required for substantial change and worth the backlash from women who ascended "the hard way." Where targets are rejected, other mechanisms "with teeth" are necessary—almost all the top US performers on gender diversity have goals, if not targets. In Europe, we identified a gap between the measures companies now have in place and how carefully these companies apply and monitor them. Some have targets for women in senior positions, for example, but no plans for implementation; others have targets and plans but fail to communicate them. Companies with cultures inimical to top-down diktats should consider adopting a regular report that candidly evaluates progress and prompts senior management to brainstorm for new ideas.

[4] For more, see "What successful transformations share: McKinsey Global Survey results," mckinseyquarterly.com, March 2010.

Shifting mind-sets and behavior

Leaders with the best of intentions may still fall short unless they can change the way they and their organizations think. So if, for example, the prevailing view is that truly committed executives work 24/7 and travel at the drop of a hat, many talented women will turn their backs on further advancement. Such prevailing attitudes are hard to shift: in our experience, that can be done only by role models who challenge them through their actions and by a learning environment that cultivates self-awareness. More women at the top should help, though of course women can be as responsible as men for promoting a culture of nonstop work.

The top performers on gender diversity value and promote inclusiveness. Their leaders firmly believe that mutual respect drives better customer service and hence sales. When such beliefs take hold, they are powerful. One global cosmetics company we know, which operates in 88 countries and has a customer base that's 90 percent female, now cites gender diversity as one of its key strengths. Another consumer-based business, headquartered in Europe, makes mostly products for men but learned through research that women usually make the buying decision. Increasingly, the company looks to female employees to refine its marketing and product-development approach.

Certain institutional biases are subtle—for example, a reluctance on the part of men to give women the tough feedback everyone needs on their way to the top. Many men, fearing that sponsoring women might seem inappropriate, find it difficult to do so. Most people feel more comfortable promoting those who behave and think as they do. A willingness to question can make a difference. When one company discovered, through an audit of its recruiting processes, that recruiters were more critical of female than male candidates, it devised a training course for the critics. One of them was asked to lead a session and has since become among the company's most vocal supporters of diversity and inclusion.

The mind-sets—and aspirations—of women themselves are as important as those of the companies that employ them. Interviews with 200 successful middle-management and more senior women in 60 large companies across the United States highlighted some common threads: early career acceleration coupled with significant sponsorship, a willingness to change employers to gain greater opportunities, and a propensity to stay in line jobs for much of their advancement. These women remained optimistic even in the face of significant challenges.

Early-tenure women want to move to the next level as much as men do. Yet we found that only 18 percent of entry- and midlevel women have a long-term eye on the C suite, against 36 percent of men. That finding reinforces our belief that inspirational leaders should intervene with talented female middle managers to discuss their aspirations, build their confidence, embolden them to aim higher, and seek ways to make line roles more palatable for them. In particular, we would emphasize the need for women's leadership-development programs to focus on personal mastery of thoughts, feelings, and actions and thus to make women accountable for their own future.[5] In the average Fortune 500 company, a 10 percent boost in the odds that women will advance from manager to director and then to vice president would yield an additional 90 female executives, including five senior vice presidents and one member of the executive committee.

Four priorities for committed leaders

The widespread applicability of the principles above suggests a short list of actions that should be on every committed leader's priority list:

1. Treat gender diversity like any other strategic business initiative, with a goal and a plan that your company monitors and follows up at the highest levels over many years. Build in a "report or explain" process and articulate a well-supported point of view on the value women bring to your organization and the case for or against explicit targets. If greater representation of women in the talent pipeline promises a competitive advantage, successful leaders will work hard to include them. If greater female representation better serves the company's customers, those leaders will make that happen.

2. Ask for—and talk about—the data, sliced and diced to identify 'pain points' in the pipeline by business, geography, and function. Go well beyond measuring success by the number of women at the top. Discuss the percentage of talented women at each stage of

[5] For more, see Joanna Barsh, Susie Cranston, and Rebecca A. Craske, "Centered leadership: How talented women thrive," mckinseyquarterly.com, September 2008.

the pipeline, their odds of advancement versus men's, and the mix of women between line and staff jobs compared with that of their male counterparts. Make sure your entire top team and those who report to its members are accountable for the numbers, and brainstorm about what it will take to improve them.

3. Establish a culture of sponsorship, encouraging each top executive to sponsor two to three future leaders, including women. Instill a mind-set of "paying it forward," so that every woman sponsored will in turn sponsor two or three others. Embed effective sponsorship of women into the profile of successful leaders at your company and raise the issue in performance dialogues with your own direct reports. Show your wider commitment by talking with top female talent when you visit regional divisions and business units or participate in external events.

4. Raise awareness of what a diverse work environment looks like, celebrating successes to reinforce the mind-set shifts you desire. Use frequent personal blogs, top-team meetings, and town hall gatherings to communicate what you are doing to drive change. To increase awareness of the new mind-sets, question your own personnel choices, and think about whom you tend to work with and why. Top executives who work hard to encourage diversity of thought across a company will increase everyone's determination to bring the best to work—ending up not only with what they set out to achieve but with even more: an engaged community that corrects itself when things go off track.

A wide range of global companies made real advances in gender diversity over the past five years. They know that this is hard work—a journey measured in years rather than months. But they also know that improving the pipeline of female talent is possible, with rewards that include tapping the best brains, improving customer service, increasing employee engagement, and everything that comes with these benefits.

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Executive perspective

'We're at a tipping point'

Terri Kelly, president and CEO of W. L. Gore & Associates, an advanced-technology fabric, medical-device, filtration, and electronic-products company, reflects on its seven-year push to encourage greater diversity.

At Gore we believe that diversity of all kinds—gender, race, cultural identity—invariably drives better business outcomes from our teams, whether we're working on new products, sales, or manufacturing processes. Our starting point has been to raise awareness of those benefits.

This doesn't mean, as some of us may have assumed initially, that our culture on its own will take care of the problem. We now have tools that help us to view HR and other processes through a diversity lens so that we consider the full range of talented associates (the word we use for all our employees) for key positions. It's essential to track and monitor the progress of women as we evaluate our needs for current and future leaders.

We are aware of the midcareer challenges identified by McKinsey's global research. Quite recently, we carried out a comprehensive study to explore how women move into broad leadership roles in Gore and why some do not. We uncovered everything from the challenges men and women face in building strong working relationships with each other to hesitation on the part of some women to promote themselves and concerns that taking a new role could hamper the flexibility they need outside their work lives. And we've been pulling together a list of ways our leaders can provide stronger and more visible support for the development of women.

One powerful tool we're using is what we call sponsorship, which is distinct from leadership or even traditional mentoring. All associates at Gore have their own sponsors, who are committed, first and foremost, to helping them maximize their potential. When this relationship works well, it's a very effective source of career advocacy for women. It also provides the ideal environment for identifying and providing support for "stretch" opportunities that women may not know about.

Terri Kelly is president and CEO of W. L. Gore & Associates. She joined the company in 1983 and was appointed CEO in 2005.

But we also picked up on comments that women weren't always getting the sort of straight, constructive feedback that men may find easier to give each other. I often hear women say, "I need that tough conversation to develop in my job but I'm not getting it." For this reason, we have introduced some new training to help our male sponsors become more effective in the way they interact with their female "sponsees."

We've chosen not to rely on quotas. There isn't a right or wrong answer on this issue; it's more a matter of what works best within your environment. At Gore, we felt quotas could clash with our cultural values. To understand the potential mismatch, you need to understand Gore's culture. We believe that spending time up front, clearly demonstrating the business benefits of diversity, engages the organization more effectively than simply telling associates what to do. When they buy into an initiative because they believe in it, they're more committed to achieving its outcomes. And in the process of making the case, the effort attracts associates who are personally passionate about leading it. In this way, momentum builds across the organization.

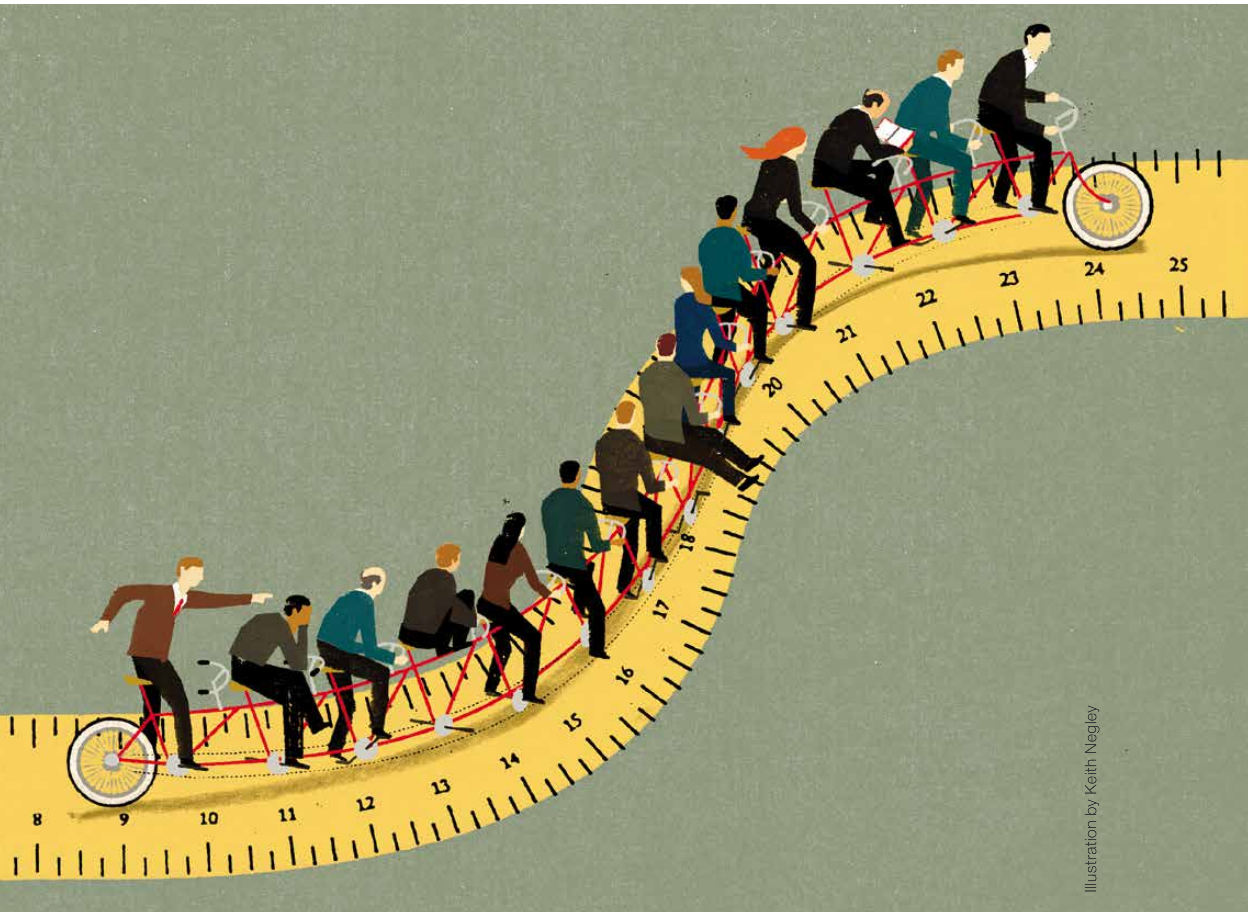
None of this squares with having gender-based quotas imposed on the businesses. I think we'd get grudging acceptance at best and, more likely, resentment and disengagement from many men. I for one wouldn't want to be a leader who got her job here just because we needed a female CEO.

It's too soon to quantify the recent results of our efforts to support the career progression of women into business leadership roles. We always knew there was no quick fix, but we have already seen dramatic productivity improvements in teams that have worked to build trust and inclusiveness. By opening up the debate—and encouraging women to talk openly, with men who are now more informed and receptive, about how tough their challenges are—we have helped male associates gain a new understanding of how to address the issues. I feel we're at a tipping point and that there's a lot of energy and peer pressure building up to make further progress. ○

This commentary is based on an interview conducted by **Tim Dickson,** a member of McKinsey Publishing who is based in McKinsey's London office.

Applied Insight

Tools, techniques, and frameworks for managers



Encouraging your people to take the long view

Toby Gibbs, Suzanne Heywood, and Matthew Pettigrew

Employees and managers should be measured as much on their contribution to an organization's long-term health as to its performance.

Measuring the performance of people, especially managers and senior executives, presents a perennial conundrum. Without quantifiable goals, it's difficult to measure progress objectively. At the same time, companies that rely too much on financial or other "hard" performance targets risk putting short-term success ahead of long-term health—for example, by tolerating flawed "stars" who drive top performance but intimidate others, ignore staff development, or fail to collaborate with colleagues. The fact is that when people don't have real targets and incentives to focus on the long term, they don't; over time, performance declines because not enough people have the attention, or the capabilities, to sustain and renew it.

Yet measuring, let alone strengthening, the capabilities that help companies thrive over the long haul is difficult. These "soft" measures of organizational health—for example, leadership, innovation, quality of execution, employee motivation, or a company's degree of external orientation[1]—are tricky to convert into annual performance metrics. Moreover, an organization's health may not change much in a single year, and an employee's contribution often comes down to judgments and trade-offs. What risks to take and avoid? Which people to develop, and how? Getting a handle on the employee's personal contribution typically requires in-depth conversations and a more thorough 360-degree style of evaluation than most employees (including senior managers) generally receive. Because of all this, few companies manage people in ways that effectively assess their contributions to corporate health or reward them for improving it.

When companies do try, they often end up using metrics that are discretionary, weighted less heavily than traditional measures of performance, or applied inconsistently. One mistake is to become confused about issues that appear related to organizational health but in practice lie at the heart of an individual's operational, day-to-day job (and are therefore more appropriately assessed in the context of immediate performance). It's fine, for example, to judge a senior product manager's contribution to a company's external orientation by tracking the number and quality of the new external contacts he or she develops over a year. But it makes little sense to apply the same health test to a media relations specialist for whom meeting new people is an essential part of the role. Similarly, it wouldn't be helpful to measure an HR manager's contribution to leadership, capabilities, and innovation (other key features of organizational health) by tracking the time he or she devotes to building the skills of employees and training them—very much features of that person's day-to-day performance.

Managers and others quickly recognize flaws such as these and respond accordingly. At a global consumer goods company, for example, the head of HR admitted that managers view the organization's health-related targets as a lever to "top up" their incentive packages. That was hardly the effect the company intended, and a perception that's proving difficult to change.

Against this backdrop, we believe it's useful for CEOs and their senior teams to step back and collectively examine how—and in some cases whether—their people-management systems give sufficient priority to the long-term health of their organizations. This article, drawing on work we've done recently with several companies in sectors where execution is central to long-term success, suggests three tried-and-true ways for leaders to build health into performance management. While the specific measures of health that organizations employ will ultimately be unique to them, the principles outlined here should be applicable to any company.

1. Root out unhealthy habits

Senior executives know in their bones how to handle managers who don't do well on traditional performance measures: provide clear feedback, a development plan to address the problem and build the necessary capabilities, and an evaluation to judge progress. The processes for handling such issues are second nature to most companies.

In principle, the same should go for incorporating measures of organizational health. In reality, however, the organizational processes and mechanisms companies employ may well send mixed messages about the importance of health and even undercut it. Often, it's necessary to start by unlearning bad habits. High-hazard companies, for example, have had to do just that in the wake of much-publicized accidents and subsequent pressure from regulators and consumers for improved safety.

One such company started by conducting an audit of critical roles across the organization and compiling a list of all the key safety-related competencies required for each of them. The goal was not only to ensure that workers had the necessary technical know-how and leadership skills but also to spot HR processes, systems, or managerial-training programs the company needed to change so that problems identified at the line level could be traced to their roots.

It was one thing for the company to add more realistic emergency scenarios that line managers and their teams could act out together, another to insist that the new approach be taken seriously. Managers who struggled with the new simulations were therefore removed from their roles until they improved, even if their previous track record of operational safety had been impeccable.

Mechanisms alone, in other words, won't cut it. Getting organizations to assess and compensate managers on their contributions to health, and to view this issue as a deal breaker (or maker) in promotion decisions, often requires a significant shift in company culture. Strong support from the CEO and executive team is a must.

The high-hazard company began to succeed with its new corporate-health agenda only when senior executives who personified the new ethic—longer-term performance as the priority—were promoted. Only then did employees start to believe the change was real. Changing promotion criteria is, of course, difficult at the best of times but particularly so if no one is ready to replace existing role holders. This reinforces the need for a strong talent pool and the importance of building health into a company's broader talent-development strategy (and metrics on corporate health into the performance appraisals of senior managers responsible for it).

2. Prioritize values

Identifying the right values requires discussion and debate, informed by extensive engagement with a range of employees, among senior leaders. Organizations conducting such discussions are beginning to create metrics that shed light on how well employees respond to particular health-related values.

Leaders of a global pharmaceutical and consumer goods company, for example, prioritized a number of values, such as treating others with respect, behaving with integrity, and managing for the long term. To give managers a qualitative basis for evaluating the way employees upheld these values, the company began introducing clearly defined standards of leadership in each of them. In addition to gauging business results, the standards include the qualitative measurement of softer skills, like developing organizations and people, mastering complexity, and focusing on customers and market conditions. The moves are helping to create a common language for discussing how the company gets results, not just *what* they should be.

Airlines too depend on their values. All airlines must prioritize safety to succeed, but to embed this important ingredient of long-term health, many voluntarily go beyond what regulators require. Some create detailed performance-management metrics to dig into the nature of key interactions that a company values highly—for example, to see how well flight crews work together to solve problems or how pilots and flight attendants interact. (Rooting out excessive hierarchy in such relationships is important because flight attendants are often the first to spot in-flight troubles and must therefore feel empowered to respond decisively.)

The pilots of one Middle East–based airline frequently write incident reports that candidly raise concerns, questions, and observations about potential hazards. The reports are anonymous and circulate internally, so that pilots can learn from one another and improve—say, in handling a particularly tricky approach at an airport or dealing with a safety procedure. The resulting conversations reinforce the safety culture of this airline and the high value it places on collaboration. Moreover, by making sure that the reporting structures aren't punitive, the airline's executives get better information and can focus their attention where it's most needed.

Emphasizing health-related values can be particularly important in turbulent times. During a significant change-management effort, executives at a North American manufacturer codified a list of leadership values for which it would hold managers accountable. These included softer values, such as putting people first and teamwork, along with more traditional performance-related goals, such as continuous improvement and drive for results. The effort sent employees an important signal that management was serious about changing how the company worked. The resulting performance conversations and role modeling by senior executives are reinforcing the company's commitment to health, much as the employee discussions at the Middle East airline reinforced the values of safety and cooperation.

3. Keep it simple—but meaningful

A final principle companies should embrace when trying to improve organizational health is simplicity. In short, don't let the metrics get out of hand. Companies sometimes try to impose a comprehensive set of health measures on each employee, though a handful of well-chosen ones would suffice. A certain organization, for example, discovered that over time it had captured so many hundreds of competencies in its performance-management processes that it couldn't manage any of them actively. Similarly, a professional-services firm we studied introduced a suite of health-related metrics so complicated and bureaucratic that few employees took them seriously.

Poor outcomes are more likely when the affected business units don't get involved with corporate-health measures. Best-practice manuals delivered from on high tend to be ignored or scorned. By contrast, the best companies encourage business units to play a meaningful role in determining how to translate health-related goals into a handful of metrics on which to act.[2] Since some of the metrics will be new—and, often, qualitative—senior executives should work with leaders of business units to make sure that the metrics are "owned" by employees and remain up to date and effective, and that business units have the investigative skills to gather the necessary data from multiple sources.

Another thing business units can't always do alone is look at the big picture and act on it. Here again, simplicity is essential. For example, one global energy company relies on a central audit team to aggregate a number of metrics used by the company's core business units into a single, simplified report for corporate-level leaders evaluating personnel, incentives, and career progression plans for business leaders.

What's crucial is to develop mechanisms that reward people while corporate health improves. For example, one oil and gas company links incentives associated with big capital projects to their operational results two to three years after launch. That's long after the managers involved in the original decisions have moved on to other tasks.

Once companies develop the right handful of health metrics, define the behavior that supports them, and implement assessments of the willingness of employees to practice that behavior, the final step is ensuring that their compensation reflects contributions to health. This should be true for senior executives as well—indeed, we believe that organizational health warrants more consideration in executive-level compensation decisions than it often receives.[3]

Of course, the balance between health and performance will vary by company and context. But in our view, companies should start with the expectation that health-related considerations are just as important as performance-related ones. Some companies may go so far as to base monetary compensation equally on contributions to performance and health (as a European bank recently did). Others focus more on nonfinancial rewards—in particular, for employees in technical disciplines. Given the proven power of nonmonetary incentives to drive positive behavior, such moves are wise and worth investigating further.

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Over time, traditional performance metrics can encourage short-term success at the expense of an organization's long-term health. By starting to think about individual performance in the light of the three core principles discussed here, companies can start spotting ways to make sure their people-management systems are built for the long haul.

[1] For more, see Scott Keller and Colin Price, "Organizational health: The ultimate competitive advantage," mckinseyquarterly.com, June 2011.

[2] See Aaron De Smet, Mark Loch, and Bill Schaninger, "The link between profits and organizational performance," mckinseyquarterly.com, August 2007.

[3] For more about CEO compensation, see David F. Larcker and Brian Tayan, "Does your CEO compensation plan offer the right incentives?," mckinseyquarterly.com, April 2012.

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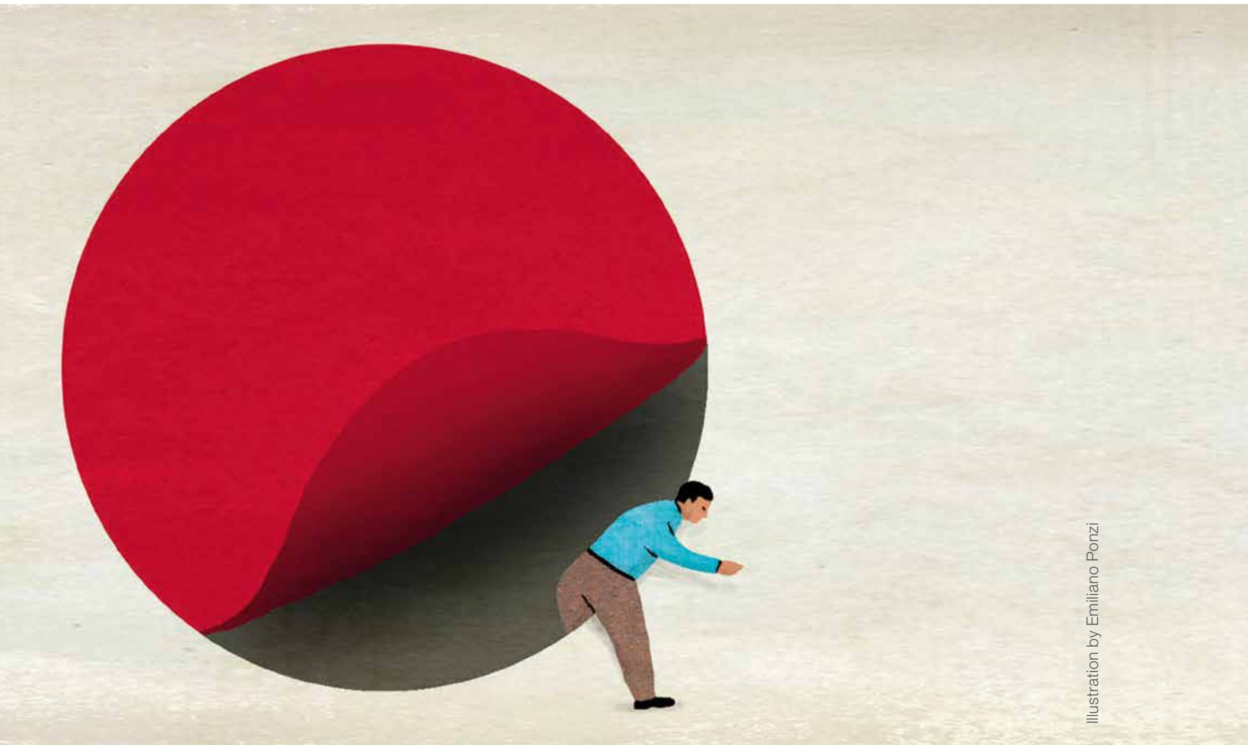

Illustration by Emiliano Ponzi

A yen for global growth: The Japanese experience in cross-border M&A

Keiko Honda, Keith Lostaglio, and Genki Oka

Four distinct approaches to postacquisition management seem to be paying off—and offer food for thought for all companies facing cultural stumbling blocks.

Buoyed by an appreciating yen and a stagnant domestic market, Japanese companies with bold growth aspirations are quietly making international forays: it is a little-reported fact that the number of outbound M&A deals in Japan has been on an upward trajectory in recent years. If the trend continues, Japanese cross-border M&A activity will soon surpass its 1990 peak.

Veteran senior executives and students of management history will probably recall that the previous boom in Japanese acquisitions was characterized by well-publicized failures. Certainly, such memories haunt Japanese companies, whose experiences underscore the abundant pitfalls along the road to international M&A. Although some of these problems are now well known and studiously circumvented, others—notably those having to do with fundamental differences in business and management culture—remain difficult for companies everywhere to avoid.

To understand how 21st-century Japanese companies have been managing international acquisitions, we interviewed non-Japanese executives whose organizations have been acquired by Japanese firms in large cross-border M&A deals within the past decade. We also conducted in-depth outside-in analyses of a handful of deals in which Japanese companies—such as Hitachi Construction Machinery, Suzuki Motors, Takeda Pharmaceuticals, and Toshiba—boosted international sales through cross-border M&A.[1]

Our findings, relevant for Japanese and non-Japanese companies alike, highlighted stumbling blocks that continue to undermine the M&A efforts of many firms. The research also revealed four quite different approaches that have helped a few Japanese companies achieve more satisfying results from their acquisitions. Of course, each company's strategic intent, unique characteristics, and industry dynamics will dictate the specific tactics it uses. That said, the approaches we identified represent useful food for thought—not just for Japanese acquirers, but also for any company seeking to overcome its own unique manifestations of the kinds of obstacles that often bedevil Japanese acquisitions.

Perspectives of the acquired

Japanese acquirers, like those everywhere, often disagree with acquired companies over how quickly to pursue cost and revenue synergies, how subsidiaries should be positioned within the parent company, and how transferable the acquirer's business processes are. In addition, our interviews with executives at several US and European[2] companies acquired by Japanese ones highlighted seven issues that seem fairly specific to the country's business culture. The first four, which influence talent retention, help explain why non-Japanese executives often leave acquired companies. The last three defy easy categorization; to some extent, they are simply more extreme versions of common M&A stumbling blocks.

- *A hands-off approach*. Although Japanese executives may think an acquired company would prefer to be left alone—and although the parent company's restraint may at first appear admirable and wise—many foreign executives come to feel that this is the wrong approach. One major benefit of being acquired, they say, should be that the subsidiary can fully leverage the capabilities of its parent company. Foreign executives typically want the acquirer to engage with its new subsidiary and jointly tackle issues as they arise.

- *A confusing power structure*. Non-Japanese executives have difficulty determining where true power lies within a Japanese organization. For example, the deal executive in an M&A transaction could have a lofty title, such as senior managing director. The target company might therefore focus on building a relationship with this person, continue to interact with him after the acquisition, and belatedly discover that he actually has no direct reports and no influence over day-today business. In one case, the deal executive was kept on staff only because he was a favorite of the former CEO.

- *The tyranny of the middle*. Our interviewees said that a parent company's middle managers, who derive power from their proximity to the Japanese CEO and try to control the flow of information, can be a destructive force. A common example: if the acquired company requests additional capital investment for growth, Japanese middle managers may choose not to pass this request on to the CEO. When the leaders of the acquired company follow up with the CEO a few months later, they learn that he was never informed about it. Incidents such as these can cause middle management to lose the respect of line leaders at the acquired company.

- *A glass ceiling for foreigners*. Japanese companies often have an insular culture; in general, they assume that a foreigner can rise only so high in the organization. Foreign executives thus consider leaving not because of unsatisfactory compensation but because they feel their careers have been capped unfairly.

- *Detail orientation*. A US or European executive typically has difficulty understanding the Japanese attention to detail. A Japanese company's due-diligence checklist, for example, is typically three times longer than that of an acquisition-savvy Western company, in part as a result of the Japanese companies' aversion to risk. In a postacquisition setting, a Japanese company would want to understand, for instance, discrepancies between sales forecasts and actual sales. It could very well decide to investigate assumptions made a year ago; a Western company would care only about the actual sales figure and how to improve it.

- *Poor postacquisition planning*. Attention to detail notwithstanding, Japanese companies tend to be laissez-faire about what happens immediately after a deal closes. They do not see value in creating a concrete architecture to ensure a successful transition. Foreign executives often grumble that transition governance and interim processes for decision making, resource allocation, and the escalation of business-critical issues aren't discussed enough.

- *A sudden metamorphosis from friendly partner to distant boss*. Our interviewees reported several experiences in which the initial integration phase was friendly and collaborative but was then abruptly followed by intense discussions about steep cost reductions. Although this happens in non-Japanese settings as well, it is particularly pronounced when Japanese companies engage in M&A, because their executives can be extremely polite in a way that foreigners sometimes find misleading. In one case, even though the acquirer had already decided to eliminate a target company's research department, Japanese executives still made multiple visits to the target's research sites to keep up appearances. When employees at the target company learned that the decision to eliminate the unit had been made months earlier, their trust in the parent crumbled.

Four approaches

To find out how the Japanese have addressed one or more of these pitfalls, we examined the approaches of 14 companies that had completed at least five acquisitions during the past decade and generate more than half their revenues from overseas markets. In each of the deals we examined, the acquirer used a different postacquisition approach, depending on the focus of a change program. These approaches are not mutually exclusive. A company can emulate elements from all of them, depending on its particular industry, context, and objectives.

1. Establish mentorship or exchange programs to build leadership talent.
For acquirers whose main objectives include leadership development, one tactic involves pairing a high-potential manager from the acquired company with an executive from the parent one as a coach and mentor, to build alignment between the acquirer and the acquired. Frequent and direct communication between leaders at both entities—without having to go through middle management—also allows for tighter coordination.

When in 2002 Japanese automaker Suzuki Motor, for example, acquired a majority stake in the Indian company Maruti Udyog, Suzuki engineered change at the top. It appointed a Suzuki executive as Maruti's president and CEO and took over 6 of the 11 board seats. But it also promoted four high-potential Maruti leaders—in administration, marketing, R&D, and sales—to corporate-officer roles and assigned each a functional executive from Suzuki as a mentor. The pairs were held jointly accountable for formulating new strategies.

Another promising tactic is the two-way dispatch of executives, from acquirer to target and vice versa. When Takeda acquired US pharmaceutical company Millennium, in 2008, it engineered an exchange of personnel to facilitate the mutual understanding of corporate cultures. For one thing, it invited Millennium's CEO to join Takeda's management team. To strengthen the research capabilities of the two companies, researchers from both traveled between Japan and the United States. In 2011, Takeda transferred several Millennium researchers to its new research center in Japan. And recently, Millennium's head of strategy—a Westerner—was appointed head of business development for Takeda, showing the company's openness to high-potential leaders from its subsidiary. Thanks to Millennium, which has been put in charge of all oncology efforts, Takeda is now preparing to begin trials of three or four cancer drug candidates a year—a significant increase from historical levels.

These talent-development programs signal to foreign executives that the parent company is willing to invest in their professional advancement, giving them confidence that they can break through the perceived glass ceiling.

2. Create a special coordination unit at the division level.

Another model entails the creation of a coordination office or unit specifically to manage integration. Depending on a company's objective, the unit can be large or small. A large coordination office may make sense if there is a strong appetite for capturing value from cost synergies (by streamlining operations) and revenue synergies (by launching new initiatives that leverage both companies' strengths). If the goal is intervention in one or two functions, a smaller, SWAT-type team may be more apt. In either case, this model helps to avoid a leadership gap in postacquisition management. With a team specifically created to manage the integration effort, there is no question about who is leading it.

Toshiba, for example, acquired US-based Westinghouse Electric in 2006 to raise Toshiba's global presence in nuclear generation. The Japanese company sought to influence Westinghouse while also allowing it a degree of autonomy—which was critical, since the two had different types of nuclear technology. Toshiba set up a pair of coordination offices: one, within Westinghouse, had members drawn from Toshiba and its strategic partners, Shaw Group and IHI (both of which had minority stakes in Westinghouse), and the other within Toshiba. The offices worked together developing and implementing strategy. Three years later, Toshiba had record orders, including its first from the United States, one of which was for two large-scale nuclear projects.

Hitachi Construction Machinery took a slightly different tack when it acquired a majority stake in Indian construction-equipment manufacturer Telcon, a joint venture with Tata Motors, in 2010. To improve Telcon's products, Hitachi dispatched seven of its experts to Telcon functions (such as quality assurance and product design) that needed fundamental change. This specialist team, expanded in 2010, had full authority to direct Telcon's performance-improvement efforts and created plans to optimize manufacturing processes, support services, and employee training. By creating a specialist team, a company can begin to build internal skills that will prove useful in subsequent acquisitions. In the best cases, the people chosen for the coordination office are high-potential executives with excellent communication skills and business savvy.

3. Develop local trainers as change agents.

In the third model, the front line is the focus of change. Employees from the foreign company are brought to Japan for "train the trainer" sessions that are more than just a way to transfer technology—they also become opportunities to promote Japanese corporate values and management philosophy. These sessions help create a sense of belonging among the acquired employees, and that, in turn, can improve their motivation and retention rates.

When a Japanese manufacturer acquired a Southeast Asian company in 2006, for instance, it became the industry's second-largest player. The acquirer chose to transfer its technology to its new subsidiary in a deliberate way: it abandoned its traditional system of sending senior Japanese engineers to overseas subsidiaries to serve as trainers. Instead, select employees from the acquired company trained in Japan and then returned to their home countries to train people there. Approximately 700 non-Japanese employees have now undergone training in Japan; 60 of them have gone on to further study and been designated as expert trainers. Although the Japanese corporation suffered, along with the rest of the industry, during the economic crisis, the combined entity recently beat the market leader for a high-profile contract—an achievement in which the new subsidiary played a critical role.

By choosing not to dispatch employees but rather to bring in people from the overseas company, the Japanese acquirer can create room for "translation": the change agents at the new subsidiary come to understand the corporate strategy and the vision for the integrated entity, and they develop a greater understanding of and appreciation for each company's technical strengths. These people become effective champions of Japanese techniques and practices.

4. Implement company-wide culture infusion programs.

To infuse the Japanese culture into an acquired company, acquirers can launch initiatives that differ completely from any that may have preceded them and ensure frequent communication on all fronts (for example, through employee newsletters or town halls). The most effective initiatives appear to be informal mechanisms that model Japanese norms while also bridging the divide between management and the front line. Suzuki, for instance, gave all Maruti employees sufficient exposure to Suzuki's unique way of doing things. For example, it promoted an open corporate culture, which was foreign and jarring in the Indian context. Top management and employees eat in the same cafeteria. Everyone, from the CEO to the factory worker, wears the same uniform to work. All employees—again, including the CEO—participate in morning exercise routines. (Although several Japanese companies hold dear the ritual of morning exercises, no others, to our knowledge, have introduced them at a non-Japanese subsidiary.)

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There are a variety of promising approaches to postacquisition management, and leaders of Japanese companies must develop their own winning approaches. That may take some trial and error, but for Japanese companies using acquisitions to jump-start their global growth efforts, the payoff should be substantial. ○

[1] We focused on deals in which the acquirer sought partial integration (neither full autonomy for the subsidiary nor a complete merger), since this is a common model applied by Japanese companies, many of which do not have the confidence to integrate an overseas entity fully.

[2] We interviewed executives at six acquired companies in the United States and Europe with valuations ranging from $200 million to $1 billion.

The full version of this article is available on mckinseyquarterly.com.

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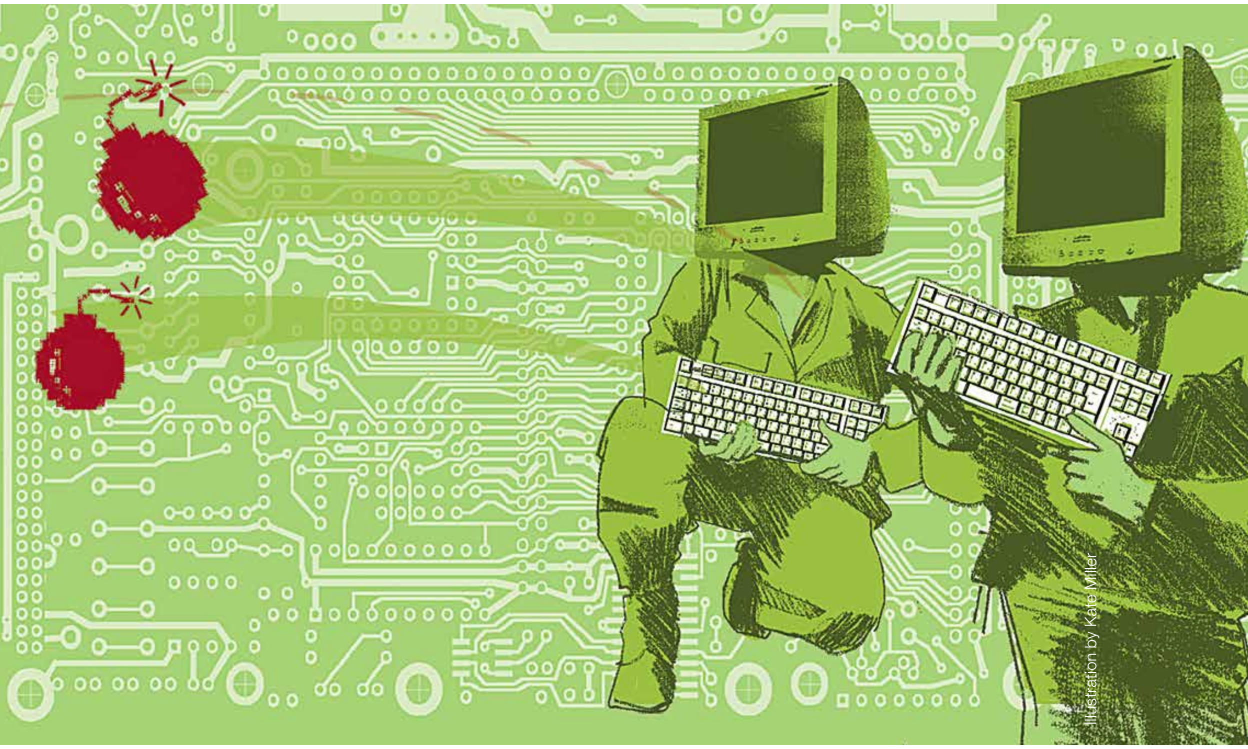

Illustration by Kate Miller

Using war games to prepare for cyberattacks

Tucker Bailey, James Kaplan, and Allen Weinberg

A poor response can be far more damaging than the attack itself.

Cybersecurity is top of mind for CEOs and other senior executives in the wake of highly publicized cyberattacks on large, well-respected companies. Executives are right to be worried: protecting digital forms of intellectual property and business information is getting harder, even as the importance of safeguarding these assets is rising.[1] Meanwhile, cyberattacks are getting more sophisticated as criminals, "hacktivists," and disgruntled company insiders devise better and more targeted ways to infiltrate corporate networks.

In response, a few forward-looking companies are borrowing a page from the strategist's playbook and using war games to test their organizations' readiness for cyberattacks. The approach is well suited to the problem. Simulating a real business scenario (say, a "spear-phishing" attack exposing customers to fraud) that involves the real participants (colleagues from corporate communications, customer care, IT, legal, marketing, and operations) can help companies spot technical vulnerabilities while gaining invaluable insights into how their managers will respond. In fact, such games often answer key questions about the cross-functional capabilities required for success:

- **Will we identify and assess the breach quickly?** One European financial-services company found that the processes its security team used to assess a breach depended entirely on e-mail and instant messaging; the company would have only a limited ability to respond to an attack that compromised those systems.

- **Will we make effective decisions in containing the breach?** An insurance company discovered that it didn't have functional guidelines for deciding when to shut down parts of its technology environment in the event of a breach. Consequently, senior executives would have ordered external connectivity severed unnecessarily, thereby preventing customers from accessing their accounts.

- **Will we communicate effectively with all our stakeholders?** At one financial institution, a war game demonstrated that guidelines for communicating with people whose data had been breached didn't distinguish between different kinds of customers. As a result, high-net-worth ones would have received an impersonal e-mail.

- **How well will we adjust our strategies and tactics?** At one manufacturer, a war game revealed that business managers had never thought through what they would do if competitors or counterparties gained access to sensitive information. They therefore wouldn't, for example, be able to change negotiation strategies quickly after the disclosure of proprietary information about the company's cost structure.

What's more, the analysis required to develop relevant scenarios for a war game can facilitate valuable discussions among senior executives about which risks and types of information assets are most important, who would want to compromise them, and what the implications of an attack might be (see sidebar, "Applying the lessons: Three scenarios"). This information is not always clear beforehand. For example, one public institution found that most of its IT security processes were geared toward preventing online fraud, even though the biggest risk was actually the loss of confidence associated with a public breach.

Likewise, the analysis required to ensure that game scenarios are realistic can highlight important security risks. One retail brokerage discovered that much of its most sensitive information was hosted on applications that had not undergone security reviews and employed out-of-date controls for authenticating users.

Most companies can plan and conduct a game in less than three months. Aligning its scope and objectives is the first step—determining, for example, how many scenarios to include and how sophisticated to make them, as well as how much participation will be required of the representatives of each business function who will help design the game.[2]

The simulation itself can last anywhere from a day to a week, depending on its

Applying the lessons: Three scenarios

1 Threat: A company's core computer system, infected with malware, is actively sending customer information to an unknown third party.

Weakness: Acting swiftly, the chief information security officer (CISO) moves to take the system offline to prevent additional data leakage. But an exasperated head of business operations wants to gather more information first, arguing that this system is the organization's core customer-fulfillment engine and that taking it offline would cost tens of millions of dollars a day. The two executives reach a stalemate over this critical decision.

Remedy: A committee composed of the CIO, the CISO, and the business unit heads creates rules to establish clarity. For decisions involving core systems, for example, both the CISO and the head of business operations must agree on a course of action. If they can't, the issue is escalated to the CIO and the business unit president. If the CIO and the business unit president can't settle it, the CEO decides.

2 Threat: A very public data breach sparks a PR crisis.

Weakness: The company quickly dispatches messages to a few key customers, regulators, and other important stakeholders to get ahead of the story. However, the message the legal department drafts for regulators differs materially from the one developed for customers, so the regulators lose trust in the response they received. To compound the problem, the company's customer service reps are left to their own devices in explaining the breach to the majority of its customers and the media.

Remedy: To avoid unwarranted speculation, by customers or the media, about what the problem may be, the company creates generic scripts for customer service reps to use for any cyberincident. Meanwhile, it creates a broader response plan to provide key outward-facing functions (for instance, regulatory, public relations, and legal) with consistent messages for a range of potentially high-impact cyberscenarios.

3 Threat: A cybercrime syndicate accesses company data held by a third-party vendor.

Weakness: The company discovers and quickly moves to remediate the vulnerability by closing the dataport the vendor uses to access data and by working with it to quarantine its systems as stipulated in the service contract. However, the company fails to engage with its other vendors, some of which are subsequently targeted by similar attacks.

Remedy: The company creates a cyberintelligence team to help analyze patterns of adversarial activity and to predict the location of future attacks—essentially, viewing the full attack landscape for potential threats. Recognizing those associated with third-party vendors, for example, the intelligence team works with them to identify and defend against emerging threats before these problems escalate into larger ones.

complexity. Throughout the course of the game, the facilitator (an internal or external war-gaming expert) provides players with intermittent updates on which they can act. At each turn, the data the players receive depend on the actions they have just taken.

The last and most important phase takes the insights the game generates and converts them to action. These steps typically include implementing tools that increase an organization's ability to foresee attacks, clarifying responsibilities, developing guidelines for making high-stakes decisions under pressure, and creating communications protocols that can be used in the event of a cyberattack.

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An ill-thought-out response to a cyberattack can be more damaging than the attack itself. By using war games to test a company's ability to respond, senior executives can spot vulnerabilities and begin building the "muscle memory" required to make appropriate decisions in real time with limited information.

The full version of this article, "Playing war games to prepare for a cyberattack," is available on mckinseyquarterly.com.

[1] Greater value is migrating online than ever before (for example, in the form of customer information and transactions), and corporate strategies increasingly require more open and interconnected technology environments. For additional information, see James Kaplan, Shantnu Sharma, and Allen Weinberg, "Meeting the cybersecurity challenge," mckinseyquarterly.com, June 2011.

[2] For more about designing war games, see John Horn, "Playing war games to win," mckinseyquarterly.com, March 2011.

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Extra Point

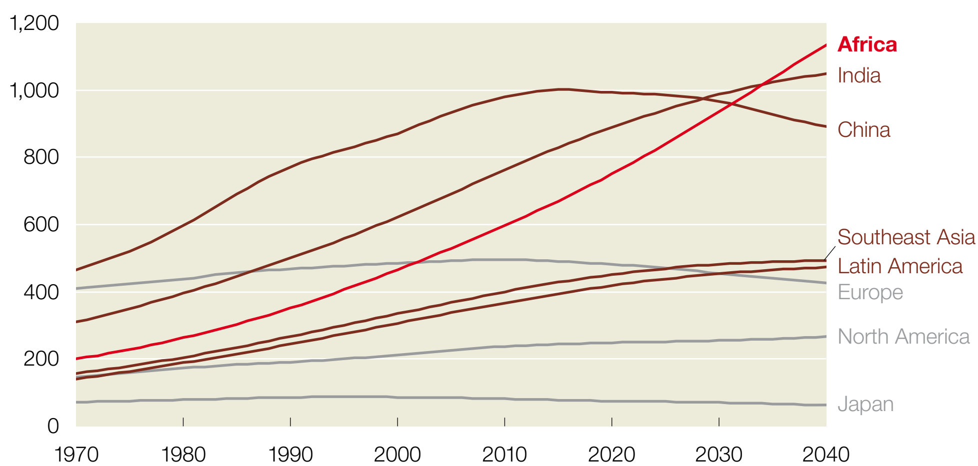
How Africa will emerge

In the coming decade, Africa's labor force will grow by nearly one-third, at a time when North America's will barely increase and Europe's will contract. By 2035, the continent will have the world's largest working-age population, overtaking China and India.

To employ these workers, Africa needs more wage-paying jobs, and many of these are likely to come from agriculture, manufacturing, retailing, and tourism. Improving access to finance, building needed infrastructure, cutting red tape, and encouraging vocational training could help create stable employment for an additional 72 million people by 2020, versus just 54 million on current trends.

If that happens, Africa will be well set to turn a demographic dividend into better lives for the bulk of its people—and to become an increasingly important port of call for multinationals hoping to grow in emerging markets.

Size of the working-age population (aged 15–64), millions of people



Source: International Labour Organization; UN World Population Prospects; McKinsey Global Institute analysis

This analysis is drawn from the McKinsey Global Institute report *Africa at work: Job creation and inclusive growth*, available on mckinsey.com. For more on emerging markets, see our cover package, "Emerging markets on the move," on page 18.

Highlights:

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