McKinsey & Company

The McKinsey guide to excelling as a CEO

The CEO role is arguably more challenging than it's ever been. Become the most effective leader you can be with expert insights and advice on topics that should be at the top of your agenda.

Compendium
October 2023

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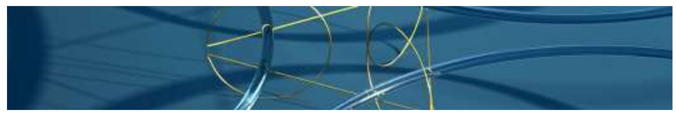

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Introduction

CEOs and their teams have been operating in an unrelentingly volatile and uncertain environment for years; the pace of change hasn't slowed since the onset of the COVID-19 pandemic. While grappling with shock in the macroeconomic environment, disruptive technology such as generative AI, shifting consumer preferences, and rapidly evolving markets, business leaders are also juggling a range of organizational shifts that have significant implications for structures, processes, and people.

Meanwhile, net zero has become an organizing principle for business. Since the outbreak of the war in Ukraine, leaders have faced the "devilish duality" of following through on longer-term decarbonization commitments while successfully managing short-term energy disruptions. And they're increasingly expected to champion social and environmental causes, making sustainability and corporate responsibility integral parts of their role.

Balancing competing interests while protecting the bottom line is a delicate act that demands astute diplomatic and strategic skills. So how do the best CEOs do it?

As a firm, McKinsey has published some of the most compelling insights for CEOs and senior leaders since the founding of the *McKinsey Quarterly* in 1964. And our colleagues Carolyn Dewar, Scott Keller, and Vik Malhotra made several bestseller lists with their impeccably researched book, *CEO Excellence: The Six Mindsets That Distinguish the Best Leaders from the Rest* (Scribner, March 2022).

In this 160-page compendium, we've gathered some of our most popular recent and enduring insights on what matters most in the quest to excel at being a CEO, organized for simple browsing by the topics that we've found are top of mind for the C-suite today: generative AI, digital transformations, the changing talent landscape, growth and resilience, the net-zero transition, and diversity, equity, and inclusion. They also highlight what the best corporate leaders are doing to address risks while meaningfully pursuing sustainable *and* inclusive growth. Whether you're a CEO, a board member, or a manager, we hope these insights encourage you to excel in your role as a leader as you continue to navigate a world in flux.

And if you're not already a subscriber to our new digital edition of the *McKinsey Quarterly*, please visit McK.co/MQMembership, where you can claim your free membership. It includes access to each issue of the magazine, bonus digital content, and exclusive access to free downloads of McKinsey's 100 most important reports.

Don't forget to also check out McKinsey.com/user-registration/register to explore our more than 40 email offerings aimed at helping you stay up to date on McKinsey's latest thinking.

Raju Narisetti

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McKinsey Global Publishing

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Chapter 1

The leaderships traits of successful CEOs

CEOs have the same responsibilities: they work with the board, engage stakeholders, set direction, and create a positive culture. But one-third to one-half of new CEOs fail within 18 months. What separates the best CEOs from the rest? Partly, it's their approach. "Great CEOs are bold," says senior partner Vik Malhotra, who coauthored the best-selling book *CEO Excellence* with senior partners Carolyn Dewar and Scott Keller. "You can be bold regardless of context. Or you can be bold within that context. If you're not bold in that first year, you're not going to move the needle. That is the crux that'll actually let you conquer any context and any situation around failing." Dive into these insights to learn more about the key traits of successful CEOs, and learn how leaders can effectively navigate this moment of unprecedented challenges and opportunities.

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Three McKinsey senior partners looked across more than 20 years' worth of data on 7,800 CEOs from 3,500 public companies across 70 countries and 24 industries to identify the mindsets that helped top chief executives deliver extraordinary impact.

In this edition of *Author Talks*, McKinsey Global Publishing's Raju Narisetti chats with McKinsey senior partners Carolyn Dewar, Scott Keller, and Vik Malhotra. In their book, *CEO Excellence: The Six Mindsets That Distinguish the Best Leaders from the Rest* (Scribner, March 2022), Dewar, Keller, and Malhotra offer a manual for excellence for those who shoulder the burden of being the one on whom everyone counts: the CEO. An edited version of the conversation follows.

McKinsey: Why did you write this book?

Scott Keller: To set the scene, we get what we call "next-up CEOs" or "potential next-up CEOs"—someone who would be two, three years out from the role, maybe even sooner. And we have a group of these next-up CEOs come together. We essentially have three days with them where we expose them to what being a CEO is like, and there's a lot of CEO guest speakers as part of that.

This particular [gathering] was in Maryland, and we had three guest CEOs. One of the questions that Vik asked was, "How do you describe the role of a CEO?" The first CEO the first night talked a lot about resource reallocation and what businesses they're in and not in. There was such conviction and such eloquence that everyone walked out of that room and said, "Wow. The veil has been lifted. That's awesome. I get it."

Until the next morning, when another CEO guest speaker came. Vik asked the same question. And we hear: "It's all about being a cheerleader, driving the culture, getting talent in the right place." It was with such conviction and eloquence that you're kind of like, "Yeah, that's what the role is." The third CEO who closed the retreat talked all about execution, performance management, operating rhythm, and how you drive execution.

On our drive back, we're debriefing on what went well and what didn't go well. I forgot who brought it up, but it was sort of like, "You know that question that you asked, Vik? I have to be honest. [There were] three totally different answers on what is important in the CEO role." So we asked each other, "Well, how do you describe it when you're counseling a CEO?" Our answers were a little bit different. We thought to ourselves, "OK, we do a lot of CEO counseling. We have heard a lot of CEOs speak. There should be a definitive answer out there. McKinsey should be able to share with the world what that role is, and more than that, what really distinguishes the best from the rest."

That captured our imagination. We're not just going to have an instruction manual that says, "Here's how to play guitar." We're going to say, "Here's how you become Eddie Van Halen or Eric Clapton," as opposed to a weekend guitarist. So that set us off on our journey.

Vik Malhotra: The only other thing I would say is when you actually look out there in the world, you see a lot of books written about leadership, and many, many excellent books written about leadership. You will find a lot of books written by individual CEOs on their journey. We were unable to find that definitive book written about what really defines an excellent CEO. Coming out of that journey in the car, it wasn't clear to us that we could quickly articulate it, which is why we thought, let's do the deep research. Let's get into the minds of great CEOs. Let's really pull that out and see if there's a *there* there. And we were delighted that there is a *there* there.

Carolyn Dewar: I think it's so interesting that it came out of this session, which is for next-generation CEOs. When I think about the book and what we're hoping to bring into the conversation, it is to demystify the role. They had come to that session genuinely wanting to learn. Pulling it together is not only helpful for individuals, but for folks looking ahead to their next leadership role. The fact that there are some clues, and we can look and say, "OK, I could imagine being that one day."

Yes, it's an extraordinary role with a lot of responsibility. But it's a role that you can learn, and it's a role that you can experience and live into as opposed to just being a secret club that you either are in or not in.

Vik Malhotra: I also would say that I think that there are some valuable lessons in all of this for someone who may not eventually become a CEO. At its core, it is a book about leadership. It's just taking a very unique lens on leadership, which is the CEO leadership role. But many of those lessons are very translatable into many, many other walks of life from a leadership point of view.

Excellence is never an accident

McKinsey: How did you choose which excellent CEOs to talk to for this book?

Scott Keller: We wanted to put real rigor into how we figured out how to separate the best from the rest. We decided to start with the 2,000 largest companies in the world. There's a list called the Global 2000 that's put out by Forbes. It's the largest companies in the world—the biggest, most complex, most global companies. We said, "Let's take the top 1,000 of those and ask how many people have been CEOs of one of these global 1,000 companies this century." Turns out, there's been about 2,400 CEOs. Then we said, "How about tenure, and how should that matter?" We looked at CEOs who had six years of tenure or more as the CEO of one of these 1,000 largest companies. We wanted people to have to live with the decisions they made, and show some sustainability and some confidence from their boards and their shareholders.

That brought us down to just under 1,000 CEOs who had led these companies for over six years during their tenure. We then did a performance cut because that's obviously going to be important to the equation. We asked, "Who created excess total shareholder returns versus their peers?" So this is taking out the effect of, "We're in a different industry. It's a slower growth industry." That brought us down to about 500 CEOs.

We then did another culling. Now it's not all about financial performance. It's about ethical conduct. It's about your social and environmental impact. It's about your succession planning and do you have a plan in place, or if you're a retired CEO, how did that transition go? How much performance was sustained afterward? We got to 146 CEOs and we said, "They're not the only ones who are great necessarily, but we believe these are among the best in the world this century." The problem was we looked at that list and we said, "It's heavily skewed toward a certain profile" that happens to be male and White. It was somewhat US-centric. That's not the future profile of CEOs, because it's not a diverse enough group. We didn't lower our bar on any of those things on performance, or conduct, or anything of that nature.

But we did look outside the 1,000 largest companies, and we said, "We need to get diversity of industries. We need to get diversity of gender. We need to get diversity of race." We ended up pulling in a number of companies. Some of these were private companies. Some of these were not-for-profit companies, like health systems, for example. And we ended up building back up to 200 just because that was a nice, clean number. We added back 30 percent more women and 40 percent more people of color. We felt like we had a good mix and we had a good industry mix.

Then we thought, OK, 200 people. That's a lot of people to interview. So we said, "Let's just apply the statistics," and it's a 95 percent confidence level. So we did 67 interviews, and we ended up having quite a good response to our outreach. We augmented that with a lot of quantitative data, too. So it wasn't just the interviews we were basing things on; we were also mining a huge database of performance. We put those together to come up with the insights.

It was just a joy to spend two or three hours interviewing these truly amazing CEOs and really getting into their mindsets.

Vik Malhotra: The other piece I would add is, this topic with these excellent CEOs clearly resonated. I would say a third of them were retired and two-thirds of them were still active. So we did not reach out to all 200. I think if we'd reached out to all 200, we would've had yeses from about 150 people. We really only went out with them and said, "Here's why we're doing this. Here's what we're looking to capture. Here's the basis on which we're asking you in terms of the criteria we had. Will you do this?"

It really was not difficult to get them to "Yes." The topic of CEO excellence and trying to do this in a very structured and thoughtful way actually resonated with them. And many of them opened up their calendars. They saw something in the topic, and they really engaged in these conversations.

‘A huge part of the CEO role now is external. Setting your strategy, running your organization, and delivering for shareholders is only half the job.’

—Carolyn Dewar

Carolyn Dewar: We were quite thoughtful in trying to say, “What are the lessons learned that are going be broadly applicable?” There are some founders in the book, like Reed Hastings at Netflix. We also have some family-owned business leaders. We were careful to make sure that the founder-led CEO didn’t dominate because we thought, well, when you’re the founder and the CEO, you probably have more degrees of freedom than a typical CEO would have. You typically have ownership control. Your relationship with the board is quite different than a typical CEO. We wanted to make sure we didn’t skew so much toward founders that, for the vast majority of CEOs who are not, they can still do the things that we say in the book. We wanted to make sure it didn’t dominate.

Vik Malhotra: But there’s a book to be written on founder CEOs for sure.

Carolyn Dewar: Absolutely. Founder CEOs, family-owned business CEOs. There’s a whole bunch there.

McKinsey: Are there surprises in the list of CEOs you spoke with?

Scott Keller: When we actually looked at the list, there was something that dawned on us. If we asked you, “Who’s the greatest athlete of all time?” you’d probably get Michael Jordan, Serena Williams, Tom Brady, Usain Bolt—these are iconic names that almost everyone could retrieve. If you did the analytics on who is the greatest athlete of all time, you probably get someone called Ashton Eaton. Most people haven’t heard of Ashton Eaton.

Ashton Eaton retired in 2017 as the decathlon world record holder. He set the record three times in the decathlon during his career. He won four world championships. If you go all the way back to Jim Thorpe, and you think about the decathlon itself, when Jim Thorpe won in 1912, the king of Sweden said, “Sir, you are the greatest athlete in the world.”

You have someone who in 2017 has eclipsed all the records, but no one’s heard of him. Why is that? He’s not actually the best at any one event. He’s really good. I think he was the 14th-best long jumper. He was among the 100 fastest people. But he wasn’t number one. When we looked at our list of names, there were, quite frankly, some names that we were loosely aware of, but they just weren’t the iconic names that you think of: the Jeff Bezoses, the Zuckerbergs, the Musks, the founder-led CEOs.

So there’s an element of celebrity that people gravitate to. Analytically, we were kind of excited to be able to tell the story of a whole block of amazing Ashton Eaton types. Often, the big names have already written the books, and that’s available out there. There was also a little bit of, how can we make the wisdom of this group of decathletes available, rather than just the sprinter who’s been the best in the world, whose name we all know?

Vik Malhotra: There was clearly a view expressed by a number of [CEOs] that’s, “We came into this role.” They certainly had to figure it out on their own. They typically would lean on the former CEO for advice. They’d lean on a few board members. Maybe they have an external counselor, a banker, a consultant that they get some input from. They might have other privileged relationships that they get some input from.

They may have gone out on a bit of a listening tour to two or three other CEOs, but they were essentially making up the playbook. Many of them got it right, by the way. Many CEOs did amazing things in their first year. They were bold in their vision. They went out with exciting direction. They pushed the organization in interesting and remarkable ways. But they didn't have a playbook.

There was clearly a thirst for, "I would've loved to have seen something like this. So to the extent I can contribute to it, absolutely." I do think that they've all got a great story to tell and they were eager to tell it, and everyone's a little bit different. So it was our job to find the commonalities. But every story and every one of these 67 stories was unique. There were different things that worked well for one CEO versus another.

Carolyn Dewar: Absolutely. I also think they enjoyed it themselves. A number of CEOs don't have a chance to catch their breath. You could see the wheels turning, that maybe they hadn't had time to sit down and say, "Well, what have I done?" and "What were the lessons learned?" I think it was energizing as well as imparting wisdom.

Scott Keller: I thought it was amazing how, when we went out for endorsements afterward virtually, one of the lines in the endorsement was, "I wish I had this book when I took on the role." Even Greg Case of Aon, when he heard about what we were trying to do and we were proposing doing the interview, said, "Wow. Systematic pattern recognition over a period of time from people who have done this successfully? That doesn't exist, and that would be really helpful. Gee, I wish I had that back in 2005 when I took the company over."

Be bold

McKinsey: Two of five CEOs fail in three years. How can this book help?

Scott Keller: We had a group of 20 CEOs together earlier today as part of a workshop. You look around and just the statistics would say that among that group, eight of them are probably to be considered failing when we get to that three-year mark. The CEO role, hard as it is, it's commensurately high impact in the world. About 70 million people report to CEOs.

If you look at the 200 people we identified—we did the math on it—during their tenure, they created five trillion more dollars of value than their peers, $5 trillion. That's the GDP of Japan, and that's the third-largest economy. If you think about just contribution to economies, contribution to GDP societies, it's an important role. Then you add to that all of the social, environmental aspects that are under the remit of these large companies, and you say, "If we can do anything to help move that needle from two out of five to even 1.5 out of five, that's great for society. That's great for humanity as a whole." Our hope is that it does make a dent. How much of a dent? Who knows? But any dent it makes is well worth having put the time in.

Carolyn Dewar: A huge part of the CEO role now is external. Setting your strategy, running your organization, and delivering for shareholders is only half the job. The demands being placed on CEOs to both manage external stakeholders and be thoughtful about their expectations of the company—whether it's regulators, investors, customers, the public at large—that is part of the CEO role to think that through.

If you think about the past two years, and the pandemic, and all of the external shocks, ultimately it's the CEO who is the integrator who has to think about how to navigate those moments. So how do you help the person in those shoes looking across all of the trends internally, seeing what's happening in the world, and think ahead? There's this phrase, "having a microscope and a telescope." They need to manage the day-to-day and think ahead. It's the CEO role that's more important now than ever as we navigate all these twists and turns. That's what makes it such a challenging role.

Vik Malhotra: If you're going to move this needle on being an excellent CEO, I think the one thing you would take away is, regardless of context, regardless of circumstance, regardless of industry, there is an aspect around great CEOs: great CEOs are bold. You can be bold regardless of context. Or you can be bold within that context. If you're not bold in that first year, you're not going to move the needle. That is the crux that'll actually let you conquer any context and any situation around failing. That is your one safeguard against failure.

Scott Keller: Any CEO in any given context is handed an endowment from the previous CEO. There's a certain amount of R&D that's happened. There's a certain talent base that's there. There's a certain debt leverage that's there. You're saddled with some stuff when you take it over. There's also trends in an industry or macroeconomic trends that you may or may not, but probably don't, have a ton of control over, depending on your company. And those do account for 55 percent of what drives a company's performance. If you pick a good industry to be a CEO in, one that's growing, you're naturally going to do better. What is interesting, though, is 45 percent of this is under a CEO's control.

We found that CEOs who are truly excellent think about that 55 percent differently than most. They don't really think a lot of that is out of their control, especially in this realm of boldness. One of the big things we learned is CEOs really thoughtfully migrate their portfolio into high-growth businesses.

So just because you've come into an industry that's low growth and has certain trends, you have to ask, "How do I become an exceptional futurist and ride these trends like a surfboard rather than let them be waves that wash over me and drown me?"

Second, "How do I think about whether there's a better beach to surf on? And how do I make my way toward that beach over time?" We saw chemicals companies become life-sciences companies. We saw old-energy companies become clean-energy companies.

Ajay Banga [of Mastercard] gave us a great example: "We thought of ourselves as a payments company until we realized only 20 percent of all transactions happened electronically; let's kill cash." All of a sudden there's a completely broader playing field that you're thinking about.

So they think of trends and they think of endowments, so to speak, as not just "what I'm given" but "How do I turn those into opportunity?" That's where the bold mindset comes in. If you have a bold mindset, you think, "It might be a little bit of a risk, but I'm not risking the company. I can actually go, and test, and learn, and really drive something meaningful here."

McKinsey: What does this book offer someone who is not a CEO?

Scott Keller: Let's think about some of the aspects of the role. When it comes to setting direction, there's vision, strategy, resource allocation. Let's apply it to someone who's not in a leadership role.

Do you have a vision for where your life is headed? Do you have a set of bold moves you're taking to move toward that vision? Have you allocated your time, and energy, and resources to support those

'Great CEOs are bold. You can be bold regardless of context. Or you can be bold within that context.'

—Vik Malhotra

bold moves to take you toward that vision? Already those are interesting questions for someone to face. If you're leading a team, those are interesting questions for someone to face.

Let me come back to someone who's leading a scout troop: "I want to be the best scout troop in the city." There's some measure for that. But why wouldn't you reframe that to say you want this scout troop to be the most meaning-filled scout troop in the country? What would that mean? Is that a better vision? I don't know. Maybe it is, maybe it isn't. But it would prompt you to say, "Wait. Just because I'm leading a scout troop, do I have to define within the small arena that I'm taking over?"

One of the big insights is that these CEOs reframe the game. They actually just change the playing field on which we're thinking about. So a lot of those questions are good questions to ask. And a lot of the answers are counterintuitive in the sense that they're just not naturally where you would go.

Vik Malhotra: We've taken the *CEO Excellence* lens. But it's a book about many things in many ways. It's a book about leadership broadly. It's certainly a book about how one might excel in life more broadly.

You can pick out all kinds of lessons from this, which I think we all sincerely hope people get excited about. If great leaders can lead well, maybe I can learn something from this. Maybe I, too, can take away some nugget, some view, some wisdom that I can apply in my life broadly.

Carolyn Dewar: I think equally important is CEOs have extraordinary influence on our lives day to day, in the countries and in the communities that they serve and the teams that they lead. For us all to understand, what is that role, what does that look like, what does it mean to be a good CEO, and how do we collectively set these roles up for success?

They need to do well, because they have such an influence on so much of what we do. I think it's a good contribution for all of us to understand that role better, so that we can collectively improve the odds. I also think at the end of the day, we have written a damn good story. It is an interesting, exciting read, regardless of which walk of life you're in. There are stories of grit and resilience and hard work and what it takes to achieve extraordinary things.

Scott Keller: We've all had that experience of being part of a peak performance team, or hopefully we have in some place in our life. These are CEOs who have taken one of the most complex contexts in which to create high performance and found a way to do it.

Those lessons can be applied, then, into far less complex situations in highly relevant ways. I love what Larry Culp, current CEO of GE, former CEO of Danaher, told us: "You know, guys, this role is fun. This role is fun, because it feels like when I was on my high school basketball team. We had a group together who were running hard, we had each other's backs."

'One of the big insights is that these CEOs reframe the game. They actually just change the playing field on which we're thinking about.'

—Scott Keller

I think the promise of a lot of these learnings are, how do you take all the aspects of your leadership life and get that magic that the high school basketball team had that was actually fun to be part of it?

To me, that's a really exciting part about how translatable all of this is into the broader leadership arena. If it applies at the CEO role, it probably applies in most of the other contexts.

What's new versus what's true

McKinsey: How does this book address the changing role of the CEO?

Carolyn Dewar: The role of the CEO is only getting more complex and more important. Some people have been surprised that it was six dimensions. I do think some of those dimensions might not have been there had we done this book 40 years ago. But there's the complexity of the role, the need to align and mobilize not just your own organization but also your board, your external stakeholders, these broad groups, at a pace unseen before. Think about how quickly decisions are getting made and industries are getting transformed.

I worry it's become a superhuman job. There's so much in that one role to both internal, external, present, future—they're wearing all these lenses. I think the need to be able to think through a whole system view and galvanize a whole group around you to get this job done is only going to be more important going forward. How can you spin all these plates? It's going to take a village, and it's a village that's led by the CEO.

Vik Malhotra: I might take a somewhat different lens on it, which is perhaps with the exception of external stakeholders—where I think the demands from the CEO relative to history have grown over time—I think many of these lessons were always there. And to that extent, I believe they're timeless.

The world will change, and the world will get more complicated. There'll be new trends and all of that stuff will happen. But some of these lessons are timeless.

Scott Keller: I feel like we were quite purposeful in trying to not be timely but be timeless, to what Vik has said. I go to the sailing analogy. You know, those fundamental principles of sail trim, boat trim, course made good, all the jargon around just how do you keep the boat in balance, how do you manage the wind—those have been true since the first sailing ships on the Nile, however many thousands of years ago. A lot has changed in the meantime, though. We have the keel.

But the fundamentals haven't changed. And we purposefully try to stick to the fundamentals, and we believe the fundamentals apply to upcoming challenges. Like, what's going to happen with cryptocurrency? What's going happen with China–US relations? That's going to have real influence on business. What's going to happen with return to work and how the future of work actually evolves? What's going to happen with all of these big challenges, like supply chain resilience?

CEOs are going to have to set direction. They're going to have to align organizations. They're going to have to mobilize leaders. They're going to have to deal with boards. They're going to have to manage stakeholders, and they're going to have to manage themselves in ways that are excellent through all of those trends. In 20 years there's going be a whole new set of trends, and 20 years ago there was a whole different set of trends.

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New leadership for a new era of thriving organizations

Five leadership shifts can unleash an era of sustainable, inclusive growth for companies looking to outperform in this era of disruption.

by Aaron De Smet, Arne Gast, Johanne Lavoie, and Michael Lurie

Illustration by Raku Inoue

We are living through an era of unprecedented challenges and opportunities. The climate crisis, global health challenges, and changes in social values are upending individual priorities. Globalization and geopolitics are shifting the world's tectonic plates. How we live and work is being constantly reinvented by advances in technology and the emergence of generations who were "born digital."

How should leaders navigate this moment? What does leadership look like in an era in which turbulence and disruption are the norm?

The answer to those questions can't be divorced from the answer to another one: What does an organization that thrives during such unstable times look like? For decades, organizations were designed and managed for an industrial environment. They were geared toward preserving stability, scale, and predictability with a focus on maximizing earnings for shareholders, and they paid little attention to the broader—often unintended—impact of their actions. Not anymore. Many organizations have recently decided that this approach is ill-suited to today's complex challenges, and especially ill-suited to the host of societal demands companies must now consider.

In its place, a new form of organization and management has been slowly emerging. We believe this new approach is at a tipping point where more and more companies will join the pioneers who are already riding this wave.[1] Organizations such as Allianz, Haier, Microsoft, and Nucor are transforming their industries with a new organizational approach that seeks to be open, fluid, and adaptable; unleashes the collective energy, passion, and capabilities of its people; reimagines strategy; and focuses on delivering greater value to all stakeholders. This new model focuses on a powerful aspiration: creating sustainable, inclusive growth. The companies leading the way are developing new architectures featuring collaborative networks of self-managing teams that operate in rapid cycles and focus on creating value for their stakeholders. Their cultures support a more open, collaborative, and emergent way of working. And the shift to this new kind of model changes the way businesspeople must lead.

We are moving from an era of individual leaders to an era of networked leadership teams that steer the organization. The old hierarchical model of leadership is increasingly seen as an obstacle to meeting the complex demands facing today's organizations. Companies seeking to thrive now still need leaders who are accountable for their individual roles—but leadership itself resides in the teams of leaders acting in service to the organization. High-performing leadership teams will always outperform the capabilities of their individuals. This new model has a clear purpose and focus: to benefit all stakeholders by enabling people to work and learn together to build and operate a continually evolving system for creating value.

This new approach calls on leaders to make fundamental evolutionary shifts, well beyond the standard expectation that they continually develop additional skills. They must, in fact, reimagine themselves, undertaking inner work to shift their mindsets and consciousness to see the world anew; to rethink their interactions, roles, and ways of working as part of leadership teams; and to reimagine their organizations and the industries in which they operate.

Reimagining leadership: Five critical shifts

For decades, the attributes regarded as central to being a successful company have mirrored the qualities prized in leaders: focusing on earnings, demanding results, exercising authority and control, and being fiercely competitive. For organizations to thrive now, all of these leadership characteristics must evolve.

For leaders, this means making five fundamental shifts in mindsets and ways of working (table). These shifts don't mean abandoning your traditional skills. Instead, these shifts build on those skills to

[1] Several models have emerged to describe this new kind of thriving organization, such as modern enterprise, enterprise agility, and organizing for the future (within McKinsey); Laloux's teal organization (*Reinventing Organizations*); Hamel and Zanini's *Humanocracy*; Mackey and Sisodia's *Conscious Capitalism*; and Denning's *The Age of Agile*.

		Go beyond. . .	Extend to. . .	
What we focus on	As **manager,** deliver profits to shareholders, with a mindset of **preservation**	Profit	Impact	As **visionary,** generate holistic impact for all stakeholders, with a mindset of **possibility**
How we create value	As **planner,** compete for existing value through advantage, with a mindset of **scarcity**	Competition	Cocreation	As **architect,** cocreate new value through reimagining, with a mindset of **abundance**
How we organize	As **director,** command through structured hierarchies, with a mindset of **authority**	Command	Collaboration	As **catalyst,** collaborate in empowered networks, with a mindset of **partnership**
How we get work done	As **controller,** administer through detailed prediction, with a mindset of **certainty**	Control	Evolution	As **coach,** evolve through rapid learning, with a mindset of **discovery**
How we show up	As **professional,** meet expectations, with a mindset of **conformity**	Expectations	Wholeness	As **human,** be our whole best selves, with a mindset of **authenticity**

substantially expand your capacity as a leader. In other words, you are moving beyond the current norm to an evolved ambition that's needed to lead thriving organizations in this new disruptive era. We define the five shifts as beyond profit to impact; beyond expectations to wholeness; beyond command to collaboration; beyond control to evolution; and beyond competition to cocreation. Taken together, the five shifts redefine leadership for a new era.

What we focus on: Beyond profit to impact

Where is the organization going, and what is it seeking to accomplish? For decades, companies professed a single-minded focus on maximizing profits for shareholders. While this remains necessary—organizations will fail to raise capital if they cannot generate attractive returns for investors—it is no longer sufficient. Today's organizations must go beyond profits and seek to maximize value and impact for all stakeholders, including contributing to society and a healthy planet.

To ensure that their companies successfully make this shift, leaders must evolve beyond being managers seeking incremental improvement to become visionaries with the courage to craft a resonant purpose and boldly imagine and pursue the future, key ingredients in moving from average performance to top-quintile success.[2] From a leadership perspective, this requires the following components:

— aligning people on a clear and shared purpose and aspiration

— defining the value to be created for all stakeholders, as measured by key operating and financial metrics

— contributing positively to wider society and the natural environment

Bold intention shaped the rise of Netflix. Fifteen years ago, its business centered on shipping DVDs to customers' homes. Yet five years earlier, cofounder and then-CEO Reed Hastings had clearly articulated a very different future: "The dream 20 years from now . . . is to have a global entertainment distribution company that provides a unique channel for film producers and studios."[3]

[2] Carolyn Dewar, Scott Keller, and Vikram Malhotra, *CEO Excellence: The Six Mindsets That Distinguish the Best Leaders from the Rest*, New York, NY: Scribner, 2022.
[3] Jeffrey M. O'Brien, "The Netflix effect," *WIRED*, December 1, 2002.

Netflix's leaders embedded that commitment to vision, purpose, and stakeholder impact deep into the company's culture. So as the company began streaming content directly to consumers, stopped distributing DVDs, and launched its own production arm, employees knew they were delivering on a bold ambition. As a result, Netflix created enormous value for all stakeholders, including its customers, investors, creatives, producers, actors, and writers. By 2019, 44 percent of its total business was production, and in six years the company had tripled revenue, increased earnings 32-fold, and upped its share price at a CAGR of 57 percent, compared with 11 percent for the S&P 500.

Are you thinking boldly enough? Not every company will be the next Netflix; but any company can be bold. The CEO of one industrial company felt that his organization was strategically stuck, despite months of deliberations. At a two-day strategy off-site, he asked senior leaders to look back at the history of the company. They realized that the company's success stemmed from a couple of industry-defining bold moves by its founders. But ever since the company had gone public, leaders had trapped themselves in the cycle of meeting shareholder expectations for quarterly results. Looking back gave them the courage to seek their own industry-shaping legacy: creating a learning ecosystem to revitalize metal-working trades.

How we show up: Beyond expectations to wholeness

What version of yourself do you bring to work? Many leaders conform to a mentality of "at work, I am my role and my performance." Moving toward deeper personal authenticity is challenging, but it is a necessary evolution for today's leaders, one that will only become more important in the years ahead as automation elevates the value of work that is inherently human.

Today's leaders must move beyond their identity as professionals and show up as humans, with the courage to be, and to be seen as, their whole, best, authentic selves. It is challenging. It means recognizing and acknowledging the deeper inner essence of others and being unafraid to reveal one's own essence, even the quirky bits. The intent is to move beyond task-driven and transactional relationships by taking the time to get to know one another and connect at a human level, sharing values, beliefs, hopes, and fears and enabling all to reveal the greatness that lies within. The following leadership practices can enable this shift:

— expanding awareness and consciousness—the inner state, external context, and whole-system perspective

— developing greater emotional regulation, choice of response, and adaptation to new situations

— practicing well-being as a skill—physical, emotional, mental, and spiritual

What makes this shift hard is that we are wired for survival, and our fear-based reactions send us into old habits to restore a false sense of certainty. In other words, when adaptability is most crucial, we are least able to tap into it. But if we can evolve, we can move beyond a state where fear limits beliefs and mindsets to one where people can tap into their deepest passion, wisdom, creativity, relationships, and expertise. Unleashing the full human potential in an organization is why forward-looking companies work so hard to create environments of belonging and psychological safety and to develop compassionate relationships in teams.

At a Singaporean multinational providing users with delivery, mobility, and financial services, leaders found themselves in a position familiar to senior executives at any hypergrowth company. As the young organization prepared for an IPO, leaders felt out of their depth, fatigued, and constrained by a lack of experienced leaders. The solution? The company invested in nearly 100 leaders and their teams over 18 months, helping them shift toward wholeness and authenticity. The effort helped leaders cultivate self-awareness, show up as themselves, empower others, build a feedback culture, and foster psychological safety. Armed with greater authenticity, personal resilience, and adaptability, the young leaders coped well with the pressure of leading their teams to a successful IPO during a global pandemic.

Are you allowing hopes and fears to have a voice? Hopes and fears are part of being human and part of business as usual. Are you acknowledging and addressing that with your teams? The CEO of one engineering company encouraged more candid and vulnerable engagement by sharing his feelings of frustration and powerlessness. Reflecting on his legacy as a third-generation CEO of a family business, he admitted that his desire to please investors had obstructed the higher purpose of the organization. His vulnerability helped his senior leadership team become more open and candid, enabling a new level of authentic dialogue.

How we organize: Beyond command to collaboration
Throughout the 20th century, organizations adopted increasingly complex matrix structures underpinned by siloes and opaque hierarchies. That approach has ossified. New ways of organizing work are evolving that unlock organizational bottlenecks and enable people to work together much more effectively. Moving beyond siloed hierarchies to a network of autonomous teams working together with transparency, trust, and collaboration offers companies a more adaptable and powerful organizing construct.

This shift requires leaders to evolve beyond being directors that receive and give instructions up and down a vertical hierarchy to being catalysts that empower and guide self-managing teams, fostering connection, dialogue, and cooperation across traditional organizational boundaries. This evolved approach cultivates trust, respect, and compassion; requires letting go of the power that comes with positional authority to embrace a stance of openness; and enables human connection within teams and across formal hierarchies. The following leadership practices can help drive the shift:

— encouraging and empowering people in small self-regulating entrepreneurial teams

— fostering horizontal transparency and collaboration throughout the network and beyond

— moving from a hierarchy of individual leaders to networks of leadership teams

Financial-services company Aon provides a good example of leaders acting as catalysts with a partnership mindset to shape a collaborative network organization. Built through acquisition, Aon had become essentially a federated gathering of fiefdoms, where each leader felt deep ownership of their client relationships and sought to grow their own businesses, leading to duplication and lack of coordination across the company as a whole. Senior leaders wanted to maintain the spirit of entrepreneurship, but they also recognized the need to let go of siloed thinking and inculcate a culture of collaboration. They launched "Aon United" to put clients at the center of all they did, to support one another as a global organization on their clients' behalf, and to innovate at scale to meet clients' needs.

Leaders must evolve beyond being managers seeking incremental improvement to become visionaries with the courage to craft a resonant purpose and boldly imagine and pursue the future.

The undertaking was not easy. It took years to fully adapt to the new collaborative model, with Aon investing in development and training for more than 10,000 colleagues. The goal was to shift old mindsets and behaviors and form trust-based networks across regions and product lines. Another goal was to move beyond the region-versus-product trade-off toward a mindset of partnership and collaboration by forming multidisciplinary teams focused on customers, integrating regional and product expertise. Leaders are now expected to spend one day a week helping colleagues outside their area.

The impact has been considerable, enabling Aon to integrate a federation of 60 sub-brands into a single global organization of 50,000 employees in 120 countries, and to increase its market capitalization from $6 billion in 2005 to $50 billion in 2020. The company today views its collaborative ethic as a key competitive advantage: there is a single enterprise-wide income statement; the model for client service has been standardized; and the language of "we … us … ours" is encouraged over "I … me … my."

Do you have teams of leaders or networks of leadership teams? Where are you on a spectrum ranging from a group of leaders to a true leadership team? Faced with a need to transform her business and organization, one business-unit leader realized that her leadership team was a key barrier to moving forward. Each leader had focused largely on protecting and defending the function they led, making it challenging to align on and launch a unit-wide transformation. So she initiated a journey for the team that focused on building trust, surfacing the limiting beliefs and unconscious commitments that kept them locked in this pattern, and exploring new mindsets and practices. As the journey progressed, everyone committed to making being a member of the unit leadership team their first priority; the nature of the leadership team shifted profoundly, from directing and managing to architecting, catalyzing, and coaching; and roles, targets, incentives, and responsibilities were adjusted to reinforce, rather than undermine, working as a true team. This transition from a team of leaders to a true leadership team transformed the entire organization.

How we get work done: Beyond control to evolution
Leading companies today seek to become learning organizations that are continually evolving, exploring, ideating, experimenting, scaling up, executing, scaling down, and exiting across many different activities in parallel. By accelerating change and allowing for positive surprises and innovations to flourish, they consistently outperform those companies that focus instead on always trying to deliver the "perfect" plan.

We are in the midst of a profound shift in how work gets done, one that asks leaders to go beyond being controllers with a mindset of certainty to becoming coaches who operate with a mindset of discovery and foster continual rapid exploration, execution, and learning. Leaders and leadership teams can learn how to set and work toward outcomes rather than traditional key performance indicators; to foster rapid experimentation and learn from both successes and setbacks; and to manage risk differently, through testing, learning, and fast adaptation. The leadership practices enabling this shift include the following:

— operating in short cycles of decision, action, and learning

— regularly reprioritizing the portfolio of initiatives to simultaneously execute today's business, cocreate tomorrow's business, and let go of yesterday's business

— engaging and leading people, helping them understand—and be excited by—the fact that there will be ongoing significant change

Financial-software company Intuit made such a shift when it found itself plateauing after its initial success with desktop financial-management software for consumers. In response, senior leaders decided to double down on customers, innovation, and design, fostering a culture shift to design thinking and experimentation with fast learning and fast failure at its heart.[4]

Senior executives, starting with the CEO, published their own performance reviews, admitting mistakes

[4] Brad Smith, "Intuit's CEO on building a design-driven company," *Harvard Business Review*, January–February 2015.

and seeking feedback. Employees were given 10 percent of unstructured time to experiment, and good ideas were given funding. Decision making was streamlined and accelerated, with clear responsibilities and processes based on both data and dialogue. This shift has helped the company evolve into a highly innovative learning organization, with more than 1,800 experiments running at any point in time. In the decade to 2019, the company doubled its customers to 50 million, doubled its revenue, tripled its earnings, and increased its value from $10 billion to $60 billion.

Are you helping people experiment and learn? Sometimes the way to innovate is to connect with the past; sometimes it is to connect with the future. A finance team at a hospitality company, for example, recognized it was overextending on detailed planning and control, based on a need for certainty and perfection largely driven by its perception of what the executive team and board expected of it. The CFO challenged her team to become a source of positive energy and innovation and led by example even though there were doubts about whether the company's senior leadership would support such a shift. It worked: within weeks, the team had renewed energy and began to unlock dozens of ways for the business to save costs, accelerate action, and realize more value.

How we create value: Beyond competition to cocreation

Creating value for stakeholders lies at the heart of every organization. For decades, companies have focused on generating competitive advantage to gain an ever-increasing share of existing market value. While it remains essential to offer customers greater value than other options they might consider, in an era of collapsed product life cycles and rapid commoditization, organizations must move well beyond a focus on competitive advantage. They must create new levels of value for customers and other stakeholders by reimagining their business models and industry ecosystems.

This shift requires that leaders evolve beyond being planners operating with a presumption of scarce opportunities and resources to becoming architects who shape new business models and systems by understanding and utilizing the abundance of available opportunities and resources. For many leadership teams, this represents a sea change in the primary focus and content of their work, from tactical optimization and execution to deep strategic thinking, exploration, and social connection. The leadership practices that make up this shift include the following:

— generating a strong and stable platform of core competencies that drive value

— delivering value by applying these core competencies to a continually evolving business portfolio, both organically and through systematic merger and acquisition activity

— amplifying value through creative partnerships with suppliers and competitors that shape and grow the organization's industry ecosystems

Almost a decade ago, DBS—the Development Bank of Singapore—set an audacious goal of being recognized as the best bank in the world by 2020. Its approach was not to ask, "What does the bank want to do?" but "'How do we make dealing with DBS easy, fun, convenient, and joyful?" One part of the answer lay in creating an ecosystem mindset with the bank at its core—a platform, not a product—and shifting toward a leadership mindset of creation and abundance. In 2017, DBS launched a platform with 150 APIs (application programming interfaces allow systems to communicate with one another). Five years later, that number has increased to 1,000 APIs with more than 400 partners. The bank acquired new customers through its partners, broadening into property, auto, travel, and utilities.

DBS transformed the enterprise and delivered remarkable impact. This is what can happen when a company adopts each of the five modern mindset shifts we've discussed.

— *Visionaries generating impact for all stakeholders, with a mindset of possibility.* DBS leaders first reframed their vision for the bank: to be a technology company making banking joyful. Teams were tasked with articulating that vision through shifts in mindset and behavior.

- *Humans being our whole best selves, with a mindset of authenticity.* The bank's leaders realized that culture and leadership were holding the bank back. They focused on creating and embedding transformational capabilities across the organization, anchored on a growth mindset. The change allowed people to let go of limiting beliefs, and to instead tap into deep passion and ingenuity to bring a new form of banking to customers.

- *Catalysts collaborating in empowered networks, with a mindset of partnership.* The push to become a technology platform meant DBS would become a horizontal organization, with end-to-end teams reacting fast to meet customer and employee needs. DBS leaders identified and learned from the journeys of the 100 highest-impact teams and accelerated those lessons across the organization. They fostered psychological safety within each team and extensive collaboration and dialogue across teams.

- *Coaches evolving through rapid learning, with a mindset of discovery.* The organization used transformational two- to three-month team sprints with "balcony time," or time to gather and reflect in a huddle or a retrospective grouping. This transformational team approach resonated with the new practice of rapid learning cycles and a coaching ethos.

- *Architects cocreating new value through reimagining, with a mindset of abundance.* By going beyond the focus on products to create a platform, DBS adopted an ecosystem approach that thrived on solving "jobs to be done" or problems customers were trying to address.

Transforming leadership to transform organizations

Transforming an organization into a thriving entity that is able to deliver sustainable, inclusive growth requires a comprehensive approach to leadership transformation, beginning with the senior network of leadership teams. More specifically, this typically requires the involvement of the top-three levels of the organization: the enterprise leadership team, the leadership teams of the major business and functional units, and the leadership teams of primary units within each of the major units, as well as cross-unit governance groups. In large organizations, this may comprise the 500 to 1,000 most-senior leaders in the company.

One key is that this change needs to take place voluntarily. Most of us cannot be instructed to change, so a good transformation process will develop emergently, allowing people to come to recognize they will be better off individually and collectively as a result of transforming themselves. This is how they will begin to embrace and adopt new mindsets, capabilities, and practices individually; to cocreate and implement new leadership role definitions, career paths, incentives, and performance management focused on working as a network of leadership teams; and to reimagine their businesses, organizations, and ecosystems to unlock new levels of performance and impact.

A leadership transformation program designed to engage and transform the senior leadership of a global enterprise may include the following elements:

- *Initial discovery and design.* Stand up a leadership transformation team to guide the effort, define the goals and desired impact, and create the overall architecture for the transformation program. In this initial phase, assessing the readiness of leaders is also critical. Teams need to know where they stand today versus where they would like to be to realize their full potential.

- *Immersive introduction.* An introductory experience of perhaps three to four days with mixed cohorts of leaders from across the enterprise will engage leaders, catalyze initial "aha" breakthroughs, and generate momentum and connection.

- *Leadership team journeys.* Establish coaching support for each leadership team in the network, beginning with early adopters, at three levels: for individual leaders within the team, for the leadership team as a whole, and for how the leadership team engages people both within the organizational unit it leads and across traditional organizational boundaries.

— *Collective journey.* Shift the traditional siloed and politicized management hierarchy into a flat, open, and collaborative enterprise-wide network of leadership teams that over time evolves into a leadership community operating with the new approach across the organization.

— *Internal practitioner development.* An internal community of leadership transformation coaches can help scale the new leadership approach to midlevel, frontline, and informal leaders across the enterprise.

As leaders become more self-aware and embrace new and more enabling mindsets and practices, they will build adaptive capacity by applying these practices to reimagine how they work within each leadership team and as a network of leadership teams. They will work collectively to evolve their foundation, operating model, and business model to become a thriving organization. Their progress toward building a thriving organization through collective leadership transformation should be measured at three levels, each building on the preceding one: changes in leadership mindsets and behavior; the launch or acceleration of business and organizational transformation initiatives; and holistic impact to all stakeholders.

History is filled with the impossible, or even unimaginable, becoming reality. When those moments happen, mental and emotional barriers break down, enabling others to follow suit. We are already seeing some organizations evolve and transform to meet the demands for sustainable, inclusive growth. More and more companies will now follow their lead.

Leaders who develop the new capabilities and mindsets discussed in this article can offer any organization enormous potential as catalysts and enablers of value creation. The emergent journey of leadership transformation invites senior leaders to embrace and apply new principles and practices personally, within their teams, and throughout their organization. By demonstrating new mindsets and behaviors, they are able to draw on reservoirs of organizational energy, passion, and ingenuity; enhance and accelerate the whole enterprise portfolio of performance and transformation initiatives; and unlock new levels of value for customers, employees, investors, and other stakeholders.

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How to be a great 21st-century CEO

What do CEOs do? Why do they do it that way? And what matters most?

by Gautam Kumra, Vikram Malhotra, and Joydeep Sengupta

To answer those questions, we identified 200 highly successful CEOs and conducted in-depth interviews with 67 of them. We found that there is no simple recipe for success, but there is virtue in simplicity. Indeed, the CEOs we interviewed could describe their business strategy in an elevator ride up Shanghai Tower.

We also found that, in a sense, all CEOs have the same responsibilities, such as working with the board, engaging stakeholders, setting direction, and creating a positive culture. What separates the best from the rest is how they approach these tasks. All excelled at some, were good at the rest—and knew the difference. All are world-class integrators. And all applied a distinctive set of mindsets against these responsibilities. In our own effort at simplicity, we identified the six mindsets that characterize great CEOs.

Be bold. In times of uncertainty, it can be tempting to minimize the downside. However, that all but guarantees either mediocrity or decline. Successful CEOs want to avoid making mistakes, of course, but they also act boldly, actively seeking significant opportunities. They raise the aspirations of the company, and they look for intersections where the business and the market meet. In effect, they are excellent futurists and thus can define the right vision. While they will cut their losses if a move is a dud, they stick to the strategy. The vision comes first; financial performance flows from that.

Treat the soft stuff as the hard stuff. Only one in three strategies is successfully implemented—in large part because change generates resistance. That is why the "soft stuff"—that is, matters related to people and culture—can be the hardest stuff of all to get right. Research has found that companies that solve the soft stuff are more than twice as likely (from 30 to 79 percent) to execute a strategy successfully.[1] To carry their organization with them, leaders need to make the case for change, and then keep track of results.

Solve for the team's psychology. To build high-performing leadership teams, the best CEOs start with roles, not people, asking what the most important jobs are and then finding people who can do those jobs. And they design for overall functionality, bringing in a wide range of expertise. CEOs must engage with each individual while keeping some distance. And, again, the soft stuff counts.

Help directors help the business. The board is the CEO's boss, but an awkward one—a lot of people, infrequently seen. Like any relationship, the bedrock is trust. That means being open, honest, and prompt about plans and problems. Bad news is, well, bad, but delivering it is also a chance for the board to help, which is its function. CEOs should establish a strong relationship with the lead director and check in with other directors once or twice a year. Finally, introduce the board to the company by connecting the board to managers. As Piyush Gupta, the longtime CEO of Singapore's

[1] Scott Keller and Bill Schaninger, *Beyond Performance 2.0: A Proven Approach to Leading Large-Scale Change*, Hoboken, NJ: John Wiley & Sons, 2019.

Successful CEOs want to avoid making mistakes, of course, but they also act boldly, actively seeking significant opportunities.

DBS Group, put it: "The board, to me, is a partner, and they can talk to anyone in my management team. I believe the free flow of information is helpful for complete alignment."[2]

Start with "Why?" Purpose can be difficult to define. At the very least, it should be powerful enough to inspire people, simple enough to be readily understood, and make business sense. And purpose matters: companies with a clear social purpose have significantly outperformed the S&P 500 over the past 20 years.[3] The best CEOs ask themselves why their company exists, then make purpose an intrinsic part of the business model, knowing that testing strategy against purpose can open up new areas of growth. Leading with purpose can also enhance employee well-being and build loyalty.

Do what only you can do. Being a CEO is a 24/7 job, but no one can work that way. Great CEOs make it a priority to manage themselves to ensure that they are not being pulled apart. That is obviously personal, but we did find some commonalities. The most important is self-discipline, particularly regarding the use of time. Old-school techniques such as lists, stars, and color coding crop up often as time-management techniques. At the same time, the CEOs we spoke with also build flexibility into their schedule—to respond to the unexpected or simply to think. Many combine high-intensity work with recovery periods, whether that is a ten-minute break between meetings or playing the piano. Ultimately, managing personal effectiveness is about developing a sense of perspective, and then using that to see into the future.

No book can create a great CEO, any more than a boxing manual can produce a Manny Pacquiao. But in business, as in boxing, there is such a thing as good technique. CEOs matter: we calculated that the 200 CEOs we identified created additional economic value of about $5 trillion. By identifying the mindsets that characterize great leadership, we believe that excellence can be cultivated—now and in the future.

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[2] Carolyn Dewar, Scott Keller, and Vikram Malhotra, *CEO Excellence: The Six Mindsets That Distinguish the Best Leaders from the Rest*, New York: NY, Scribner, 2022.
[3] *The business case for purpose*, a joint report from EY and Harvard Business Review Analytic Services, 2015.

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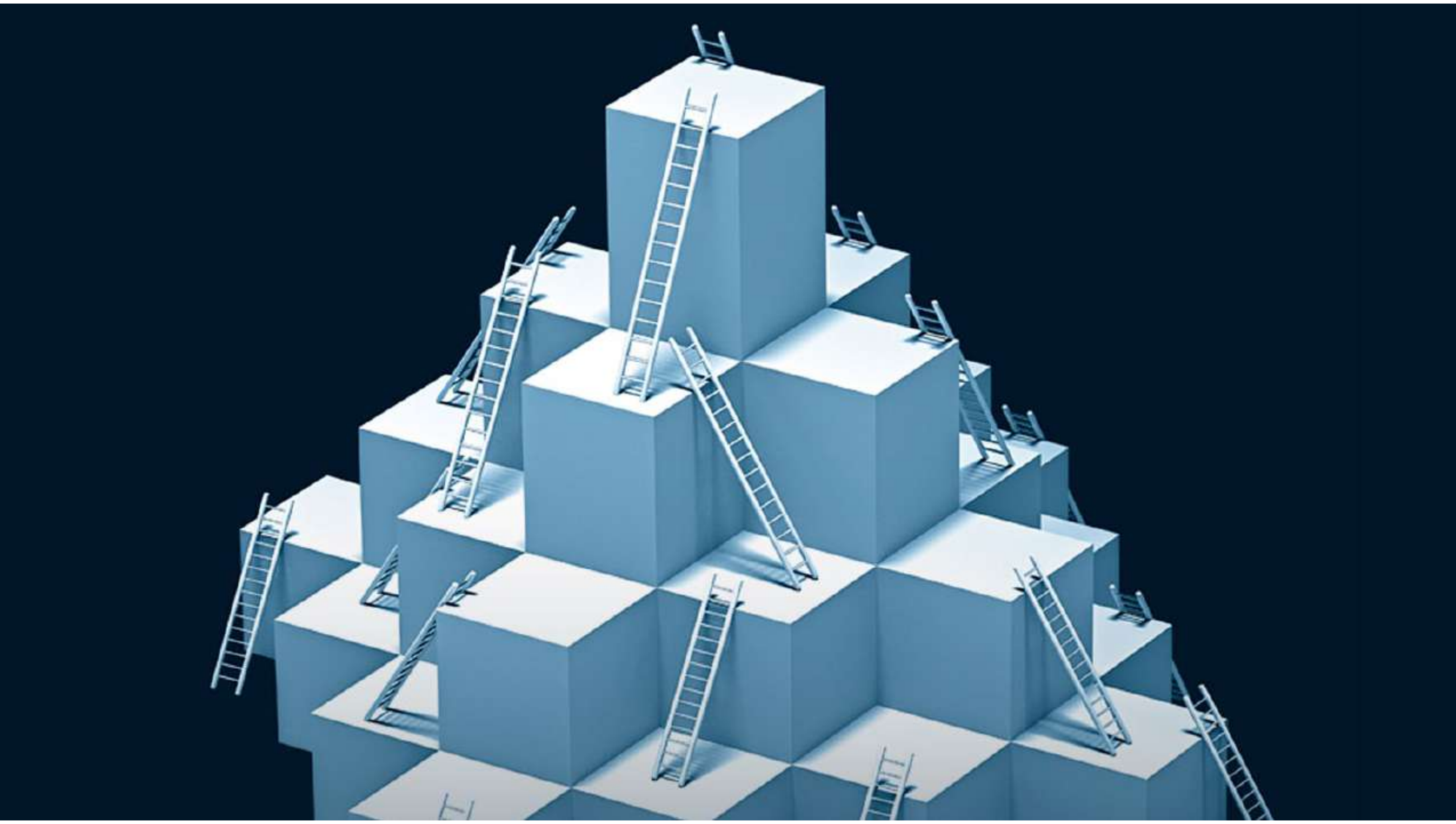
Rising CEOs: Lessons from the McKinsey Leadership Forum

Preparing for the CEO role can be a challenge and a reward. These eight lessons, drawn from more than 300 McKinsey Leadership Forum participants and the CEOs who advise them, will benefit any top executive or aspiring CEO.

by Meagan Hill, Celia Huber, Ishaan Seth, and Kurt Strovink



What does it take to become a CEO? Every year since 2006, the McKinsey Leadership Forum has convened an elite group of C-suite executives to tackle this and other key questions facing those near the very top of their organizations. In candid dialogue with current and former CEOs, as well as McKinsey's own experts, participants discuss their aspirations, leadership philosophies, network building, career paths, and other factors facing those preparing for the role. Just over 300 leaders have attended the forum, with 88 participants becoming CEOs.

In this article, we'll look at eight key lessons that we've gleaned from this uniquely rich data set, which showcases years of dynamic interactions between diverse personalities. To preserve the confidentiality of participants, we will not name CEOs, but we will weave in their insights throughout.

The CEO's job has changed considerably since 2006. Technological know-how has become a prerequisite of the job. External stakeholders demand much more attention than they once did. As the Great Attrition makes clear, CEOs now must spend considerable capital addressing the health and well-being of their employees. Attention to environmental, social, and governance (ESG) issues, an acute focus on the very purpose of companies, and the call for CEOs to speak out on societal issues are all on the rise. The public nature of the job is greater than ever. Finally, and perhaps most critically, we seem to be in an era where volatility is the norm, not the exception. Starting with the 2008 financial crisis, business leaders have had to deal with one game-changing external disruption after another. In the wake of the COVID-19 pandemic and amid geopolitical turmoil and the ongoing effort to combat climate change, CEOs of the future will need nimble courage to manage through constant volatility.

These new demands on CEOs have altered the process of preparing for the role. This is reflected in the following eight observations. There are now more, and increasingly diverse, pathways to becoming CEO, rather than just the one or two approaches where candidates all tick the same boxes. The participants at the Leadership Forum are ready to turn to their peers and veteran leaders for support in different ways than they have in the past. And there's a much greater focus on personal, emotional, and psychological readiness. The result: it's more complicated than ever to prepare for the CEO role. But the rewards to be gained from examining your own strengths and weaknesses are greater than ever, whether your ultimate destination is to become a CEO or simply to become a better leader.

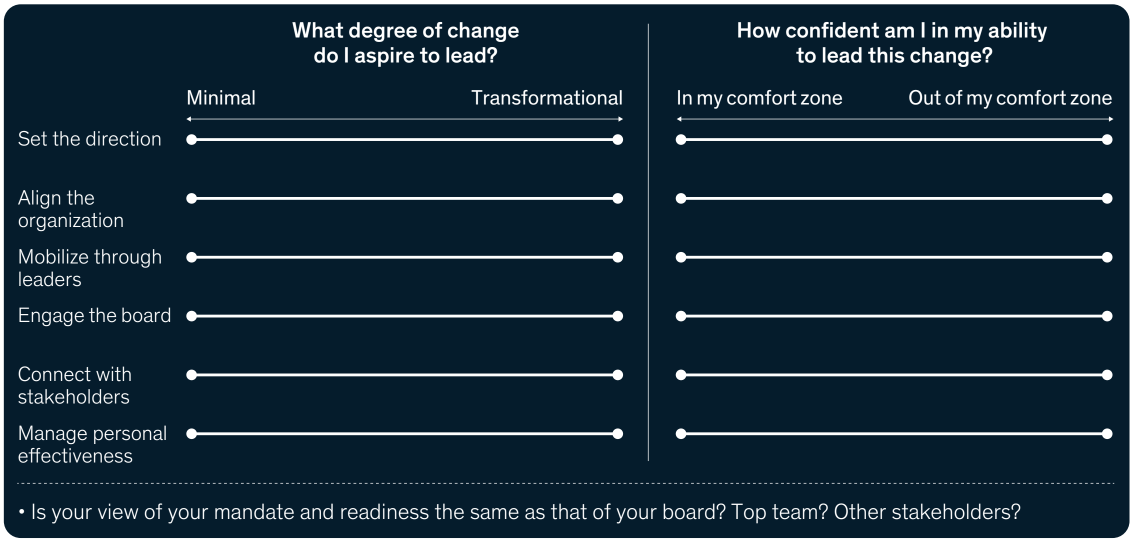
You're never ready

Almost every CEO who participated in the forum tells us they thought they were well-equipped for the job, given their experience leading significant business units or functions—only to realize that the job required muscles and expertise they had never developed. For example, a leader with a strong operating background was challenged to run enterprise-wide initiatives. An expert at strategy with little previous exposure to directors found himself learning the intricacies of engaging the board as his key partner. A CEO with stellar functional experience started building her operating muscle. "There were a lot of things that I didn't know," one CEO told forum participants, "so many things that I'd never worked on."

A purposeful preparation process helps you identify those areas that may prove most challenging. During forum sessions, participants have found it helpful to measure their readiness against the six key elements of a CEO's job: setting the direction, aligning the organization, mobilizing through leaders, engaging the board, connecting with stakeholders, and managing personal effectiveness. Within each of these elements are a range of responsibilities; for instance, setting a corporate strategy means creating a vision, but it also means making the final call on allocation of capital. "The more you know and understand the key business levers and the financials associated with all those levers, the more effective you can be," said the CEO of one leading telco. "I learned those on the job. I wish I'd known more about them ahead of time." During the forum, participants have access to a range of resources, including a unique self-assessment tool (Exhibit 1). Working with this tool as a foundation, forum participants can start to get a clear view of where they stand against the myriad challenges of the top job.

Exhibit 1

CEO candidates use a unique self-assessment tool to measure their readiness against the six key elements of the top job.



Source: CEO Excellence service line

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What's true for rising CEOs is true for any leader: there are always ways to round out your experience and qualities. Taking a considered approach to CEO preparation doesn't mean turning yourself into a perfect candidate. Our research, and the feedback from CEOs who have since graduated from the forum, suggests that there is no such thing. But a successful preparation process will help you intentionally design the next steps of your professional journey, ensuring that you are building capabilities in a way that adds to the breadth of your qualifications. This kind of intentionality is critical for any leader preparing themselves for their next challenge at any stage of their corporate journey.

Develop insight and edge from a diverse 'kitchen cabinet'

In volatile times, the competitive value of true insight rises. This is true for tier-one executives as business leaders and as CEO candidates. Yet one of the most important—and most challenging—aspects of being a top leader is getting expert, unvarnished, and diverse insight into yourself and the world around you. "I always believed in business that you should have an environment where people can tell you the good and the bad," said one CEO. "You have to want to know it all."

At the Leadership Forum, candidates relish the opportunity to network with peers across industries. They tell us that seeking feedback from a wide range of sources is now the norm. Within their companies, they want to hear from people far outside the senior team. One CEO explained: "You have to learn the business from the ground up. You've got to go to the people who live the work every day to understand it." So they reach out to customers who engage with salespeople; suppliers whose needs affect everything from retail touchpoints to investment allocation; external stakeholders; leaders from other industries; and experts on geopolitical, regulatory, and technological issues. To stay abreast of a business environment where external pressures are constant and constantly changing, they need better insight from a more diverse range of people.

CEO candidates want a similarly broad range of views about themselves, but getting such honest insight can be difficult. It's often said that being a CEO is the loneliest job—perhaps the second loneliest is being a CEO candidate. Family and friends can provide intimacy and knowledge of your personal strengths and challenges, but seeking out the professional perspective and counsel you need is a sensitive task. Rising CEOs describe the feedback of peers as invaluable to understanding how they should continue to prepare themselves. But they worry about seeming overly careerist as they seek out such feedback, and they know that some of the people whose advice would be most helpful, such as the incumbent or board members, are simply inaccessible. The sensitivity of the task might make it tempting to forge ahead without the feedback. But the process of finding and listening to the right diverse group of people will do more than give you invaluable insight; it's also good training for the sensitive collection of insight that will be central to your success as a CEO leading a team of people with a range of conflicting needs.

Ready your value-creation thesis

What will you deliver? What is your promise? To put it bluntly, how will you double the company's market cap in five years?

Rising CEOs must offer a clear and detailed vision of how they will transform the company they hope to lead. They need to specify a handful of decisive moves they will take to execute that vision. And they must show, whatever their experience, that they can create value across the widest canvas—that of the entire company.

Sometimes, this value-creation thesis becomes a blueprint for a CEO's first 100 days. When one food industry CEO visited the Leadership Forum, he told participants that he had a four-point plan ready when he ascended to the top job: rethink partnerships, crack the China and India markets, rationalize the portfolio, and launch the next wave on digital. It was a classic value-creation thesis: bold and comprehensive, with clear actions that were taken up immediately.

Rising CEOs at the Leadership Forum have found it helpful to detail this thesis on a "placemat": a slender document that serves as a forcing mechanism for a set of complicated decisions whose answers depend largely on the state of the company (Exhibit 2). Many candidates have gone on to use this placemat as part of their presentation to the board during the selection process. For those who do rise to the top, it has also proved useful as a way to align their top team and mobilize the organization.

For rising CEOs at well-performing companies, what's the justification for dramatic pivots? What kind of distance do you want to put between yourself and the current CEO? Where will you leverage your personal strengths to drive breakthroughs that others would have a difficult time creating? A persuasive value-creation thesis positions you for a quick takeoff and lays the groundwork for the growth message you'll be communicating to the whole company. "I've actually gone back after all these years and looked at all the strategic changes we'd planned, at where we said we wanted to take the company," reflected one CEO. "We worked on creating a culture for the company, a new approach to 'How are we going to do things around here?' And we did a pretty good job."

Act like a chief human resources officer

However well-conceived your value-creation thesis may be, your success as CEO will depend on deploying the right talent against the most important initiatives. Many CEOs have told forum participants that their only regret was not acting faster on talent changes.

Any leader preparing to be CEO should be ready to clearly define the highest-value roles and to know who should be in them. There is nothing easy about this challenge. Our research suggests that only 10 percent of the 50 most valuable roles in a corporation report to the CEO, and that while 60 percent can be found at the next level down, 20 percent are below that level. Since most rising CEOs have excelled in individual areas of the company, their knowledge of the very top talent across the entire company can be limited.

These talent decisions can be critical to reshaping the culture of an underperforming institution. "Do you have a high-performance culture? What is a

Exhibit 2

Sample output: Develop a bold, comprehensive strategy that you can effectively communicate and execute.

Illustrative

Where are we headed? (vision)	Deliver double-digit operating income growth by operating as one firm		
What will we deliver for our stakeholders?	**Cross-selling**	**Working together**	**Technology optimization**
How will we make it happen? (bold, strategic moves and key initiatives)	• Customer segmentation strategy • “Best in front” strategy • Key account management program • Sales and product knowledge skill building • Product bundling	• Incentive alignment • Regional office partnership model (single brand) • Process standardization • Functional centers of excellence • Centralize transactional activities	• Systems integration • Technology road map • Cybersecurity upgrade • Data and analytics strategy • Employee enablement retooling
How will we know? (measures of success)	• Cross-sell rates • Customer loyalty	• Expense ratio • Compliance	• Systems duplication • Risk incidents
How will we reallocate resources to enable this?	Dynamically reallocate resources based on a quarterly reevaluation of our priorities Scale back slower growth verticals Do not trade off on customer or employee experience		

Source: CEO Excellence service line

McKinsey & Company

high-performance culture?” reflected one CEO. “It’s a culture that is focused on the purpose. It’s a culture that is principle based rather than rule based. The biggest change we made with the new team was taking the company from a rule-based culture to a principle-based culture.”

Rising CEOs who want to step into the role with a broader, more accurate view of talent go to great lengths to broaden their view across the organization. They find ways to lead town halls with a wide range of talent. They regularly conduct field visits, something that’s become increasingly important as technology has extended innovation to the periphery of company networks. They make a point of paying attention when they find diamonds in the rough, knowing that in this technological age, transformative leaders may or may not have followed traditional career paths. “It’s a really good thing to assess the team members,” said one CEO. “Not only yours but also those in critical roles further down in the organization.”

They also develop their external networks as much as possible. If their value-creation thesis will move the company in new directions, sometimes an outside hire will be needed to kick-start change. As one financial-services leader told us, “The best way to introduce new thinking is to introduce new thinking.”

Do what only you can do

As leaders rise through the organization, they learn that truly scaling their operating model means not overextending themselves, and instead doing what only they can do. "I try to control what I do and where I spend my time," said one CEO, reflecting a sentiment we heard from many others. "I don't do a very good job of it, I'll be honest with you. But I do try to be deliberate about where I think I can have the most impact."

This realization has become more important as the CEO job has become more complex, and it's a skill that every rising CEO must master. At recent Leadership Forums, visiting CEOs have provided examples of the personal steps they take to ensure that they are not distracted by noise and instead focused on doing what only they can do. Some of this is time management: carefully allocating time to top priorities, building flexibility into their schedule so that they can manage unexpected events, and structuring in recovery time after management "sprints." Many rely on a set of mechanisms to enforce this discipline—mechanisms that enable them to be fully present in every interaction and to devote the maximum amount of energy to the most demanding tasks. "So much of the CEO's role is taking things that are or could be highly complicated and simplifying," said one veteran CEO. "You're constantly doing it. And if you focus and execute with discipline, you actually get things done."

This, too, is one of the most profound changes we've seen at the Leadership Forum. When the forums started, back in 2006, it was common to find rising CEOs who still believed they could lead using a traditional "command and control" model. Since then, that model has been replaced by leadership models in which the CEO serves as enabler in chief. In these newer models, doing everything is both ineffective and impossible. It is far better to catalyze the talent around you and spend your time doing things that no one else in the organization can do.

Move from a private to public persona

As Peter Drucker once observed, a CEO is the link between the inside (the company) and the outside (the world with which the company interacts). Rising CEOs know this and are prepared to deal with a greatly expanded range of stakeholders, including customers, employees, the media, regulatory agencies, unions, suppliers, distributors, activists, analysts, and, of course, shareholders and investors.

What they are less prepared for is that, in today's world of social media, every word they say—or fail to say—while interacting with these stakeholders will be scrutinized. This has become a leading topic at recent Leadership Forums, with CEOs warning participants that they must be ready to react to an extraordinary range of events—geopolitical unrest, appointments of new board members, social inequities, Supreme Court decisions, the retirement of sports superstars, and who knows what else. Rising CEOs must ready themselves for today's fractured media environment, where every public utterance might present a risk.

It can also, however, present an opportunity. CEOs who deliver a consistent narrative that reflects

In these newer models, doing everything is both ineffective and impossible. It is far better to catalyze the talent around you and spend your time doing things that no one else in the organization can do.

the values of the company across traditional and social media will build trust and credibility with all stakeholders. "You can have your CFO and your IR [investor relations] person do a lot externally with your shareholder and constituents, but your visibility is very impactful as well," said one CEO. "I've gotten a lot of positive reinforcement, and we've had a great reflection on our stock and share prices because they felt like they had a great connection to me as well as our CFO. You've got to manage and balance that."

One key topic where rising CEOs can make their mark is sustainability. This most public-facing issue has become a top management focus over the past few years and affects all stakeholders. Being prepared with a consistent, credible strategy on sustainability is a requirement for today's new CEOs.

Manage your personal energy

It's hard for function leaders and business unit heads to really internalize what becoming CEO might mean for them personally. They have grown accustomed to managing intense demands on their time and personal space, but the CEOs we speak with agree that the top job is intrusive in a completely different way. Inside and outside the company, people track a CEO's every utterance and action, looking for signals. Everything is amplified.

Rising CEOs should be prepared to figure out a unique model for safeguarding, developing, and tapping into their personal energy. This isn't solely a matter of work–life balance; bringing the right energy to work is a job requirement. "Balance your own personal life," one CEO urged forum participants. "We can all work a lot, but if you don't bring yourself to work every day refreshed and energized, it's really hard to be great at what you do when you are in the office."

CEOs employ a variety of techniques to manage their personal energy. Some schedule two hours of pure thinking time in the middle of the day. Some schedule their most important meetings for the morning. Others turn to hobbies that are all-consuming but profoundly different from their CEO responsibilities—triathlons, painting, even serving as DJs—with the hope that they will be completely refreshed when they return to the job. Intense fitness routines are common, and many CEOs fiercely protect their vacation time to ensure they have the recovery time needed to serve as a true corporate athlete.

At one forum, a CEO talked about the difference between "rubber balls" (things a CEO can ignore) and "crystal balls" (things a CEO dares to ignore). "The easiest thing to call a rubber ball and let drop," she explained, "is your own personal management: your own health, your own time management, your own think time. Most people tend to think of that as the rubber ball. And it is a rubber ball—until it's not." The message is clear: while there's no single recipe that works for every leader, rising CEOs need to be ready with their own plan for managing their personal energy.

Committing to preparation is the rewarding first step

Committing to a rigorous CEO preparation process is one of the most rewarding developmental journeys a top executive can make. The process is a deeply personal and challenging experience that asks a lot of candidates across several dimensions. It is a science, a methodology with a clear set of stepping stones, including the ones mentioned in this article. Engaging fully improves the likelihood of a candidate's success. But that's just one of the rewards that comes with the hard work.

Candidates have to take an honest look at their personal and professional track records, skills, and development areas and assess their readiness for the top job. They have to approach the task with humility. As one CEO explained, "If you get to a leadership role and you're afraid to ask for help and afraid to say you don't know something, my guess is you are walking on some pretty thin ice. Ultimately, it helps build credibility." Rising CEOs have to sharply craft a fact-based, holistic, integrated aspiration for the company they'd like to run. They have to identify ways to enhance their capabilities by gaining relevant knowledge and expertise via workshops, forums, and "go and sees" (for instance, visiting other organizations) and by taking on opportunities that build a particular content area (for example, digital, analytics, and sales). And they have to prepare for interviews with the board of directors by conducting mock interviews with advisers and coaches.

These things have been part of the process for decades. But the additional focus on external events and external stakeholders, as well as a deeper, more realistic examination of the personal challenges that come with the CEO role (or, for that matter, with any top leadership job these days), make the CEO preparation process more rigorous—and more rewarding—than ever.

It's rare to get a collection of rising CEOs together for candid conversation, and rarer still to be witness to such conversations for more than 15 years. What we've learned from the more than 300 leaders who have participated in the Leadership Forum is invaluable. It's clear that the experience of CEO candidacy helps leaders emerge with a clearer understanding of their strengths, development areas, and professional and personal goals. They are more likely to see themselves clearly as leaders inside and outside of their organizations. And from what we've seen at the Leadership Forum in recent years, they are increasingly likely to become the leaders the world needs now.

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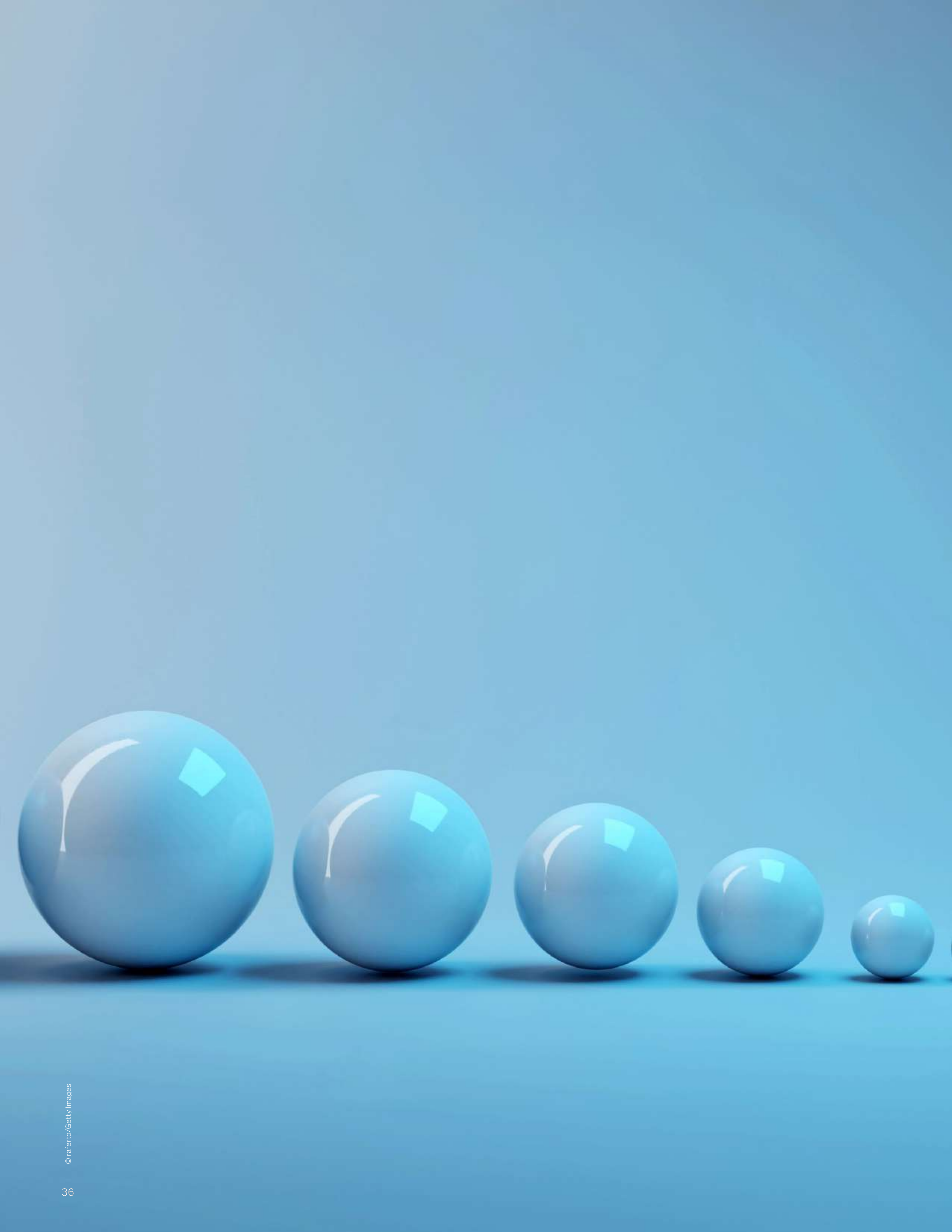

Are you a growth leader?

Growth leaders generate 80 percent more shareholder value than their peers over a ten-year period—but about a quarter of companies don't grow at all, and between 2010 and 2019, only one in eight achieved more than 10 percent revenue growth annually. "Growth leaders set, communicate, and commit to growth consistently and without significant resourcing," write Michael Birshan, Biljana Cvetanovski, Rebecca Doherty, Tjark Freundt, Andre Gaeta, Greg Kelly, Erik Roth, Ishaan Seth, and Jill Zucker. Check out these insights to uncover what happens when business leaders make and follow through on a purposeful choice to grow.

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Choosing to grow: The leader's blueprint

Driving sustainable, inclusive growth requires the right mindset, strategy, and capabilities. Here are some steps that could help foster successful growth.

This article is a collaborative effort by Michael Birshan, Biljana Cvetanovski, Rebecca Doherty, Tjark Freundt, Andre Gaeta, Greg Kelly, Erik Roth, Ishaan Seth, and Jill Zucker, representing views from McKinsey's Growth, Marketing & Sales and Strategy & Corporate Finance Practices.

Growth is something every CEO and business leader aspires to deliver, but for many, it remains elusive. About a quarter of companies don't grow at all, and between 2010 and 2019, only one in eight achieved more than 10 percent revenue growth annually.[1] Sustained, profitable growth is possible, however, and it comes down to "choice."

Do you, as a leader, make an explicit choice to grow? Or do you pay lip service to your growth ambitions and let your resolve falter if profit isn't immediate?

When sustainable, inclusive, and profitable growth becomes a conscious, resolute choice, it shapes decision making across every area of the business. Growth becomes the oxygen of an organization, feeding the culture, elevating ambitions, and inspiring a sense of purpose. Growth leaders generate 80 percent more shareholder value than their peers over a ten-year period. Beyond creating shareholder value, growth attracts talent, fosters innovation, and creates jobs.

With only one in ten S&P 500 companies reporting growth above GDP for more than 30 years, sustained, profitable growth may seem difficult. But the choice to grow is paramount—and it is available to every leader, regardless of industry or economic climate. Indeed, many high-growth companies, including Hewlett-Packard, Burger King, Hyatt Hotels, Microsoft, and Airbnb, to name a few, were founded during economic downturns.

Incumbents have also achieved impressive growth during downturns. US-based retailer Target managed to deliver growth during each of the last two recessions. In 2000, Target doubled down on growth investments, adding new locations, products, and partnerships that resulted in double-digit growth for sales and profits. In 2008, Target analyzed customer trends and expanded its food offerings to include more fresh meat and produce; the food category has since added billions to annual revenue. In 2020, Target achieved record growth during the COVID-19 pandemic by investing consistently in online services and accelerating its ability to use stores as distribution centers and enable online-order pickups from their parking lots.[2]

The leaders who choose growth and outperform their peers not only think, act, and speak differently but also align around a shared mindset, strategy, and capabilities. In turn, they actively track leading and lagging growth indicators to tie their aspirations to clear and measurable KPIs. They explore and invest in opportunities both within and outside their core business. Their commitment to growth leads them to invest in an appropriate mix of enablers at the right time and scale, and they stay resolutely faithful to their growth vision in the face of unexpected challenges in their business and operating context, even turning disruption to their advantage.

Drawing on McKinsey's extensive research into growth and leadership as well as our experience in partnering with leaders in every sector on sustainable, profitable growth, this article explores what happens when business leaders make and follow through on a purposeful choice to grow.[3] The leader's blueprint for growth shows how subtle changes in thoughts and actions arising from choice can make the difference between sustained standout growth and remaining with the pack.

When a business leader chooses growth, that choice begins to shape behavior, mindset, risk appetite, and investment decisions, creating a growth orientation across the organization. In fact, growth leaders across the C-suite are 70 percent more likely than peers to have growth as their top priority.[4]

Growth-oriented leaders also shape their thinking and actions toward growth over both short- and long-term horizons. They react decisively to shorter-term disruptions that can be turned into opportunities—what we term "timely jolts"—and

[1] Statistics in this section are based on McKinsey's analysis of data from Corporate Performance Analytics by McKinsey and regulatory filings, S&P Global, for the period 2010–19.
[2] Ranjay Gulati, Nitin Nohria, and Franz Wohlgezogen, "Roaring out of recession," *Harvard Business Review*, March 2010.
[3] For more, see Mehrdad Baghai, Stephen Coley, and David White, *The Alchemy of Growth*, New York, NY: Basic Books, 1999; Mehrdad Baghai, Patrick Viguerie, and Sven Smit, *The granularity of growth: How to identify the sources of growth and drive enduring company performance*, New York, NY: John Wiley & Sons, 2007.
[4] Biljana Cvetanovski, Eric Hazan, Jesko Perrey, and Dennis Spillecke, "Are you a growth leader? The seven beliefs and behaviors that growth leaders share," McKinsey, September 26, 2019.

Exhibit 1

Follow this holistic growth blueprint to achieve sustained profitable growth.

1. Set an aspirational mindset and culture	Foster an inclusive and sustainable mindset, set bold, actionable ambitions, and develop a culture championed by all stakeholders	**2.4×** Companies that have successfully adopted growth mindsets are 2.4x more likely to outperform.
2. Activate pathways	**Expand the core** **Innovate into adjacencies** **Ignite breakout businesses**	**97%** Companies are 97% more likely to outperform when they invest in multiple pathways for growth.
3. Execute with excellence	**Lay the foundation** (Growth operating model and dynamic resource reallocation) **Programmatically execute on inorganic opportunities** (Ecosystems, M&A, alliances or joint ventures) **Develop functional capabilities** (eg, marketing, customer experience, sales and channel, digital, innovation)	**3×** Having the right growth-oriented operating models and capabilities delivers 3x more TSR than peers.

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build organizational resilience and agility to respond to change and leverage disruption. These leaders follow a timeless blueprint for growth that flows from mindset into growth pathways and execution (Exhibit 1).

Set an aspirational mindset and culture

C-suite growth leaders share a common series of mindsets and behaviors from their communications to their willingness to learn through failure. Those who display at least three of the five key growth mindsets are 2.4 times more likely to profitably outgrow their peers (Exhibit 2).

The first part of the timeless holistic growth blueprint is to support aspirations with clear targets, milestones, and motivators—creating a North Star that feeds the broader strategic and cultural narrative of the business. Leaders are able to commit their company to action and maintain this focus in the face of timely jolts, inspiring an organization-wide culture that continually seeks out and pursues growth opportunities.

On the other hand, the leader who aspires to growth but underinvests in initiatives or removes funding from growth is one whose actions do not match their aspirations. C-suite leaders who choose growth are much less likely to yield when challenges arise, finding opportunity in headwinds and reasons to innovate where others retreat to conventional defensive playbooks.

A further differentiator of growth leaders is their ability to build organizational buy-in, including from the board and investors. They tend to directly involve the board in their growth planning and they proactively communicate with investors[5] using significant and credible targets to show how the growth plan will generate value. Growth leaders allocate the resources required to achieve goals and

[5] For more, see "Where companies with a long-term view outperform their peers," McKinsey Global Institute, February 8, 2017.

Exhibit 2

Growth leaders set, communicate, and commit to growth consistently and with significant resourcing.

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are more willing to change their operating model to enable growth, if that is what is needed.

Activate the growth pathways

When leaders choose growth and develop the right leadership mindsets and behaviors to support that choice, their natural position is to look for opportunity wherever it exists. Those companies that set growth strategies to address all available pathways to growth are 97 percent more likely to achieve profitable above-peer growth.

The second part of the timeless holistic growth blueprint is activating three pathways: expanding the core business, innovating into new markets and adjacencies, and purposefully pursuing opportunities for breakthrough growth through new-business building or M&A.

The most successful companies are able to balance and sequence these growth choices in response to their changing operating environments, advances in technology, and emerging customer needs and preferences.

Expand the core business

Growth begins with the core, and growth leaders understand the importance of optimizing their current core business. With more than 80 percent of total revenue growth, on average, derived from the core, achieving excellence in current operations is crucial.[6] Some sectors—healthcare, for example—

[6] Statistics in this section are based on McKinsey's analysis of data from Corporate Performance Analytics by McKinsey, regulatory filings, and S&P Global, for the period 2005–19; we have analyzed the 3,000 largest public companies as of 2018 reporting revenues by segment. Total revenue growth split is derived from the summation of the respective company segment revenues in this sample.

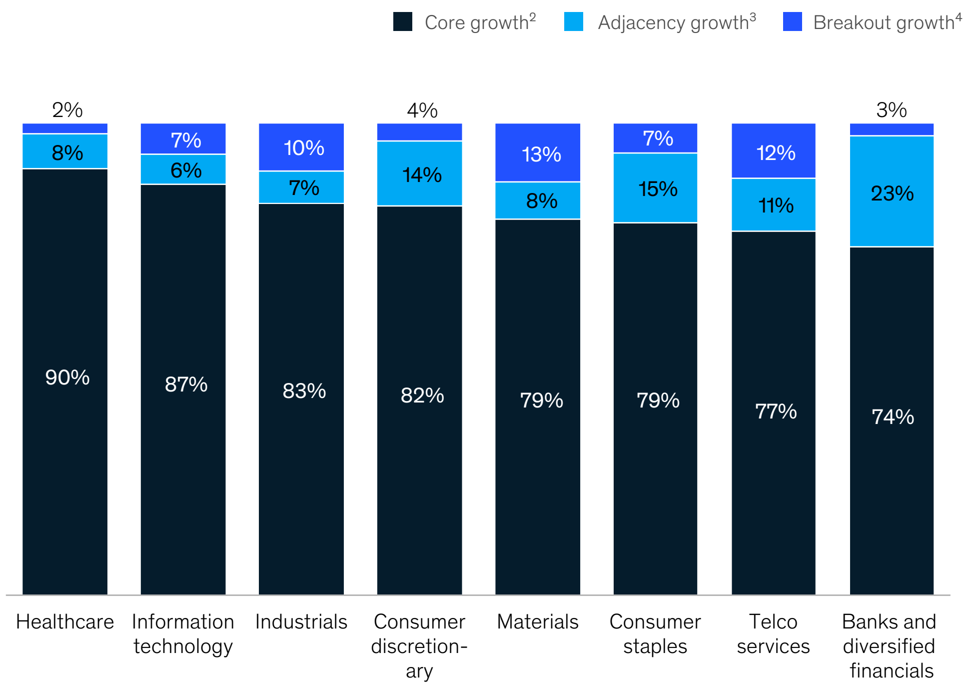
Exhibit 3

Growth begins with the core, but leaders expand beyond the core to drive growth.

Weighted average share of total revenue growth[1]

82%	12%	6%
of revenue growth comes from core growth	of growth comes from adjacency growth	of growth comes from breakout growth

Share of total revenue growth, by industry



[1]Largest 3,000 publicly listed companies by revenue in 2018 with an average revenue of > $1 billion in 2005–09 and reliable business segment data, 2005–09 to 2015–19 (n = 1,797).
[2]Core growth is growth in industry with the largest share of revenue at the start of the analysis period.
[3]Adjacency growth is growth in business segments that are within the subindustries the company is already active in.
[4]Breakout growth is growth into a new subindustry.
Source: Capital IQ; McKinsey Corporate Performance Analytics; Strategy Analytics

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achieve as much as 90 percent of growth from the core business, while others, such as financial services, generate around 74 percent from the core and 23 percent or more from adjacent opportunities (Exhibit 3).

These variations are partly explained by the idiosyncrasies of different industries. For example, healthcare businesses make long-term R&D and capital investments for innovation, but their patents enable them to generate most of their growth within the core. Financial-services companies, on the other hand, tend to be more able to move into adjacent services, with many companies actively making big bets across industry subsectors (for example, investment banks entering wealth management, and vice versa).

Regardless of industry, growth leaders expand their core through a mix of strategic shifts to higher growth pockets (for example, shifting product mix to higher growth value or premium segments and higher growth channels such as e-commerce), innovation around core products and services, and improved executional excellence in their commercial capabilities.

Having a growth mindset is especially important for the core business. Growth outperformers almost always grow their core, through their main products, sectors, or local market. In fact, it is unlikely that they can raise their growth trajectory without winning in their local market.[7] Fewer than one in five of the companies in our sample that had below-average growth rates in their local region managed to outperform their peers in growth.

Whatever the exact mix of strategies and focus areas, growth leaders are maximizing their core through all available means. And they are twice as likely to report having identified pockets of growth within their existing business.

Innovate into adjacencies

Having a strong core is essential. Outperformers build beyond it to achieve their growth aspirations. Businesses that expand into adjacent industries or segments are 20 percent more likely to achieve greater growth than their peers.

The obvious places to look for growth are new geographies and adjacent industries where growth leaders can adapt their existing offerings to serve new customer segments. For example, CVS Health transformed into a consumer-centric, integrated health solutions company by expanding its business from pharmacy and retail to healthcare services, which accounted for 67 percent of the company's revenue growth from 2005 to 2019.

Growth leaders recognize the need to unlock the next wave of growth through expansion beyond the core. However, choosing the best adjacencies is critical. Growth leaders are increasingly harnessing advanced analytics to identify promising or previously overlooked opportunities that leverage core competencies and provide a good chance to establish a strong leadership position. McKinsey research shows that businesses that expand to adjacencies with high similarity to their core and exploit their unique competitive advantages are more likely to profitably outperform their peers on growth.

Outperformers use the full growth blueprint to excel in adjacencies, with a particular focus on strategies that build on core competencies. They use and refresh growth maps to consistently surface opportunities, to understand which are most achievable, and set growth strategies to capture them. They choose among the different avenues to grow adjacently, such as M&A or business building, and they evolve their operating models to support these growth choices.

Growth leaders are also increasingly building ecosystems around their core capabilities and assets and deploying new offerings into adjacent products or markets. Tencent, for instance, has become an Asian tech giant worth around $500 billion through its online platforms that include messaging, gaming, payments, e-commerce and advertising in addition to evolving its social messaging app WeChat into an extensive "super app." Tencent's full ecosystem offering spans fintech, entertainment and media, cab hailing, location sharing, and more, fueling a revenue compound annual growth rate of 28 percent over the decade 2011 to 2021.

Ignite breakout businesses

According to McKinsey research on more than 1,000 business leaders, on average, executives believe 50 percent of their revenues will come from new products, services, or businesses within the next five years. Not surprisingly, many are looking beyond natural adjacencies to exploit entirely new business opportunities. Between 2018 and 2020, "new-business building" doubled its appearances among the top three items on executive agendas.

Expanding into new markets through business building can unlock new opportunities without cannibalizing existing products and services. Done

[7] Defined as the largest region in the portfolio by revenue.

right, the rewards can be well worth the risk, as illustrated by a number of growth leaders across different industries.

Amazon famously expanded beyond its e-commerce business into public cloud services through Amazon Web Services (AWS). By leveraging its core competencies of brand and commercial strength, it built AWS into a business that generated $62 billion in revenue.

Science and technology innovator Danaher Corporation combated the single-digit growth in its core industrial businesses by looking toward high-growth markets in life sciences and niche diagnostics. After testing the waters with small acquisitions and investing heavily in its platforms business, Danaher spun off its old industrial core, Fortive, repositioned life sciences and diagnostics as its new core business—and beat the S&P 500 by 3.8 times between 2002 and 2016. While core growth is critical, investments in breakout opportunities could enable a long-term shift to a new core within a higher-growth market.

Marcus by Goldman Sachs launched its first digital consumer business in 2016, allowing customers to bank from their phones. In the ensuing six years, it has attracted millions of customers, accumulated deposits of more than $92 billion, and made more than $7 billion in loans via a combination of organic growth, acquisitions, and partnerships with Apple and Amazon.

Growth leaders can improve their odds of achieving growth in breakout opportunities by committing to innovation, identifying and understanding the needs and wants of valued customers, and developing the right value propositions to appeal to them. Given the accelerating pace of innovation, growth leaders also look to agile methodologies, strategic alliances, and M&A with a willingness to rapidly test and learn, fail and iterate, and invest in scaling opportunities.

Of course, pursuing breakout growth can require longer-term investment and commitment before seeing returns. That's why growth leaders need the mettle to stay the course and make significant investments—or the sense to know when to call it quits.

Execute with excellence

This is the critical and third portion of the timeless holistic growth blueprint, where strategy meets action and orchestrated execution is the final step in achieving growth. Execution works hand in hand with strategy to empower leaders to make the right choices at the right time to drive both short-term and long-term growth.

Leaders who choose growth support their ambitions by prioritizing a critical set of execution enablers: operating model and resource allocation, ecosystems, M&A, joint ventures and alliances, and functional capabilities.

Built-for-growth operating models and resource allocation

Leaders who fully commit to growth choose these initiatives for purposeful and assertive investment and are 60 percent more likely to regularly reallocate resources from lower-return to higher-return spaces. These leaders fund more dynamically, relying less on historical budgets that can be psychologically "anchoring," and they actively explore how to fuel growth without eroding their existing core businesses.[8]

Alongside this willingness to dynamically reallocate resources, growth leaders are more likely to have multiple tailored operating models to support their unique growth initiatives and opportunities. While the core business may have a distinct, more traditional operating model, breakout opportunities may adopt a more agile, learning-driven operating approach, such as having small, cross-functional teams with the autonomy to focus on rapidly building and testing products, features, or services with customers. They segment their product-development processes and combine standard product-development stage gates for incremental innovations while using venture-capital-inspired stage gates and funding mechanisms for bolder growth projects. This agility helps them respond robustly to timely jolts and opportunities.

[8] Tim Koller, Dan Lovallo, and Olivier Sibony, "Bias busters: Being objective about budgets," *McKinsey Quarterly*, September 28, 2018; Michael Birsham, Marja Engel, and Olivier Sibony, "Avoiding the quicksand: Ten techniques for more agile corporate resource allocation," *McKinsey Quarterly*, October 1, 2013.

In managing performance, growth leaders adopt a growth vocabulary, leveraging the adage “You get what you measure.” They actively track leading and lagging growth-oriented metrics, such as recurring revenue, revenue per customer, and customer-acquisition cost, tying them to organizational goals and incentives.

Strengthen ecosystems, M&A, and joint ventures
Specialization in a sea of sameness is a differentiator. That’s why growth leaders often look outside of their businesses to find quick access to complementary skills and capabilities to buy or scale innovation and growth. Those who do this are 30 to 50 percent more likely to continually scan for these types of alliances, joint ventures, and M&A opportunities.

In recent years, digital M&A has become increasingly popular and effective, accounting for double the share of all M&A value from 2011 to 2021. Businesses are becoming increasingly strategic about how they evaluate and leverage these digital transactions, from acquiring new talent and capabilities to accessing new markets and products.[9] Many companies with programmatic M&A strategies (that is, steadily growing through two or more acquisitions of less than 30 percent of their own market cap per year) have added digital-investment themes to their M&A blueprints. Over almost 20 years of research, it has become clear that programmatic M&A is the only M&A strategy that delivers outsize total shareholder return (TSR). M&A investment themes, especially those on digital M&A, should be highly specific and clearly articulate how they will add value for the acquirer.

Forming ecosystems with partners is another way to build capabilities and expand offerings more quickly, while simultaneously enhancing customer experience and enlarging reach and innovation opportunities across the ecosystem. This creates value along two dimensions: it allows participants to consolidate a range of customers, often across sectors, and to play a pivotal role in optimizing touchpoints in both B2C and B2B.

Functional capabilities
Execution is impossible without the right functional strengths, and growth leaders identify which new functional capabilities are needed—or need to change—to support growth initiatives, both in the short term and over longer-term innovation horizons.

From building out AI and advanced analytics platforms to deepening their customer experience capabilities—and even enhancing or modernizing existing capabilities such as pricing and marketing—growth leaders ensure the organization’s capabilities are positioned to fuel growth. While the exact blend varies by industry and company, a common cross-sectoral focus point is harnessing digital and analytics to revamp distribution, marketing returns, customer value management (CVM),[10] and dynamic pricing.[11]

In distribution, e-commerce is a powerful lever for collecting valuable digital customer data along the purchasing journey and ensuring effective and measurable media spend. Nike, for example, was able to increase its website’s e-commerce platform’s contribution to sales from 7.5 percent to 24.0 percent, thereby fuelling a compound annual growth rate of 6.7 percent from 2017 to 2021, a time frame that includes the height of the pandemic.[12]

For CVM, investing in greater personalization through advanced analytics and digital capabilities can improve both the customer experience and client lifetime value. American Express, for instance, leverages advanced analytics to provide customized recommendations to customers based on their location, opening additional transaction opportunities both for their partners and for their own credit cards.

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[9] Michael Bogobowicz, Anika Pflanzer, Leandro Santon, and Brett Wilson, “How to find and maximize digital value in any M&A deal,” McKinsey, November 9, 2020; CapitalQ; McKinsey analysis.
[10] CVM is a systematic approach to working with loyal customers. It is based on personalized offerings targeted to meet particular customer needs, created using advanced analytics, and aimed at increasing lifetime customer value through raising purchasing frequency and average basket size.
[11] Rachel Diebner, David Malfara, Kevin Neher, Mike Thompson, and Maxence Vancauwenberghe, “Prediction: The future of CX,” *McKinsey Quarterly*, February 24, 2021; Ralph Breuer, Kedar Naik, Bogdan Toma, and Martina Yanni, “Executive quick take: A guide to implementing marketing-and-sales transformations that unlock sustainable growth,” McKinsey, September 23, 2019; Matt Deimund, Michael Drory, Daniel Law, and Maria Valdivieso, “The five things sales-growth winners do to invest in their people,” McKinsey, October 9, 2018; Minti Ray, Stefano Redaelli, Sidney Santos, Jared Sclove, and Andrew Wong, “Accelerating revenue growth through tech-enabled commercial excellence,” McKinsey, December 4, 2019.
[12] Statista, ecommerceDB, and S&P Capital IQ.

Greater analytical sophistication enables companies to differentiate pricing across dimensions such as region, channel, and customer life cycle.[13] A leading Asian e-commerce company was able to increase gross margins by ten percentage points and gross merchandise value by three percentage points by developing a dynamic pricing capability.[14]

Commercial capabilities are bolstered by investments in digital—in fact, growth leaders are 60 percent more likely to have successfully used AI and advanced analytics to predict customer behaviors and become a "sensing and predicting" organization. Growth leaders also tend to invest in expanding and deepening their customer experience capabilities to streamline and personalize customer journeys.

Beyond the commercial excellence, growth leaders map R&D and product development portfolios, balanced across incremental innovations and bolder long-term breakout initiatives with clear mapping to the capabilities needed to execute. Tangentially, it is imperative to ensure that growth leaders are investing in their people, creating a pipeline of talent that will help strengthen and broaden the tools needed to achieve their growth aspirations.

Choosing to grow: the subtle difference between success and failure

The growth blueprint defines the timeless elements on which leaders need to focus diligently once they've made a deliberate and purposeful choice to grow. This blueprint prepares an organization to grow in the face of timely jolts.

The blueprint encourages leaders to answer a series of clear questions:

— Am I setting the right aspiration, mindset, and culture to encourage growth? Are my ambitions high enough, and how can I ensure my organization has the full potential to achieve them?

— Am I actively choosing growth opportunities across my core and adjacencies?

— Am I establishing the right enablers to execute against my growth aspirations and strategies?

— Do I have the right operating model and resource allocation to achieve my growth ambitions?

— And am I investing in the right functional capabilities?

The choices leaders make in response to these questions differentiate those who achieve growth from those who aspire to it but don't get results.

Take two leaders of similar-sized businesses operating in the same market. Both see an opportunity for growth and pursue it, but their outcomes are very different. Why?

The one who made a choice to grow aligned their board and leadership team on the company's direction and dedicated the necessary resources to growth. They adapted the operating model for the long term and understood the risk profile of the new businesses they were trying to build. They invested meaningfully in building the right functional capabilities, sometimes at the expense of a few quarters of earnings, to achieve their long-term growth aspirations.

The other leader, who didn't explicitly "choose growth," also did a lot of things right. They hired the right talent and took the time to understand the new businesses they wanted to build. They believed they were allocating enough resources to growth, but ultimately their focus was divided by an emphasis on quarterly earnings and short-term profitability. Though they aspired to growth, they didn't have the long-term strategy or commitment to achieve it. They tried to protect the management team so they could meet their short-term goals but didn't secure buy-in from the board for long-term growth initiatives.

[13] Claus Heintzeler, Mathias Kullman, Karin Lauer, and Maximilian Totzauer, "Pricing and promotions: The analytics opportunity," McKinsey, June 28, 2021.
[14] Gadi BenMark, Sebastian Klapdor, Mathias Kullmann, and Ramji Sundararajan, "How retailers can drive profitable growth through dynamic pricing," McKinsey, March 27, 2017.

Making the conscious choice to grow creates powerful momentum that orients the entire business toward that goal, from the C-suite to frontline employees. The growth blueprint defines the timeless elements on which leaders need to focus diligently once they have made a deliberate and purposeful choice to grow. It also prepares an organization to unlock growth opportunities in timely jolts. The clarity of purpose and vision that comes from choice is what helps leaders and their teams believe in the seemingly impossible and make it happen.

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The triple play: Growth, profit, and sustainability

Revenue growth is good. Profitable growth is better. Profitable growth that advances ESG priorities is best. Here's how outperformers who actively choose growth deliver the growth trifecta.

This article is a collaborative effort by Rebecca Doherty, Claudia Kampel, Anna Koivuniemi, Lucy Pérez, and Werner Rehm, representing the views of McKinsey's Strategy & Corporate Finance and Sustainability Practices.

Consistent and profitable growth has been hard to achieve since the global financial crisis, making it critical for companies to explicitly choose growth in their mindsets, pathways, and execution capabilities.[1] Many executives believe making that growth sustainable and inclusive requires inscrutable trade-offs, forgoing revenue and profit for the sake of society and the planet.[2] That is not always the case. Our new analysis indicates financially successful companies that integrate environmental, social, and corporate governance (ESG) priorities into their growth strategies outperform their peers—provided they also outperform on the fundamentals. The message is clear: not only can you do well while doing good—you can do better.

We looked at TSR, financial performance, and ESG ratings of 2,269 public companies, separating them into industry outperformers and underperformers along the axes of ESG scores, annualized revenue growth, and economic profit (see sidebar "Our methodology"). The analysis shows that companies that achieve better growth and profitability than their peers while improving sustainability and ESG outgrow their peers and exceed them in shareholder returns.[3] These "triple outperformers" delivered 2 percentage points of annual TSR above companies that only outperformed on financial metrics (and 7 percentage points above the rest of the dataset), suggesting that a strong ESG commitment adds additional shareholder value for companies that also exceed their peers in growth and profitability (Exhibit 1).[4]

Our methodology

We based our research on ratings data from S&P Capital IQ and S&P Global ESG. We limited the analyses to the period between the start of 2017 and the end of 2021. While such a short period entails limitations in TSR analysis, we chose it because little environmental, social, and governance (ESG) data is available for earlier years, and rating agencies rerate companies for up to five years back. We examined the performance of global companies for which we could obtain the complete data set—revenue, economic profit, TSR, and ESG ratings—for every year in that time frame.

For each company, we calculated excess revenue CAGR, excess economic profit margins, excess TSR, and excess ESG rating improvement (measured as ESG rating improvement less regional and industry peer median). We considered as ESG outperformers both companies with excess ESG rating improvement and those with ESG ratings above 85 in the first year of the analysis that further improved their rating during the period under study. The analyses relied on median values to guard against the impact of outliers. Values presented in the article (excess TSR, revenues, and economic profit) are annual.

We separated the total set into outperformers and underperformers in each region and approximately 20 industries along the axes of ESG performance, revenue growth, and economic profit. Of the total sample of 2,269 companies, 296 companies were categorized as "triple outperformers," while 233 companies outperformed their peers in growth and economic profit but lagged in ESG.

We consider ESG ratings the best available measures to assess companies' ESG performance. However, correlating ESG action with market and balance sheet performance entails limitations today, including data scarcity, especially prior to 2017; divergent ESG rating metrics that affect the correlation between scores; and fixed zero-to-100 scales for ratings.

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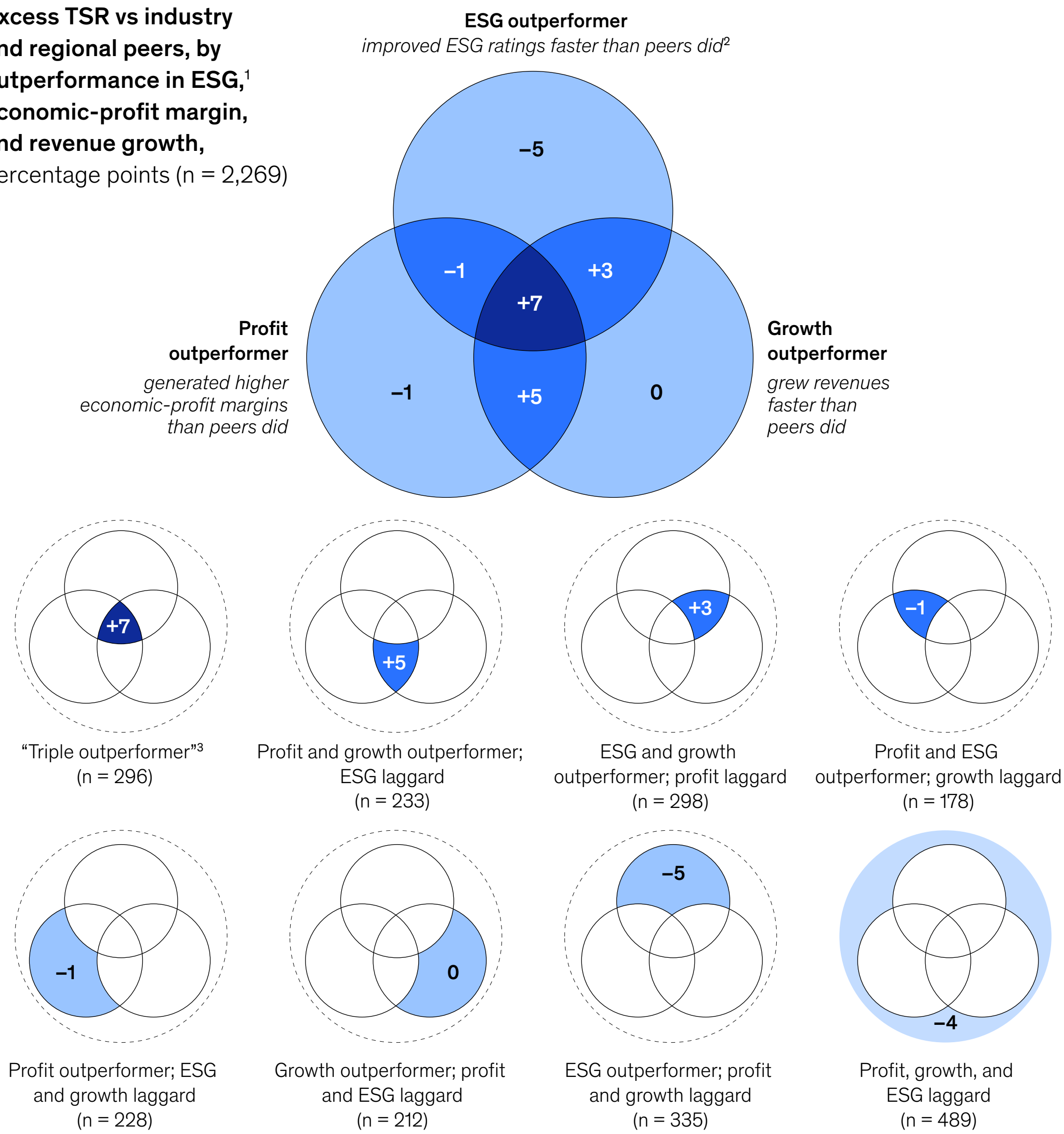
[1] "Choosing to grow: The leader's blueprint," McKinsey, July 7, 2022.
[2] Bob Sternfels, Tracy Francis, Anu Madgavkar, and Sven Smit, "Our future lives and livelihoods: Sustainable *and* inclusive *and* growing," *McKinsey Quarterly*, October 26, 2021.
[3] Improved sustainability and ESG evidenced by companies' ESG ratings improving faster than regional industry medians. Study data relies on S&P Global ESG ratings. Economic profit margin and revenue growth margin in excess of regional industry peers was measured by average economic profit margins. Economic profit is total profit after subtracting the cost of capital.
[4] Our analyses focus on the 2017–21 time frame given limited availability of ESG data for earlier and later years.

Exhibit 1

Outperformance in environmental, social, and governance seems to boost outperformance but not compensate for underperformance in profit and growth.

Excess TSR vs industry and regional peers, by outperformance in ESG,[1] economic-profit margin, and revenue growth, percentage points (n = 2,269)



[1]Environmental, social, and governance.
[2]Company's change in S&P Global ESG score between 2017 and 2021 was above industry and regional peer average or company had a 2017 score ≥ 85 and an absolute-score improvement.
[3]Companies that outperformed their peers in ESG rating improvement, profit margin, and revenue growth.
Source: S&P Global ESG scores, 2017–2021; Corporate Performance Analytics by McKinsey; McKinsey analysis

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Importantly, excelling at ESG does not compensate for poor growth and profitability. For example, growth and profit laggards that only outperformed on ESG measures underperformed peers by five percentage points of TSR. In other words, ESG is not a panacea—it won't save an underperformer with a flawed strategy. Additionally, the analysis does not imply that capital markets give valuation premiums to triple outperformers, only that those companies outperformed on financial metrics.

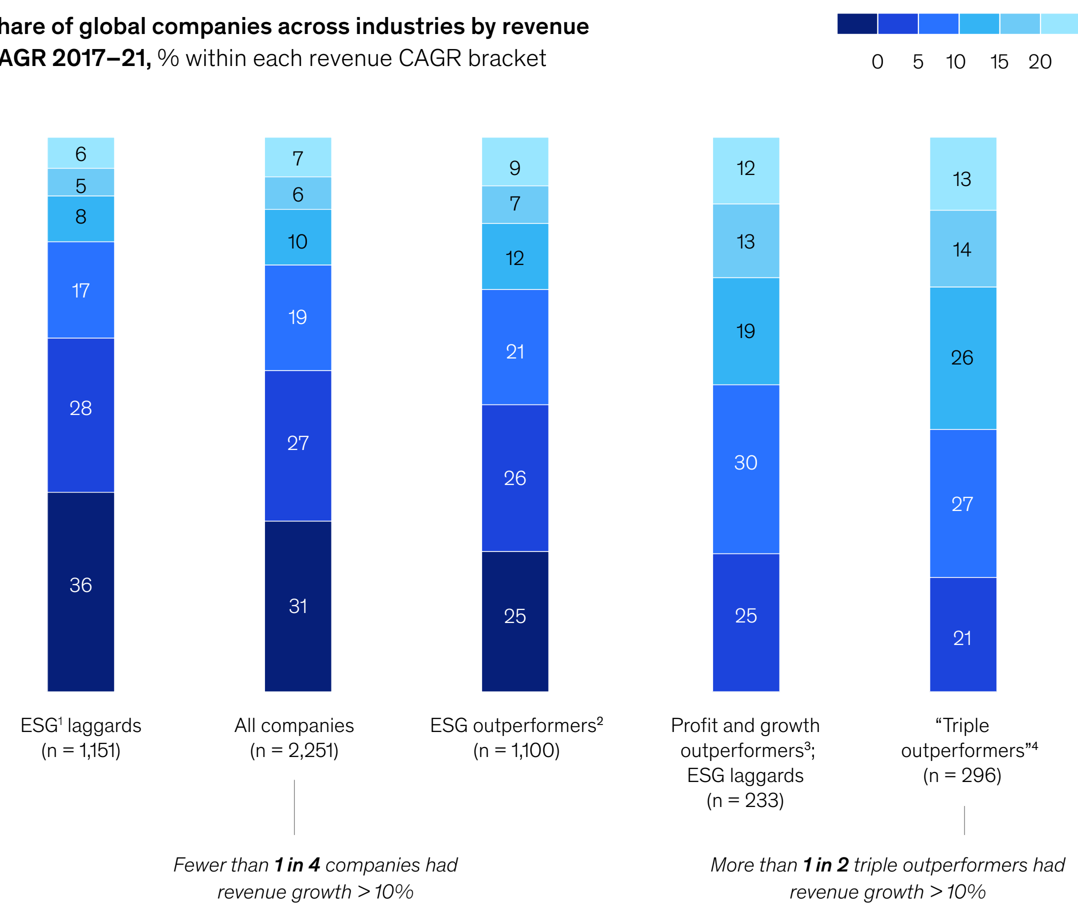
Revenue + economic profit + ESG progress = outsize returns

Strong growth has been elusive over the past 15 years, with the world's largest companies growing at half the rate they did before 2008.[5] Between 2017 and 2021, fewer than one in four companies in our sample achieved more than 10 percent revenue growth annually. Triple outperformers fared much better, however, as more than half grew by 10 percent or more (Exhibit 2).

Exhibit 2

'Triple outperformers' are more than twice as likely to grow revenues by more than 10 percent.

Share of global companies across industries by revenue CAGR 2017–21, % within each revenue CAGR bracket



Note: Figures may not sum to 100%, because of rounding.
[1]Environmental, social, and governance.
[2]Companies with a change in S&P Global ESG Score between 2017 and 2021 that was above industry and regional peer average or companies that had a 2017 score ≥ 85 and absolute-score improvement.
[3]Companies that generated higher economic-profit margins and grew revenues faster than peers did.
[4]Companies that were ESG, profit, and growth outperformers.
Source: S&P Global ESG scores, 2017–21; Corporate Performance Analytics by McKinsey; McKinsey analysis

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[5] Chris Bradley, Rebecca Doherty, Nicholas Northcote, and Tido Röder, "The ten rules of growth," McKinsey, August 12, 2022.

Triple outperformers increased their revenues at a median rate of 11 percent per year—1.4 percentage points higher than the median achieved by profitable growth outperformers that lagged on ESG. Triple outperformers also exceeded profitable growth outperformers in median excess TSR by 2.5 percentage points.

The timeless principles of shareholder value creation hold: ESG efforts ultimately have to show up in financial performance to create outsize returns. The importance of actively choosing to grow by adopting the right mindset, strategy, and capabilities also continues to be essential: If you can grow profitably as a sustainability leader, the market will reward you for this growth. A recent McKinsey analysis, for example, shows that chemical players with low-carbon product portfolios or high exposure to end markets supporting sustainability grew their shareholder returns at more than double the rate of sustainability laggards between 2016 and 2021.[6] Similarly, mining players tapping into the growth opportunities associated with rising lithium demand from green technologies are getting a positive market reception.

It's important to note that not all industries' registered shareholder returns correlated with ESG-rating improvements during our study's time frame, and some of the gains may be affected by the current downturn (see sidebar "Impact of the recent market correction"). The biggest shareholder gains accrued to triple outperformers in basic materials, advanced electronics, and the financial sector, likely due to shifting consumer preferences that supported "green premiums" and lowered risk around regulations and carbon-related costs. On the other hand, high tech and retail have not been able to realize benefits from strong ESG rating improvements—yet. Industry dynamics and the COVID-19 crisis (producing growth for high tech but a slump for retail) might have outweighed ESG effects in these sectors. We believe, however, that the ESG performance bar is rising rapidly across sectors and regions. Furthermore, merely keeping pace with your industry does not deliver market premiums—investors reward companies that improve their ESG ratings faster than peers in addition to outperforming on other dimensions.

How to make the growth triple play

So how do triple growth outperformers manage that feat? They tend to be guided by five principles: integrating growth, profitability, and ESG into the core strategy; innovating ESG offerings to drive value creation; using M&A to rapidly capture ESG growth pockets; tracking and reporting ESG and related data transparently; and embedding strategic priorities in the organizational DNA.

Impact of the recent market correction

With increased uncertainty and stock markets declining between January and June 2022, we expected that gains accrued by environmental, social, and governance (ESG) leaders might have eroded due to short-term performance pressures. While the full sample's excess TSR decreased during the recent downturn, we found that markets continued to value ESG leadership. Outperformers in revenue growth alone during the 2017–21 period saw their excess TSR advantage over peers drop by one percentage point to 3 percent in the 2017 to June 2022 time frame. For profitable growth outperformers, their 6 percent edge over peers in 2017 to 2021 decreased to 4 percent in the 2017 to June 2022 period. Triple outperformers' excess TSR of 7 percent, meanwhile, declined by two percentage points when we extended the analysis to the end of June 2022, but these companies still delivered higher returns than either revenue outperformers or profitable growth outperformers.

[6] "Chemicals and capital markets: Growing sustainably," McKinsey, April 22, 2022.

Integrate growth, profitability, and ESG into the core strategy. Top performers don't pursue ESG-related initiatives on the side but integrate them into the overarching corporate strategy alongside growth and profitability. Consider the example of a metals and mining triple outperformer that has focused its strategy and investments on decarbonization as a way to fulfill all three objectives. The company divested its coal-based business and shifted toward materials supporting the energy transition. To raise top-line growth, it set up a ring-fenced budget for investments in green aluminum, green steel, carbon-capture solutions, and other fast-growing markets. In parallel, it undertook multiple initiatives on the social dimension aimed at reducing the risk of regulatory and legal interventions while improving employee productivity. For example, it implemented a plan to create a safer, more inclusive work environment and addressed its local impact through agreements with Indigenous people and local communities.

Innovate ESG offerings to drive value creation. Triple outperformers often operate on the cutting edge of innovation, both in what they do and how they do it. Many focus their innovation efforts primarily on top-line growth by developing offerings to better meet customer needs—and, where possible, serve emerging demand grounded in ESG.

That can involve creating solutions for business customers to help those clients meet their own ESG-related customer or regulatory needs. One European transport and logistics provider, for example, turned to innovation to help it capture the ESG lead in its industry as the topic was gaining stakeholder attention. It opted to focus on helping its customers reduce the carbon footprint in their supply chains. The company created an innovation hub to guide global initiatives and set up a technology trend tracking mechanism to stay abreast of emerging technologies. It is also collaborating with external sustainability, digitization, and innovation experts to develop solutions customized to its customers' supply chain challenges. This investment has produced new premium-priced offerings for carbon reporting and offsetting, sustainable fuel, and supply chain design and optimization, significantly boosting its revenue. As a result, the company has translated its industry first-mover advantage on ESG into 20 percent higher annual revenue growth than its peers while also realizing 20 percent annualized excess TSR since 2017.

Use M&A to capture profitable ESG growth pockets at an accelerated pace. Programmatic M&A can accelerate companies' entry into new areas of growth.[7] Successful players have tended to look for underserved adjacent growth pockets and allocate ring-fenced funds to capture these opportunities. Many triple outperformers go a step further by integrating ESG criteria alongside existing financial and market criteria into their evaluation of potential adjacencies and M&A target selection.

One multinational cosmetics company, for example, developed a reputation for a high focus on sustainability and inclusion by shifting its asset portfolio toward ESG-oriented offerings. Over a decade, it acquired a dozen innovative firms, adding both luxury brands that offer sustainable, inclusive products and services and expanding into new areas such as women's health tech. By leveraging synergies between the brands, it captured growth pockets both within its core business and in adjacent segments. In the process, the company's ESG ratings soared by 39 percentage points during the period of our study, and investors boosted its shareholder returns by 25 percent per year above its industry average.

Report and communicate transparently. We often hear business leaders express frustration that capital markets fail to recognize and reward their companies' investments in initiatives with longer time horizons, which is often true for ESG-related growth ventures. While there are numerous reasons why that may be the case, rigorous reporting and proactive communication to the investment community of how these initiatives boost value,

[7] "How one approach to M&A is more likely to create value than all others," *McKinsey Quarterly*, October 13, 2021.

along with the targets and progress, are critical to gaining those rewards. Communication alone will not drive value, but transparency can accelerate investors' recognition of future potential. Once a company has set clear and ambitious goals, it needs to continuously demonstrate where the value comes from and show strides on related initiatives—with external validation where possible—for progress to be credible in consumers' and investors' minds.

For example, one European software provider created a user-friendly interactive tool that publicly tracks its progress on key ESG metrics alongside its financial performance. The dashboard is particularly robust in tracking the "S," or social, dimension, which the company has prioritized. For example, the gender ratios of its workforce can be viewed not only by seniority but also by the number of part-time versus full-time workers and permanent versus temporary workers. A multinational automotive technology supplier, meanwhile, continually reinforces the link between its technology and sustainability strategy to external stakeholders, closely tying its sustainability and ESG goals to strategic objectives such as market growth, productivity, and customer satisfaction.

Embed strategic priorities in the organizational DNA. Triple outperformers translate their high-level growth, profitability, and ESG strategies into concrete initiatives that form part of the new corporate strategy. Management teams set out clear responsibilities, performance metrics, and targets and measure them rigorously. They also reallocate their resources toward these new opportunities and ensure that internal processes encourage business leaders to integrate the relevant criteria—including ESG—into their decisions.

For example, a global shipping player that achieved triple outperformance ensured its strategy was fully embedded into the organization. The company set up committees at all levels, from the board of directors to operations, to holistically assess the most metrics, including growth, profitability and ESG. Additionally, the organization linked remuneration to key ESG targets and built partnerships with customers to codevelop new green solutions. Its strong focus on governance has not only helped it to increase revenue growth but also to optimize cost and prepare for potential legislative interventions, such as carbon emissions taxes.

While ESG performance measurement is still evolving, the direction of travel is clear, and action is needed now. Leaders need to take a long-term perspective and have the courage to invest in sustainable and inclusive growth that delivers revenue, economic profit, and shareholder returns.

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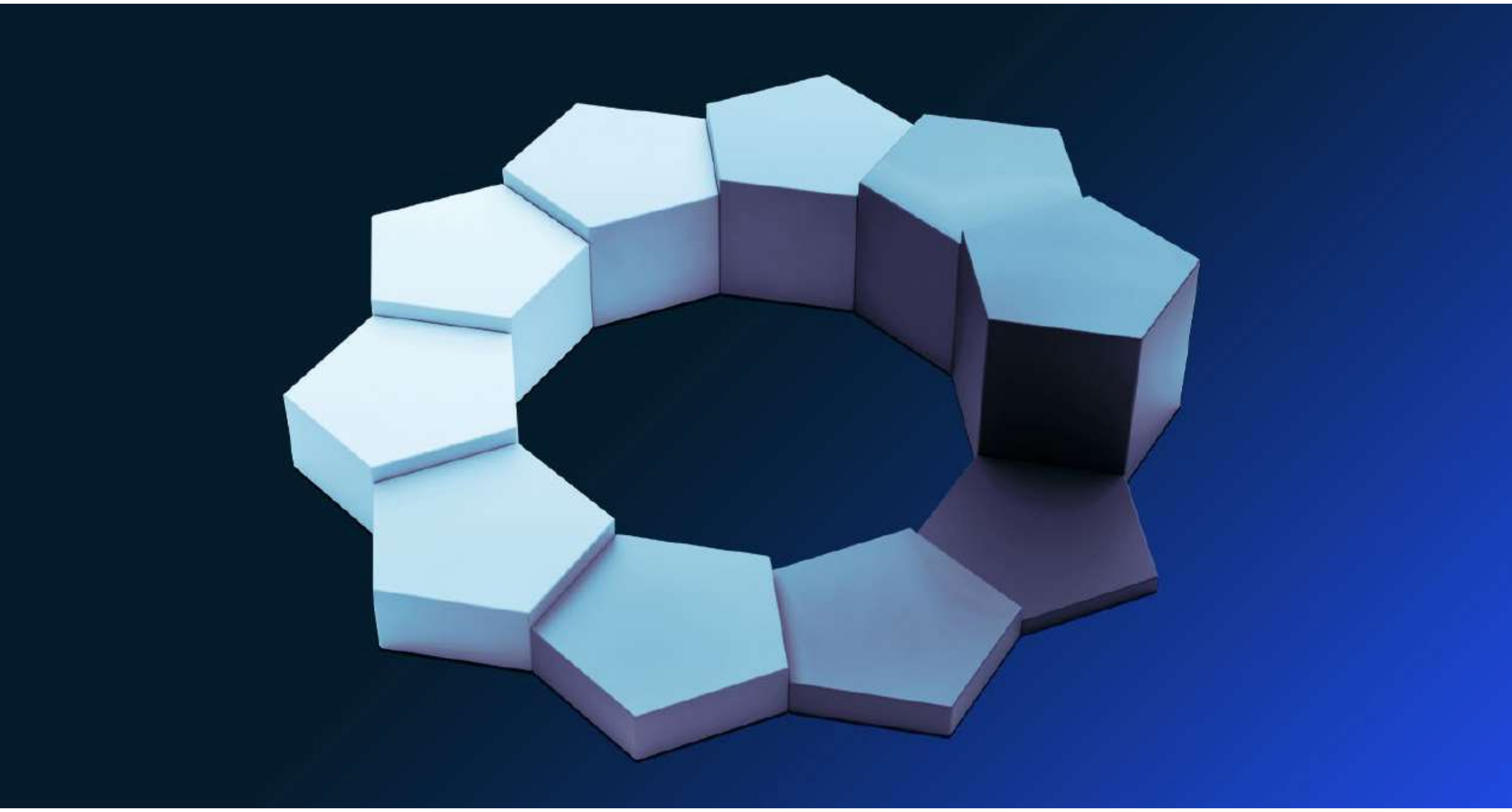
The ten rules of growth

Empirical research reveals what it takes to generate value-creating growth today.

by Chris Bradley, Rebecca Doherty, Nicholas Northcote, and Tido Röder



One of the surest signs of a thriving enterprise is robust and consistent revenue growth. That has not been easy to accomplish over the past 15 years. Corporate growth slowed dramatically after the global financial crisis, with the world's largest companies growing at half the rate they did before 2008. Furthermore, increases in capital investments outstripped revenue expansion, compressing returns. Now, with a slowing global economy, rising inflation, and geopolitical uncertainty, growth that delivers profits and shareholder value may become more elusive still.

To buck these trends, business leaders need to follow a holistic growth blueprint consisting of three core elements: a bold aspiration and accompanying mindset, the right enablers embedded in the organization, and clear pathways in the form of a coherent set of growth initiatives. To help our clients identify these pathways, we conducted an in-depth study of the growth patterns and performance of the world's 5,000 largest public companies over the past 15 years.[1]

The research reaffirmed that revenue growth is a critical driver of corporate performance. An extra five percentage points of revenue per year correlates with an additional three to four percentage points of total shareholder returns (TSR)—the equivalent of increasing market capitalization by 33 to 45 percent over a decade. Firms that managed to grow faster and more profitably than their peers during our study period did even better, generating shareholder returns six percentage points above their industry averages.

However, relatively few companies could boast such results. A typical company grew at a measly 2.8 percent per year during the ten years preceding COVID-19, and only one in eight recorded growth rates of more than 10 percent per year (Exhibit 1).

Healthy growth has also been hard to sustain. When we compared our sample's performance in the first half of the last decade with the second half, only one in three companies that were in the top quartile of growth between 2009 and 2014 managed to maintain that rate in the subsequent five-year period. Among companies that grew predominantly organically, the rate was even lower, at one in four. This suggests a strong tendency for growth to revert to the mean.

Ten rules of value-creating growth

To understand how organizations can try to overcome these obstacles, we studied the growth patterns of the sample companies through various lenses. Our findings suggest ten imperatives that should guide organizations seeking to outgrow and outearn their peers.

1. *Put competitive advantage first.* Start with a winning, scalable formula.

2. *Make the trend your friend.* Prioritize profitable, fast-growing markets.

3. *Don't be a laggard.* It's not enough to go with the flow—you need to outgrow your peers.

4. *Expand your core.* Focus on growth in your core industry—you can't win without it.

5. *Look beyond the core.* Nurture growth in adjacent business areas.

6. *Grow where you know.* Focus on growing where you have an ownership advantage.

7. *Be a local hero.* Commit to winning on the home front.

8. *Go global if you can beat local.* Expand internationally if you have a transferable advantage.

9. *Acquire programmatically.* Combine healthy organic growth with serial acquisitions.

10. *It's OK to shrink to grow.* Ruthlessly prune your portfolio if you need to.

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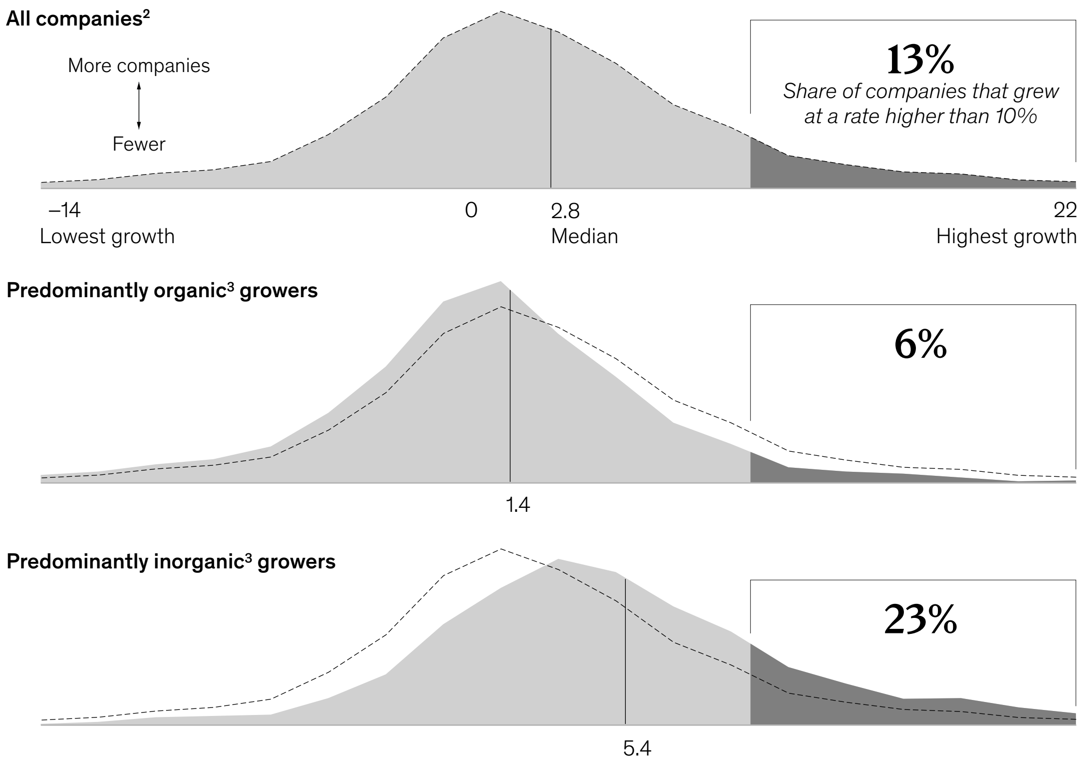
[1] Our sample consisted of the 5,000 largest publicly listed companies by revenue globally in 2019. Companies with unreliable or missing segment data were excluded from the sample. We studied the performance of these companies from 2005 to 2019, the 15 years prior to the COVID-19 crisis.

Exhibit 1

Growth is hard for companies to achieve.

Companies by revenue growth and growth approach, 2009–19, CAGR[1] %



[1]Nominal growth in dollars.
[2]Largest 5,000 publicly listed companies by revenue in 2009 with revenue and goodwill data from 2009 to 2019; 3,931 companies charted.
[3]Companies were classified as inorganic or organic growers, based on their M&A deal data, with organic defined as < 1% of market capitalization acquired from 2010 to 2019. Companies with missing deal data were classified based on their net positive change in goodwill relative to starting invested capital (< 15% = organic). Of the companies in the analysis, 59% were classified as organic growers, 41% as inorganic growers.
Source: Corporate Performance Analytics by McKinsey; regulatory filings; S&P Global; Strategy Analytics by McKinsey

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We have quantified what it takes to master each rule, as well as the extent to which excelling at each improves corporate performance. The resulting "growth code" allows you to benchmark your growth performance and set the bar for your next strategy. The more rules you master, the higher your reward. But the bar is high—fewer than half of the companies in our sample excelled at more than three of the ten rules, and only 8 percent mastered more than five (Exhibit 2).

Put competitive advantage first

A high return on invested capital (ROIC) indicates a business model powered by a competitive advantage. Companies that generate stronger returns attract and deploy more capital, a virtuous cycle that enables them to grow faster and generate still higher returns (Exhibit 3). While some firms forgo profits for a time in pursuit of growth (with Amazon being perhaps the best known), the far more typical, and practical, approach is to establish a distinctive business model and then scale it.

For example, a department store chain had a business model—brand-name bargains in stores with low inventories and costs—that in 2007 delivered 5 percent higher ROIC than its cost of capital. The management team used this advantage to expand the store network from approximately

900 locations that year to more than 1,500 in 2019. As a result, revenue grew by 9 percent per year and the company generated an impressive 29 percent in annual shareholder returns.

Make the trend your friend

This age-old axiom holds especially true today as the acceleration of pre-COVID-19 trends widens the gap between corporate winners and laggards. Over the past 15 years, companies that expanded in ways that maintained or increased their exposure to fast-growing, profitable segments generated one to two percentage points of additional TSR annually. This suggests that organizations already in attractive markets should keep investing to stay ahead of the pack. Firms facing market headwinds, on the other hand, may need to aggressively reallocate their resources toward tailwinds, potentially staging large-scale pivots.

The selection of markets needs to be precise, however. In their best-selling book, *The Granularity of Growth*, our colleagues observed that many "growth" sectors have sluggish subindustries, while relatively "mature" sectors include rapidly growing segments. Take the telecommunications services industry, which grew at 1.6 percent per year over the period of our analysis. The fastest-growing company in the sector increased its revenues by 21 percent annually, while the slowest contracted by 9 percent per year. This dichotomy reflects the influence of acquisitions and divestitures, as well as portfolio choices—that is, varying degrees of exposure to segments with different rates of growth. The cloud services category is growing faster than voice services, for example, and the growth rates of each category vary widely by country.

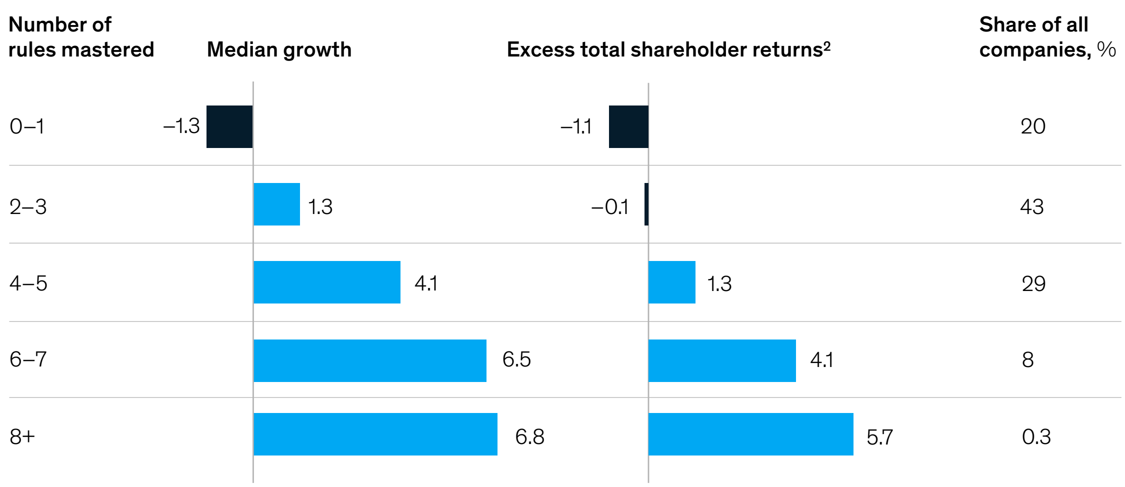
Don't be a laggard

Outgrowing your industry implies a strong business model—an advantage rewarded by capital markets whether you're in a fast- or slow-growing industry. Furthermore, companies that manage to win market share away from competitors are likely to beat the growth expectations reflected in their share price, unlocking even stronger returns.

Exhibit 2

The more rules you master to create growth for your organization, the better.

Revenue growth and shareholder returns by rules mastered, 2005–09 to 2015–19,[1] CAGR %



[1]Largest 3,000 publicly listed companies by revenue in 2018 with an average revenue of > $1 billion in 2005–09, a reliable business segment, and TSR data; 1,621 companies charted.
[2]Excess total shareholder returns calculated as the company's annual shareholder returns less the median return in its primary industry.
Source: Corporate Performance Analytics by McKinsey; regulatory filings; S&P Global

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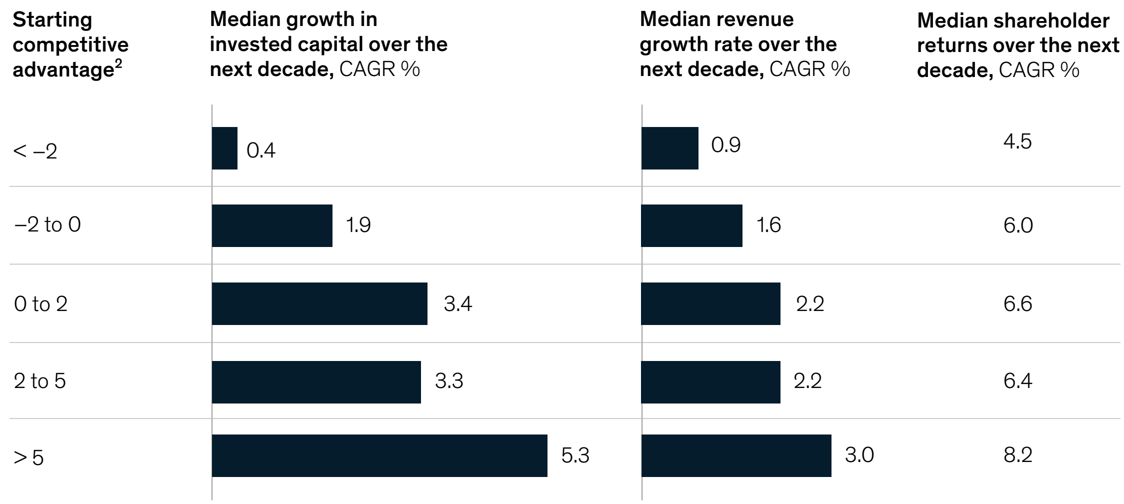
Exhibit 3

Markets reward strong business models.

Invested capital growth and shareholder returns by competitive advantage, 2005–09 to 2015–19,[1]
CAGR %



[1]Largest 3,000 publicly listed companies by revenue in 2019 with an average revenue of > $1 billion in 2005–09, a reliable business segment, and TSR data; 1,621 companies charted.
[2]Average return on invested capital less weighted average cost of capital in 2005–09, a proximate measure of competitive advantage or economic surplus captured by the company. Shown in percentage points.
Source: Corporate Performance Analytics by McKinsey; regulatory filings; S&P Global

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Consider this tale of two retail companies, both of which grew at 4 percent a year between 2007 and 2017 but in different segments. A home-improvement retailer achieved its growth in a category that grew at 3 percent annually, and the company generated annual TSR of 17 percent. A sports apparel company, in contrast, was outpaced in growth by its segment peers by one percentage point annually, and its shareholder returns were more lackluster at 1 percent per annum. While many factors could have affected these two companies' stock price aside from their growth rates, our analysis suggests that outgrowing your industry is worth, on average, an additional five percentage points of shareholder returns per year. Among companies that managed to achieve this while being more profitable than their peers, this figure was one percentage point higher still.

Expand your core

When developing a growth strategy, often the first question on a CEO's mind is, "Where should that growth come from?" To help find the answer, we categorized revenue increases among our sample companies into growth within the core industry (their largest industry segments at the start of the study period), in secondary industries (smaller but still significant revenue contributors in the first year of our time frame), and in new industries (segments where the companies did not initially have a presence).

This decomposition reinforced the importance of a healthy core business. Put simply, it is improbable that you can achieve strong growth if the core isn't flourishing. Only one in six of the companies in our data set with core-segment growth rates below their industry median managed to achieve overall corporate growth rates above those of their peers. Therefore, finding a way to unlock growth in the core needs to be a top priority. For some organizations, this may require a wholesale revamp of the operating model. Others may need to identify granular pockets with growth potential in their existing markets or new ones and reallocate resources to them from more stagnant segments.

Look beyond the core

Our study found that, on average, 80 percent of growth comes from a company's core industry and the remaining 20 percent from secondary industries or expansion into new ones (Exhibit 4). However, these figures varied among sectors during our study period. For example, industrial companies generated a full third of their growth from new industries, while utilities consolidated toward their core business areas more than other sectors.

Companies that grew into adjacent industries generated, on average, an extra 1.5 percentage points per year of shareholder returns above their industry peers. One such company was a global automotive tire supplier that diversified into brake and safety system technology, powertrains, and vehicle connectivity and information systems. Together, these segments now account for approximately 75 percent of the company's total revenue, and its growth exceeded that of its peers by 2.4 percentage points per year. But examples of this strategy abound. The current transition to net-zero carbon emissions, for instance, presents many promising opportunities for companies in chemicals, construction, and other industries to expand into fast-growing adjacencies such as recycled plastics, sustainable construction materials, or meat substitutes, as demand for their legacy products declines.

For companies with fast-growing core businesses, expanding into new areas can help position their portfolios ahead of future trends. Those with slow-growing cores, on the other hand, can use adjacent businesses to offset slow growth elsewhere.

Grow where you know

As we saw, diversifying into adjacent segments can be a valuable growth strategy, but how similar should these segments be, both to the core and to each other? We used a simple measure: industries are similar if they often appear together in corporate portfolios (for example, cable and satellite together with broadcasting, or aerospace and defense with industrial machinery).

Our analysis shows that companies growing in a way that increases the similarity of their portfolios earn, on average, an additional one percentage point of TSR per annum. Those that expand into new industries can expect an additional two percentage points if the new industry is similar to their core (Exhibit 5).

Why does similarity matter so much? We believe it is a proximate measure of whether a company is a natural (or best) owner of an asset and thus able to generate optimal value from owning or operating the business. This value could derive from synergies with other businesses the company owns, distinctive technical or managerial capabilities, proprietary insights, or privileged access to capital or talent. Take the example of General Mills' purchase of Pillsbury from Diageo. There was little overlap between Diageo's core business and Pillsbury's, while Pillsbury's and General Mills' businesses share many of the same competencies and assets. This enabled General Mills to reduce costs in purchasing, manufacturing, and distribution, and thereby to raise operating profit by roughly 70 percent.

Be a local hero

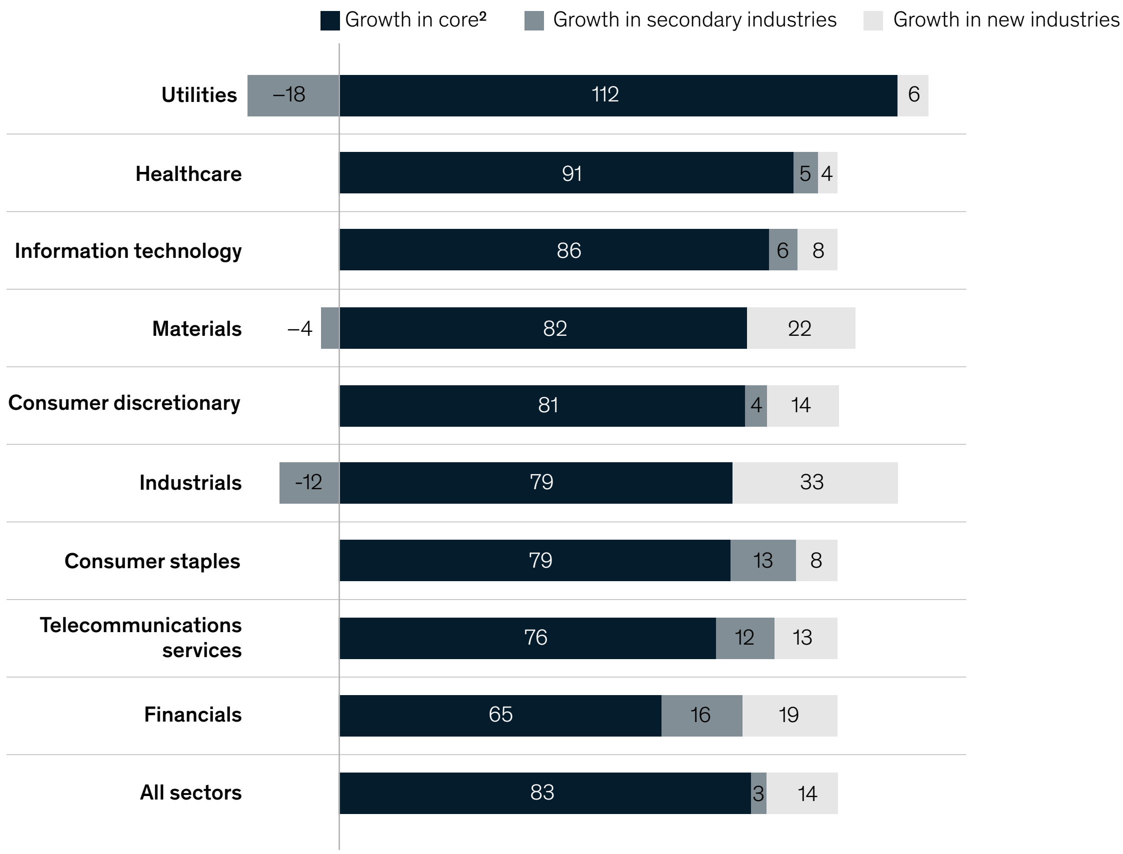
Industry (along with moves up and down the value chain) is only one aspect of the "where to grow" issue. The other is geography. Just as it is hard to achieve overall growth if your core business isn't thriving, it is unlikely that you can raise your growth trajectory without winning in your local market.[2] In fact, fewer than one in five of the companies in our sample that had below-median growth rates in their local region managed to outgrow their peers. Many members of this minority are companies in slow-growing regions, such as Japan, that offset lethargic local growth

[2] Defined as the largest region in the portfolio by revenue. We allocated each business segment in a corporate portfolio to one of 12 geographic regions. The region that accounted for the largest share of revenue at the start of the analysis period is termed the local or home region, while all other regions are classified as international regions.

Exhibit 4

Only 20 percent of most organizations' total growth comes from beyond the core.

Share of revenue growth by growth type, 2005–09 to 2015–19,[1] %



Note: Figures may not sum to 100%, because of rounding.
[1]Largest 3,000 publicly listed companies by revenue in 2018 with an average revenue of > $1 billion in 2003–07, a reliable business segment, and TSR data; 1,595 companies are charted.
[2]We allocated each reported business segment to one of 130 industries and then used the following definitions: the core industry was the one with the largest share of revenue at the start of the analysis period; secondary industries were all noncore industries in a company's portfolio at the start of the analysis period; and new industries were those that a company entered during the analysis period.
Source: Corporate Performance Analytics by McKinsey; regulatory filings; S&P Global

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with aggressive international expansion. An air-conditioning and refrigeration manufacturer, for example, managed to offset slow growth in Japan by successfully expanding to North America and China.

Go global if you can beat local

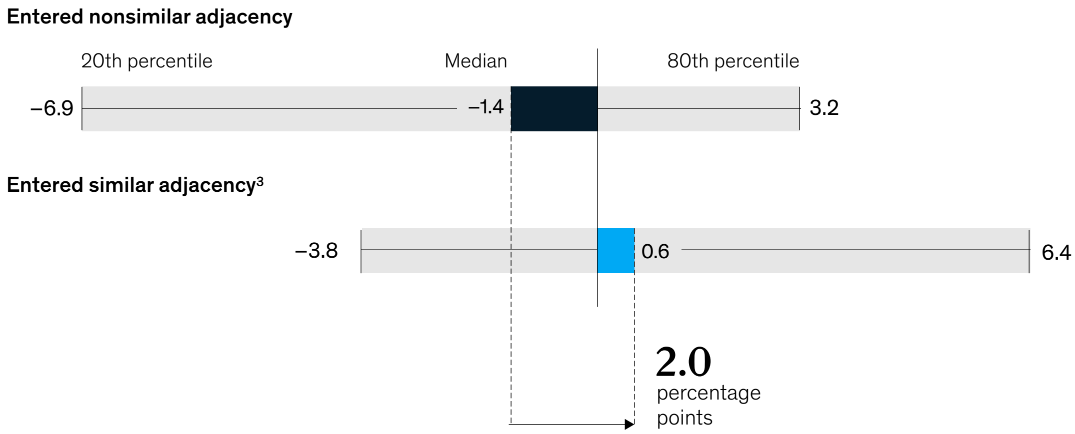
Approximately half of the total growth by companies in our sample came from geographies outside their home regions—an aggregate number fueled by Japanese and European companies that relied on international markets to compensate for slow growth at home. In faster-growing areas, such as China and North America, international regions accounted for closer to 30 percent of total growth.

Companies that expanded internationally generated 1.9 percentage points more annual TSR than their industry peers, but those with healthy growth in their home markets benefited more than

Exhibit 5

Companies that grew into similar adjacencies outperformed their peers.

Excess total shareholder returns[1] by similarity of new growth areas, 2005–09 to 2015–19,[2] %



[1]Excess total shareholder returns calculated as the company's annual shareholder returns less the median return in its primary industry.
[2]Largest 3,000 publicly listed companies by revenue in 2018 with an average revenue of > $1 billion in 2005–09, a reliable business segment, and TSR data; 1,621 companies charted.
[3]Top-quartile industry similarity score: we calculated industry similarity based on how frequently two industries occur together in corporate portfolios.
Source: Corporate Performance Analytics by McKinsey; regulatory filings; S&P Global

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those merely treading water at home. The former category generated an additional 2.6 percentage points of annual shareholder returns through geographic expansion, while those that struggled locally gained only 1.3 percentage points—not enough to offset the performance drag from the weak home market (Exhibit 6).

To succeed at international expansion, it's critical to have a clear source of competitive advantage that is transferable across regions. Without it, foreign companies will probably struggle to compete with incumbents that better understand the local context. This reality may explain why companies that grow strongly at home benefit so much more from global expansion—they are more likely to have winning business models, aspects of which can be transferred to new regions.

The case of a high-performing European manufacturer of agricultural and municipal vehicles illustrates the benefit of venturing abroad from a strong home base. The company leveraged its equipment's stellar reputation to expand into the United States, where it continued to generate market-beating returns. On the other hand, when a European grocer that struggled in its home market expanded aggressively into Latin America, its TSR trailed that of its peers by seven percentage points per annum over the subsequent decade.

Acquire programmatically

Mergers and acquisitions account for approximately one-third of the revenue growth among companies in our data set. McKinsey's long-standing research into M&A strategies has repeatedly reaffirmed that it is not the total value of transactions but the deal pattern that drives shareholder returns. After segmenting companies into four categories, our colleagues found that programmatic acquirers—those that did at least two small or medium-sized deals a year along the same theme—outperformed peers using other M&A approaches.

We wondered whether programmatic acquirers outperform organic growers simply because they grow faster, so we extended the analysis to control for growth rates—in other words, comparing the performance of companies with different M&A strategies but similar growth rates. We found that programmatic acquirers still outperformed their organic peers. This suggests that even when companies that grow purely organically match the growth rates of their acquisitive peers, they are less likely to generate peer-beating shareholder returns (Exhibit 7).

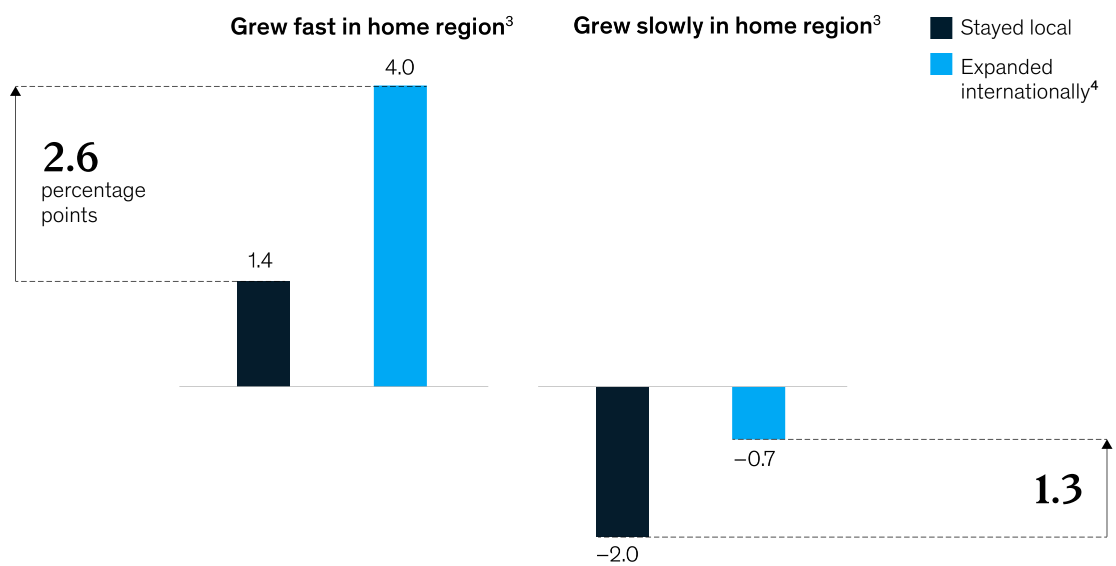
Today, many companies with legacy business models are using programmatic M&A to both digitize and enlarge their businesses. Take the example of a European publishing group that made more than 60 acquisitions over the past decade to expand its portfolio into digital media offerings: digital assets now account for more than 70 percent of its revenue.

Why is programmatic M&A so powerful? First, practice makes perfect: programmatic acquirers build organizational capabilities and establish best

Exhibit 6

Organizations with fast growth in the home region can benefit most from international expansion.

Excess total shareholder returns[1] by speed of growth and expansion location, 2005–09 to 2015–19,[2] %



[1] Excess total shareholder returns calculated as the company's annual shareholder returns less the median return in its primary industry.
[2] Largest 3,000 publicly listed companies by revenue in 2018 with an average revenue of >$1 billion in 2005–09, a reliable geographic segment, and TSR data; 1,372 companies are charted.
[3] We defined a company's home region as the region (n = 12) with the largest share of revenue at the start of the analysis period; all other regions were classified as international regions. Grew slowly in home region was defined as growing below the median home region growth rate of all companies in the sample set (1.8% per annum).
[4] We classified a company as expanded globally if its international growth in the ten years from 2005–09 to 2015–19 amounted to >20% of 2005–09 (starting) revenue. The companies were distributed across the four categories as follows: 29% were classified as stayed local and grew fast in home region, 34% as stayed local and grew slowly, 21% as expanded internationally and grew fast, and 16% as expanded internationally and grew slowly.
Source: Corporate Performance Analytics by McKinsey; regulatory filings; S&P Global

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practices across all stages of the M&A process, from strategy and sourcing to due diligence and integration planning. Second, those that pursue large deals often need to overpay to secure the asset and then must successfully integrate two businesses of similar size—something that's notoriously difficult to get right. Finally, doing many small deals enables companies to gain access to new markets or consolidate fragmented ones without the risk of "betting the house."

It's OK to 'shrink to grow'

Many management teams feel pressure to deliver consistent growth, which is understandable: the 10 percent of companies in our sample that grew for seven of the ten years between 2010 and the end of 2019 strongly outperformed their peers. But suppose you don't have this consistent growth engine? Statistically, the worst thing you can do is try to buy growth with a "big bang" acquisition. Your best option is to periodically prune back by divesting slow-growing parts of your portfolio and reinvesting the proceeds into new areas (Exhibit 8).

Companies in our sample that used such shrink-to-grow strategies divested assets in one or two years but grew consistently during the other years. They managed to generate five percentage points more annual excess TSR than inconsistent growers and large-deal acquirers. The key is not to confuse increasing scale with value-creating growth. For example, one Australian conglomerate has consistently divested less attractive parts of its portfolio, such as insurance, and put the proceeds into growth opportunities. Its shareholders have been handsomely rewarded, with a TSR of more than 10 percent per year from 2009 to 2019.

Exhibit 7

Programmatic acquirers outperform, even when the analysis controls for growth.

Excess total shareholder returns[1] by deal pattern, 2009–19,[2] %

	Revenue CAGR			
Growth pattern[3]	**< 0%**	**0–5%**	**> 5%**	**All companies**
Programmatic M&A	–1.0	2.8	5.1	2.1
Organic only	–2.7	0	1.5	0
All other M&A	–3.2	0.2	1.4	–0.2
Large deal M&A	–3.9	–0.4	2.3	–0.8

[1]Excess total shareholder returns calculated as the company's annual shareholder returns less the median return in its primary industry.
[2]Largest 2,000 publicly listed companies by revenue in 2018 with reliable M&A and TSR data; negative-growth companies not shown but same pattern holds; 1,990 companies are charted.
[3]Large deal was defined as 1 or more deals with deal value > 30% of acquirer market capitalization (MCAP); programmatic as more than 2 deals per annum; none as > 30% of acquirer MCAP; organic as < 2% of MCAP acquired over the period; 14% of companies were classified as programmatic, 26% as organic only, 16 percent as large deal, and 44% as all other.
Source: Corporate Performance Analytics by McKinsey; regulatory filings; S&P Global

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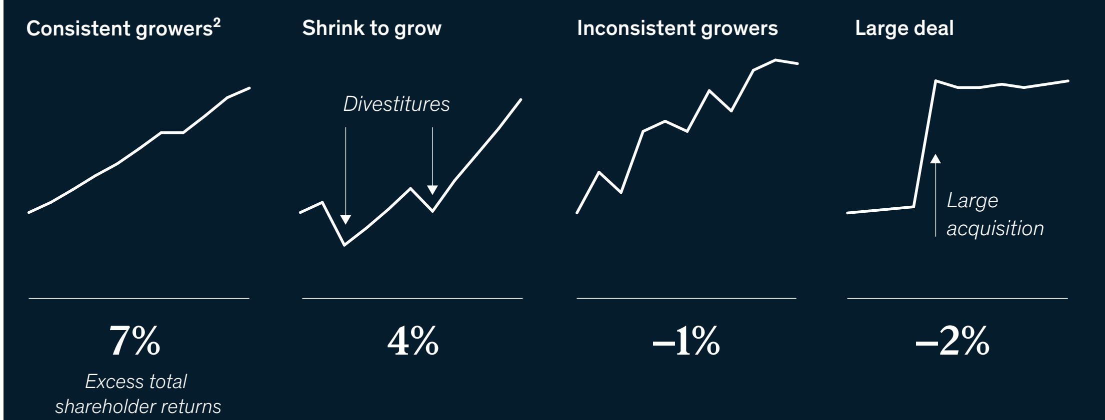
Exhibit 8

For companies that don't have a consistent growth engine, periodic pruning of slow-growing parts of a portfolio is the best alternative.

Excess total shareholder returns[1] by growth profile, 2009–19, %



Note: Consistent growers accounted for 10% of all companies, shrink to grow 14%, inconsistent growers 68%, and large deal 11%.
[1]Excess total shareholder returns were calculated as the company's annual shareholder returns less the median return in its primary industry.
[2]We analyzed the revenue growth of the largest 3,000 companies in 2019 from 2010 to 2020. Each company was classified into one of four categories: Large deal are those with a single year when revenues grew by 50%; shrink to grow are not large deal, had one or two years with net divestitures (shrunk revenue by more than 5%), and grew in at least all but 2 of the other years. Consistent growers were not large deal or shrink to grow, and grew in 7 or more years of the analysis period. All others were inconsistent.
Source: Corporate Performance Analytics by McKinsey; regulatory filings; S&P Global

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All business leaders have cost benchmarks. Now you have a growth benchmark, too. However, mastering the ten rules of value-creating growth is only one part of a holistic growth recipe. Start by developing a clear growth ambition: a quantum of growth that is more than just the momentum of your current businesses. Then develop a coherent set of growth pathways that encompass as many of the rules as possible. Finally, instill the capabilities and operating model to execute with excellence.

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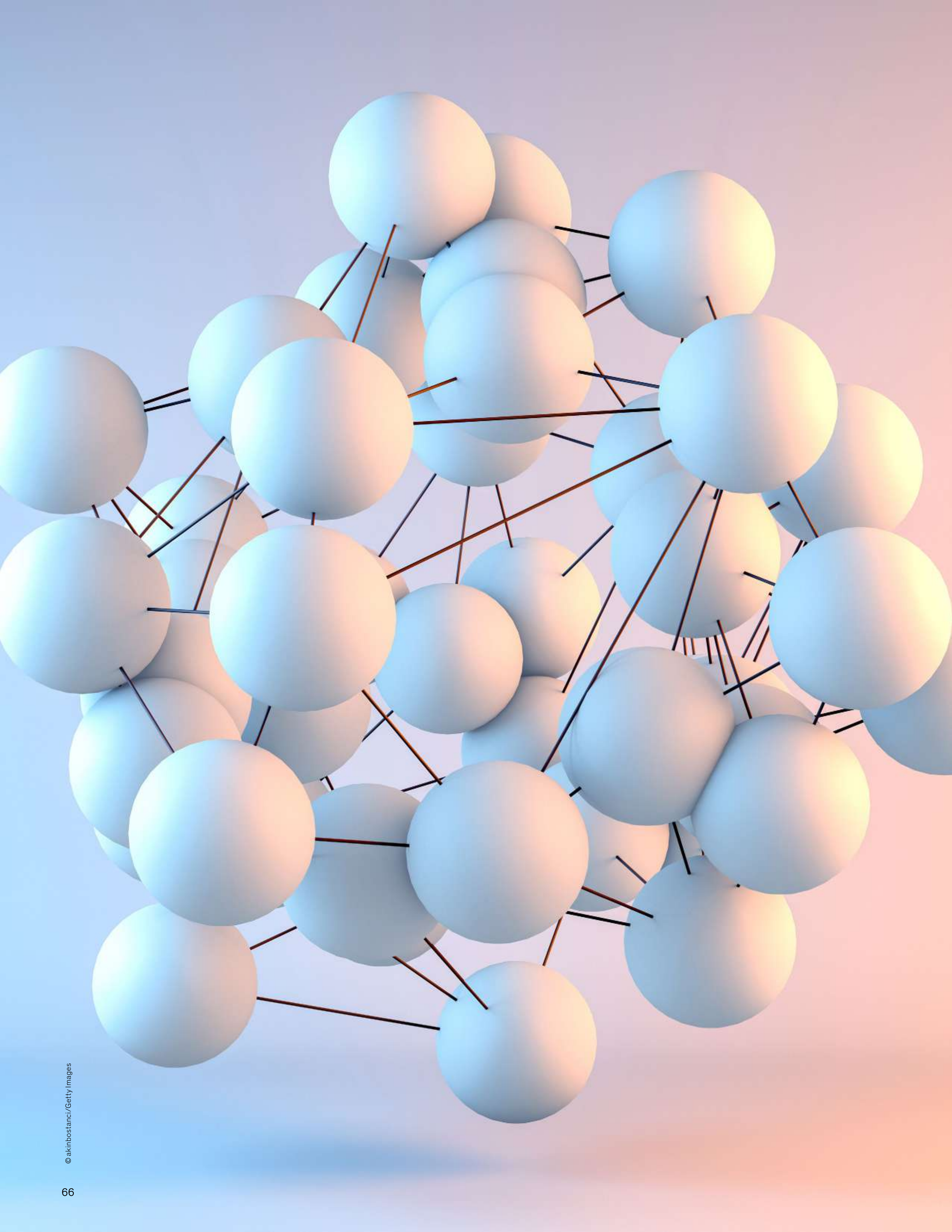


Chapter 3

Navigating the board and CEO relationship

The relationship between the CEO and the board is crucial, interdependent, and evolving. CEOs lead organizations to carry out strategy and create value; the board of directors provides direction and oversight to protect shareholder and broader stakeholder interests. “Poorly managed, the relationship between the CEO and the board can devolve into a loss of trust and paralyzing ineffectiveness,” write senior partners Carolyn Dewar, Scott Keller, and Vik Malhotra in the best-selling book *CEO Excellence*. And board effectiveness is a high-value endeavor: research shows that it’s strongly correlated with better performance and higher market valuations. Check out these insights to learn how to get board effectiveness right, and dive into topics that are at the top of the board agenda.

68 **Five ways to increase your board’s long-term impact**

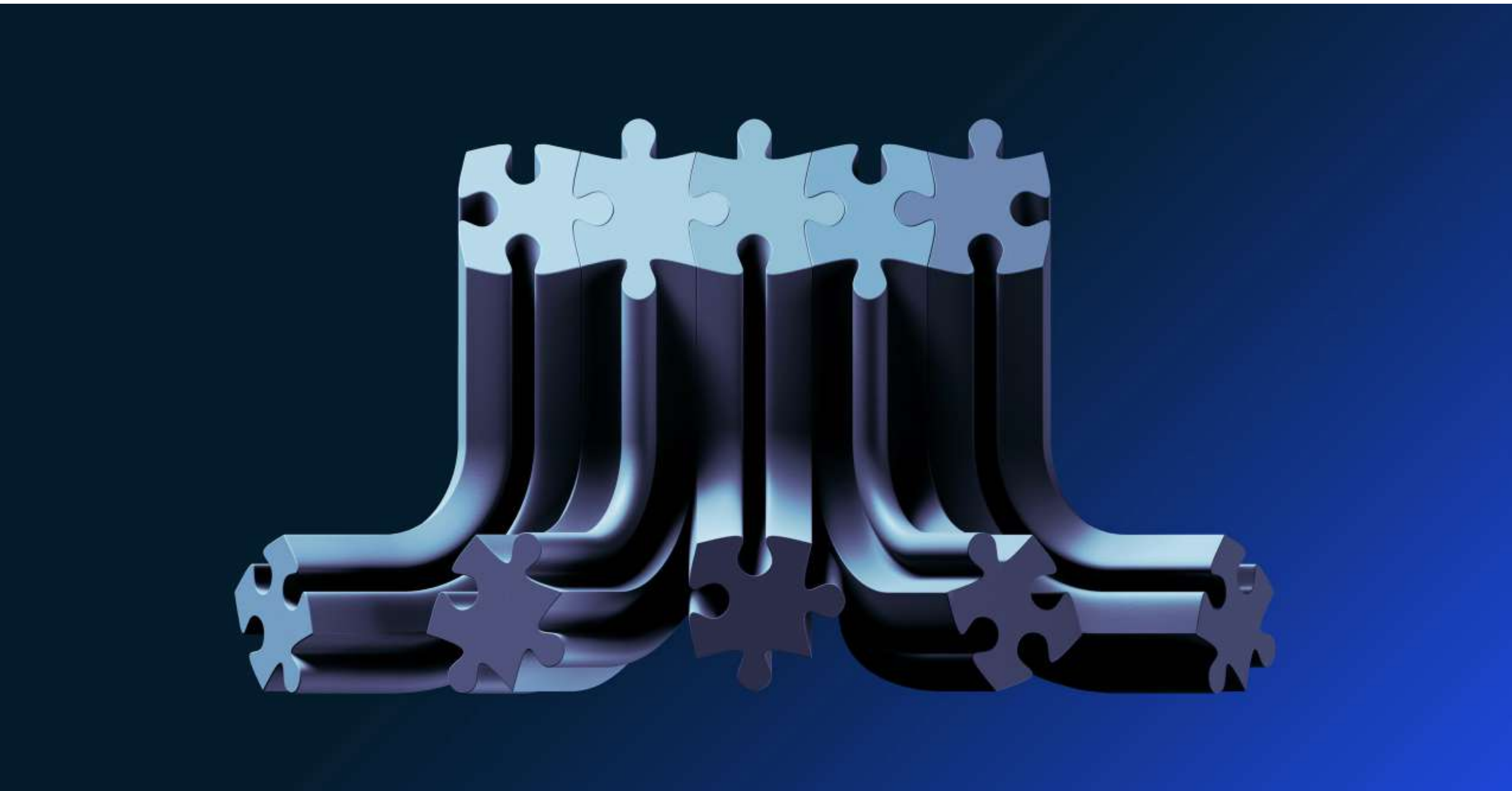
73 **Author Talks: Dambisa Moyo on how boards can work better**

77 **Four essential questions for boards to ask about generative AI**

82 **The board’s role in building resilience**

Five ways to increase your board's long-term impact

Directors are spending more time on their work, yet few say their boards are better at creating long-term value. Survey data highlight the operating models that correlate most with value creation.



Over the past two years, company leaders have faced unprecedented management challenges in multiple dimensions of their business, and our ongoing research indicates that many board directors have risen to the occasion. In our newest McKinsey Global Survey on boards,[1] directors report both a growing number of days spent on board work and that they expect to devote even more time to board work this year than they did in 2021 (Exhibit 1).

Yet despite that additional time spent, many directors do not report a corresponding increase in their boards' overall impact on value creation. Between our 2019 survey (conducted a few months before the pandemic) and our newest research, the results suggest no material change in the impact that a board's decisions and activities have made on their organizations' long-term value creation.[2]

Of course, the COVID-19 pandemic's prolonged volatility has hindered every board's ability to plan and create value for the long term. But directors' awareness that they need to invest more time in their work raises the question: How can they spend that additional time most effectively to secure their organizations' long-term prosperity?

The operating models that support board impact

The survey asked about 12 key aspects of boards' operating models. Based on our work with boards, these are the elements that more active and involved boards are pursuing. The majority of them have become more commonly implemented at respondents' boards since the COVID-19 pandemic began (Exhibit 2).

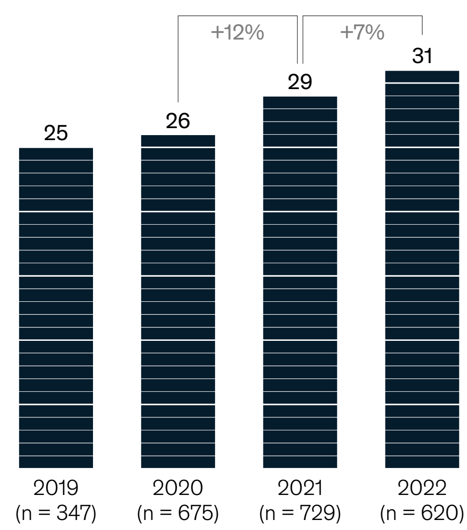
[1] The online survey was in the field from August 17 to August 31, 2021, and garnered responses from 1,054 participants representing the full range of regions, industries, and company sizes. Of them, 857 were board directors and answered each question for the board with which they were most familiar; the other respondents were C-level executives answering for the boards of the organizations they lead. To adjust for differences in response rates, the data are weighted by the contribution of each respondent's nation to global GDP.

[2] In the 2019 survey, 62 percent of directors say their boards' decisions and activities had a high or very high impact on long-term value creation; in 2021, 58 percent of directors said the same.

Exhibit 1

On average, directors say they are spending more and more time on board work.

Average number of days per year directors spend on board work[1]



[1]The 2019 and 2020 figures reflect responses from directors who were asked about the actual number of days spent on board work in the prior calendar year. For 2021 and 2022, respondents were asked to predict the number of days they expected to spend on board work in each year.
Source: McKinsey Global Surveys of boards of directors, Sept 15–25, 2020, 846 board members and C-level executives; Aug 17–31, 2021, 1,054 board members and C-level executives

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This is especially true among the “very high impact” boards, where directors say their decisions and activities have a strong influence on the organization’s value creation.[3] We identified five changes to these operating models that very-high-impact boards are significantly more likely than others to have made. This, in turn, suggests which aspects of the operating models other boards would do well to revisit to increase their overall effectiveness as organizational leaders and as stewards (Exhibit 3).

To make these five changes to boards’ operating models—and to do so effectively—we recommend the following, based on our experience:

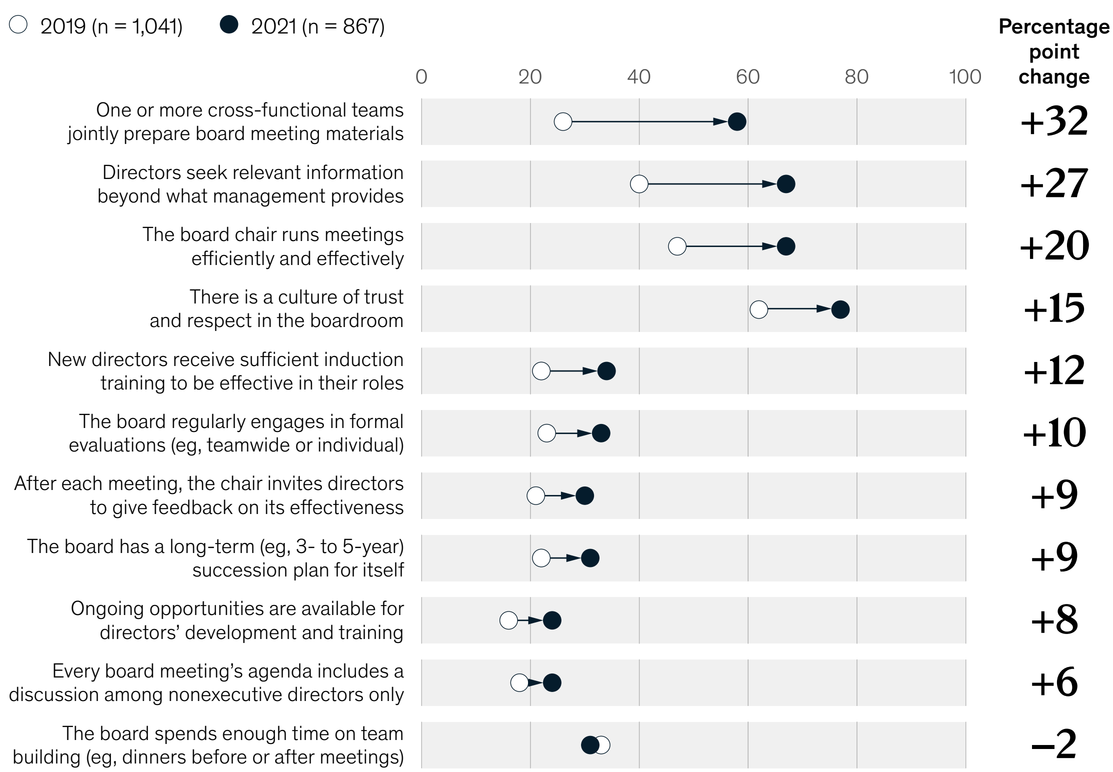
1. *Seek company information more proactively.* At most organizations, the management team provides its board directors with access to a range of relevant materials and insights—usually in the form of board reports—before every board meeting. In most jurisdictions, board directors are also legally empowered to ask for any other information that would inform their perspective or decision making on a given topic. The survey results suggest that directors on the highest-impact boards have been doing just that, much more so than they did in 2019 *and* when compared with their peers: 83 percent now say their board members seek relevant information beyond what management

[3] We define the “very high impact” boards as those whose members rate the impact of their boards’ decisions and activities on the organization’s long-term value creation as very high. In the 2021 survey, n = 169.

Exhibit 2

Between 2019 and 2021, boards made significant tactical changes to their operating models.

Share of directors reporting tactics practiced by organization’s board, %



Source: McKinsey Global Survey of 1,054 board directors and C-level executives, Aug 17–31, 2021

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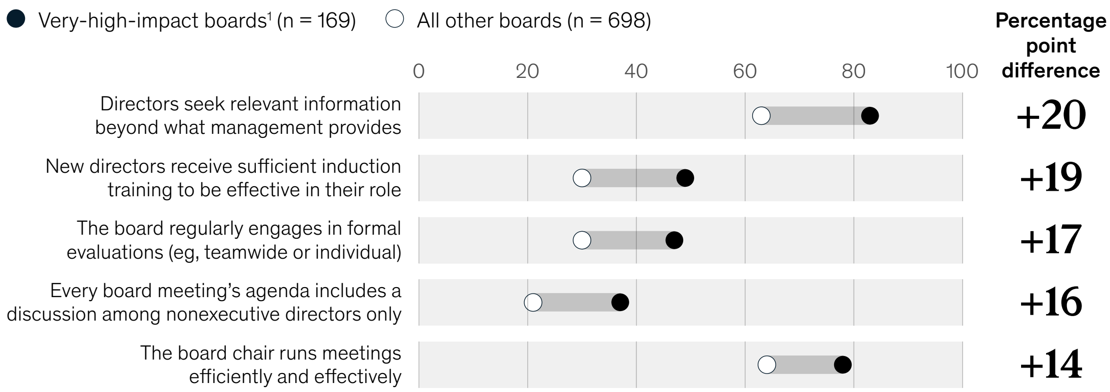
Exhibit 3

Very-high-impact boards are significantly more likely to have implemented changes in their operating models—especially in five key areas.

Share of directors reporting tactics practiced by organization's board, by board type, %



[1]Respondents who said their boards' decisions and activities have very high impact on the organizations' value creation over the long term (ie, the next 3–5 years).
Source: McKinsey Global Survey of 1,054 board directors and C-level executives, Aug 17–31, 2021

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provides, compared with 63 percent on other boards. This practice enhances a board's potential impact by increasing board members' familiarity with the organization's overall context and the particular situation at hand, and also signals to the management team that the directors are making the effort to learn and contribute as much as possible. The board members who do seek additional information are better prepared to participate actively in discussions, to ask good questions, and to review the management team's proposals more constructively and critically.

2. *Invest time in onboarding.* Regardless of a new board member's background, learning curves tend to be steep at the beginning of one's tenure. It takes time to learn an organization's strategy, culture, and overall ways of working—including how the board itself operates. Thorough, focused onboarding processes help board members learn quickly, so they can make effective contributions sooner rather than later. In our experience, an effective onboarding program is comprehensive and also partially tailored to the needs of a new director. For example, a director with little prior knowledge of the sector would benefit from receiving an in-depth industry perspective as well as current information on the company's strategic direction, a summary of important board discussions from the past two years, and a personal introduction to key stakeholders, including the management team, all other board directors, and major shareholders or investors.

3. *Increase the cadence of board evaluations.* While an annual performance evaluation is recommended for boards in most jurisdictions, in our experience, few board members actually engage in regular, formal evaluations—whether individually or collectively. A board's performance can vary greatly over time and depends on several factors, including the chair's leadership, the board's overall composition, and the economic life cycle of the organization. According to the survey, the highest-impact boards are more likely than other boards to regularly examine their performance and have increasingly engaged in formal evaluations since 2019. In our view, it's best if boards conduct a more in-depth evaluation of their overall

team performance at least once per year—for example, through interviews with all directors—and complement this effort with regular feedback sessions after every meeting.

4. *Create space for nonexecutive voices.* Giving independent directors the opportunity to discuss board topics among themselves increases accountability for both the board and the organization as a whole. If, at every board meeting, independent directors are given time to talk only to one another—with no company executives in the room—they can have more candid discussions about topics that would be difficult to address otherwise: for example, the CEO's well-being. By making independent-directors-only discussions a regular part of board meetings, these honest conversations can take place without creating any tensions among the broader group that might arise if, say, the nonexecutive directors scheduled separate, ad hoc meetings on their own.

5. *Appoint a chair who can facilitate effectively.* Board meetings can be stressful, particularly if an organization is not performing well, and the stakes of these discussions are often high. From CEO hiring and firing to M&A deals and plans for contending with unsatisfied shareholders, the very nature of board responsibilities requires directors to make decisions on difficult topics, and with limited time for discussion. The board chair plays a critical role in ensuring that meetings are both efficient and effective. To do so, the chair must create a clear agenda that balances fiduciary and strategic topics, encourage all board directors to voice their opinions, and effectively synthesize and summarize different perspectives to form a good basis for decision making.

These operating models and processes can help directors make the best use of the increasing time they spend on board work. We've seen that the boards that use these core operating models are better equipped to make valuable contributions to the organization and greater overall impact in the long term. Boards would do well to spend more of their time strengthening these core processes—and establishing the ones that aren't yet in place.

The survey content and analysis were developed by **Celia Huber,** a senior partner in McKinsey's Silicon Valley office; **Greg Lewis,** a part-time lecturer in business administration and strategy at the Ross School of Business and a senior adviser to McKinsey; **Frithjof Lund,** a senior partner in the Oslo office; and **Nina Spielmann,** a senior expert in the Zurich office.

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Author Talks: Dambisa Moyo on how boards can work better

In her new book, Dambisa Moyo explores the role of corporate boards in the 21st century and how they need to adapt to greater demands.

In this edition of *Author Talks*, McKinsey's Astrid Sandoval chats with Dambisa Moyo, global economist and board member of several large global organizations, about her new book, *How Boards Work: And How They Can Work Better in a Chaotic World* (Basic Books, 2021). Moyo offers a primer on the role that boards play and the growing challenges they face to meet greater social and cultural demands. An edited excerpt of the conversation follows.

Why this book and why now?
I joined my first board just over ten years ago, and the truth is in many ways, I did not embody the conventional board member. I was 39 years old and relatively young compared to the average board age. I'm Black. I'm from Africa, and I'm a woman. The other aspect, which was really crucial, is I didn't come from the C-suite. Very often, boards are looking for people who have had tremendous experience as CEOs or CFOs of large, global, and complex organizations. In that respect, the chairmen of the different companies of whose boards I joined were really taking a chance on me.

Since then, I have had a decade of incredible experiences. I have had the trauma of a CEO chairman dying while in the office. I've had a company get taken over for $100 billion in 2016, the largest transaction of that year. I've had activists in a stock where I was on the board, which can be incredibly disruptive. I've had to fire a number of CEOs, very often, though not all the time, but very often for ethical infringements. And I've also had a situation where we've had a stock price go from nearly $60 down to $7 and generate a lot of concern that the company wouldn't survive. Thankfully, I can assure you that the company is still around.

So it's been a wild ride for ten years. I've learned a tremendous amount and been very grateful for the opportunity. But it has really refined my thinking about how complex organizations are and how we need everyone at the table—government, corporations, and civil society—in order to solve some of the biggest challenges that the world faces today.

What problem were you trying to solve with this book?
I was trying to solve two problems. The first problem is a macro problem on what the role of corporations is and should be in the 21st century. The book talks about the challenges that boards and corporations face in trying to recalibrate and reassert the importance of corporations at a time when there are greater demands on what the board and the corporate mandate actually are.

The second problem I address in this book is the lack of information on what exactly the board does. And this was true, and became very clear to me in conversations with students in MBA classes, employees at the companies where I serve on the board, and also, more generally, with friends and family. There was a negative narrative about boards being described as a group of people who just played golf and drank fine wines. I wanted to be very clear on not only what the mandate is, but also to explain why it's so difficult and challenging to do a lot of things that people think should be easy and straightforward, such as firing a CEO or implementing some of the big ESG [environmental, social, and governance] agenda questions that are very pervasive these days.

What surprised you most about writing this book—in the research, writing, or response?
The really surprising thing for me was trying to articulate the trade-offs that board members and corporations face on a day-to-day basis. There is definitely a sense out there in speaking to people that boards and corporations are not aligned with societal needs and that boards have a relatively easy job in terms of dictating what the responsibilities of the company should be. Trying to bring people along to help them understand this is actually a very complicated, very difficult job, which is fraught with mistakes and a lot at risk, was an area that was quite surprising.

Winning in all environments

Even before the pandemic, we have been living in what feels like a more chaotic world. How has that affected boards?
It is absolutely true that a world of more digitalization and greater pressure from social demands is making it much more challenging for boards to think about their mandates and how to navigate corporations through these challenged periods. However, and I think COVID-19 is a great example of this, the best

> ‘It is absolutely true that a world of more digitalization and greater pressure from social demands is making it much more challenging for boards.’
>
> –Dambisa Moyo

corporations are managing their businesses, and by that I mean in terms of foundational aspects of having good controls, strong balance sheets, and well-run operations in terms of people, operational staff, et cetera. Those aspects, when they are bedded down, will work regardless of the broader economic environment.

One of my CEOs often uses the term “winning in all environments,” and I like that because we don’t know what challenges—whether they’re economic, macroeconomic, a pandemic, or geopolitical—may emerge. But our responsibility as a board, and as senior business leaders, is to make sure that we have not only risk-mitigated in the way companies run, but also are constantly making sure that regardless of what gets thrown at us, the companies can continue to operate.

How important is it to have a diversity of perspectives in the boardroom, particularly during a crisis?
It is clear that it’s not just about racial diversity or gender diversity but also the broader lens of diversity. Having people with different perspectives—whether it’s from geopolitical and public-policy backgrounds, academe, and scientists—bringing those into the boardroom so that it doesn’t just reflect businesspeople is clearly something that I believe is beneficial to the organization.

The best corporations will continue to think about adding diverse voices and perspectives to the boardroom. It is also patently clear to me that you want the boardroom to be at least 40 percent populated by people who have been in the CEO seat previously. What is clear is that CEOs of large, complex, global organizations, in particular, need to be able to find counsel, support, and objective perspectives from people who have essentially been in that specific role and seat before.

Know your mandate

What is one piece of advice you would give existing board members and those considering joining a board for the first time?
One of the things I would say to existing board members is that we shouldn’t flatter ourselves. Other boards before us have had, I would argue, even greater challenges. Think for a moment about trying to run a business during the middle of a civil war, or indeed World War I and World War II. That would have been incredibly challenging. We are in a challenged environment, but I’m very optimistic that we can actually do something that will continue to drive better business over a longer period of time.

With respect to new board members, I think the salient point here is for them to understand the mandate of the board and the levers that boards have in order to effect change. The mandate of the board has three key aspects. One is to oversee the strategy of the company, and we do this by having a full-on strategy day. It’s usually two or three days. But also we do that through regular short-, medium-, and long-term strategy planning.

The second is to hire or, in some instances, fire the CEO. This is a very important aspect because the relationship between the CEO and the board is critical, and the CEO defines the cultural aspects of how a company operates. Traditionally, boards focus on financial, operational, and past experiences.

‘When joining a board, you’re joining in the middle of a movie. Boards have existed for a long time. There’s a lot of scope for improvement.’

—Dambisa Moyo

But we also need much more perspective on the ethical history of CEOs as we think about them as candidates. We have a lot responsibility and a great opportunity to effect change in the organization by who we hire, but also through compensation. And more and more, I’m pleased to see that many boards are now adding social aspects that contribute to compensation.

The third role of the board is this cultural frontier, which I separate into two parts in the book: the part about nonnegotiables, things like excellence, professionalism, and the new cultural-frontier aspect, are much more challenged and have a whole array of trade-offs associated with them.

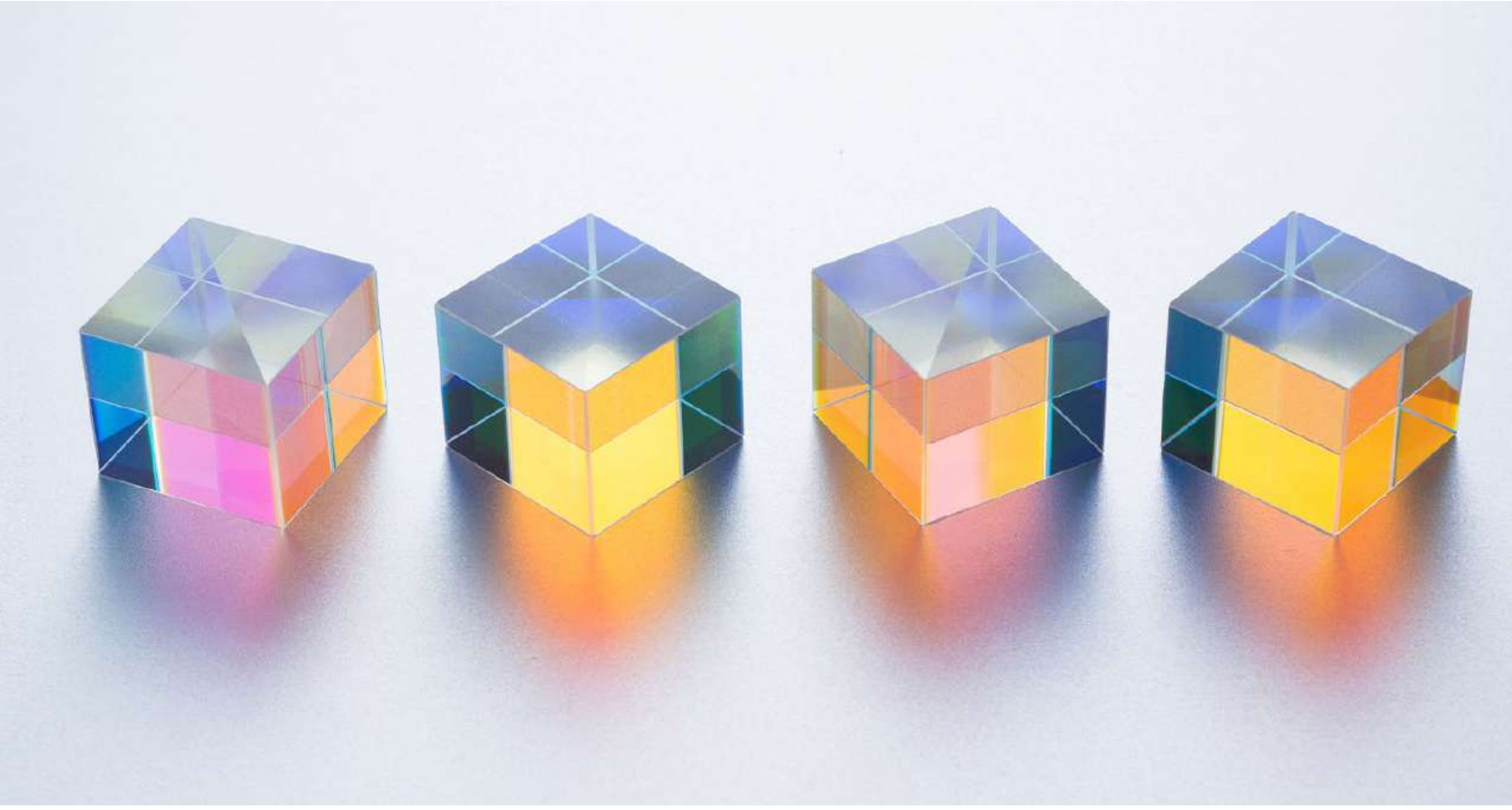
When joining a board, you’re joining in the middle of a movie. Boards have existed for a long time. There’s a lot of scope for improvement, but fundamentally there’s an important role that boards have played, do play, and will continue to play. And the best new board members are those that bring fresh perspectives but also understand the subtlety and the more nuanced challenges that corporations and boards face.

Dambisa Moyo is a global economist and author. **Astrid Sandoval** is an executive editor in McKinsey’s London office.

Four essential questions for boards to ask about generative AI

Boards are responsible for how generative AI is used at the companies they oversee. Asking company leaders the right questions will help unlock the technology's value while managing its risk.

by Frithjof Lund, Dana Maor, Nina Spielmann, and Alexander Sukharevsky



Company executives are scrambling to understand and respond to generative AI. This technology is still nascent, but of those who have used it, few doubt its power to disrupt operating models in all industries.

We recently provided a view of how CEOs might start preparing for what lies ahead.[1] But what is the role of the board? Many board members tell us they aren't sure how to support their CEOs as they grapple with the changes that generative AI has unleashed, not least because the technology seems to be developing and getting adopted at lightning speed.

The early use cases are awe-inspiring. A software developer can use generative AI to create entire lines of code. Law firms can answer complex questions from reams of documentation. Scientists can create novel protein sequences to accelerate drug discovery. But the technology still poses real risks, leaving companies caught between fear of getting left behind—which implies a need to rapidly integrate generative AI into their businesses—and an equal fear of getting things wrong. The question becomes how to unlock the value of generative AI while also managing its risks.

Board members can help their management teams move forward by asking the right questions. In this article, we provide four questions boards should consider asking company leaders, as well as a question for members to ask themselves.

Questions for management

Generative AI models—deep learning models trained on extremely large sets of unstructured data—have the potential to increase efficiency and productivity, reduce costs, and generate new growth. The power of these "foundation" models lies in the fact that, unlike previous deep learning models, they can perform not just one function but several, such as classifying, editing, summarizing, answering questions, and drafting new content. This enables companies to use them to launch multiple applications with relative ease, even if users lack deep AI and data science know-how.

Board members can equip their C-suite to harness this potential power thoughtfully but decisively by asking the following four broad questions.

How will generative AI affect our industry and company in the short and longer term?
Forming any sensible generative AI strategy will require an understanding of how the technology might affect an industry and the businesses within it in the short and longer term. Our research suggests that the first wave of applications will be in software engineering, marketing and sales, customer service, and product development.[2] As a result, the early impact of generative AI will probably be in the industries that rely particularly heavily on these functions—for example, in media and entertainment, banking, consumer goods, telecommunications, life sciences, and technology companies.

Even so, companies in other industries should not delay in assessing the potential value at stake for their company. The technology and its adoption are moving too fast. Recall that the public-facing version of ChatGPT reached 100 million users in just two months, making it the fastest-growing app ever. And our research finds that generative AI can increase worker productivity across industries, adding up to $7.9 trillion in value globally from adoption of specific use cases and the myriad ways workers can use the technology in everyday activities.[3] Each company will want to explore immediate opportunities to improve efficiency and effectiveness. Those that don't may quickly find themselves trailing behind competitors that answer customer queries more accurately and faster or launch new digital products more rapidly because generative AI is helping write the code. They risk falling behind on the learning curve, too.

Simultaneously, companies will want to begin looking further out. No one can predict the full implications of generative AI, but considering

[1] "What every CEO should know about generative AI," McKinsey, May 12, 2023.
[2] "The economic potential of generative AI: The next productivity frontier," McKinsey, June 14, 2023.
[3] Ibid.

them is important. How might the competitive environment change? How might the business benefit, and where does it look vulnerable? And are there ways to future-proof the strategy and business model?

Are we balancing value creation with adequate risk management?

An assessment of the new frontiers opened by generative AI will rightly make management teams eager to begin innovating and capturing its value. But that eagerness will need to be accompanied by caution, because generative AI, if not well managed, has the potential to destroy value and reputations. It poses the same—and more—risks as traditional AI.

Like traditional AI, generative AI raises privacy concerns and ethical risks, such as the potential to perpetuate bias hidden in training data. And it heightens the risk of a security breach by opening up more areas of attack and new forms of attack. For example, deepfakes simplify the impersonation of company leaders, raising reputation risks. There are also new risks, such as the risk of infringing copyrighted, trademarked, patented, or otherwise legally protected materials by using data collected by a generative AI model.

Generative AI also has a propensity to hallucinate—that is, generate inaccurate information, expressing it in a manner that appears so natural and authoritative that the inaccuracies are difficult to detect. This could prove dangerous not just for companies but also for society at large. There is widespread concern that generative AI could stoke misinformation, and some industry experts have said it could be as dangerous to society as pandemics or nuclear war if not properly regulated.[4]

Companies will therefore need to understand the value and the risks of each use case and determine how these align with the company's risk tolerance and other objectives. For example, with regard to sustainability objectives, they might consider generative AI's implications for the environment because it requires substantial computing capacity.

From there, boards need to be satisfied that the company has established legal and regulatory frameworks for the knowable generative AI risks assumed across the company and that AI activities within the company are continually reviewed, measured, and audited. They will also want to ensure mechanisms are in place to continually explore and assess risks and ethical concerns that are not yet well understood or even apparent. How, for example, will companies stand up processes to spot hallucination and mitigate the risk of wrong information eliciting incorrect or even harmful action? How will the technology affect employment? And what of the risks posed by third parties using the technology? A clear-eyed early view on where problems might lie is the key to addressing them.

The bottom line is that AI must always be subject to the effective oversight of those designing and using it. Support for the effort can come from government regulatory frameworks and guidance being developed on how to use and apply generative AI. It will be important for companies to keep abreast of these.

How should we organize for generative AI?

Many companies took an experimental approach to implementing previous generations of AI technology, with those keenest to explore its possibilities launching pilots in pockets of the organization. But given the speed of developments within generative AI and the risks it raises, companies will need a more coordinated approach. Getting stuck in pilot mode really isn't an option. Indeed, the CEO of one multinational went as far as to ask each of his 50 business leaders to fully implement two use cases without delay—such was his conviction that generative AI would rapidly lend competitive advantage.

Company leaders should consider appointing a single senior executive to take responsibility for the oversight and control of all generative AI activities. A smart second step is to establish a cross-functional group of senior people representing data science, engineering, legal, cybersecurity, marketing, design,

[4] Cristina Criddle, "AI executives warn its threat to humanity rivals 'pandemics and nuclear war,'" *Financial Times*, May 30, 2023.

and other business functions. Such a team can collaborate to formulate and implement a strategy quickly and widely.

Bear in mind also that a foundation model can underpin multiple use cases across an organization, so board members will want to ask the appointed generative AI leader to ensure that the organization takes a coordinated approach. This will promote the prioritization of use cases that deliver fast, high-impact results. More complex use cases can be developed thereafter. Importantly, a coordinated approach will also help ensure a full view of any risks assumed.

The board will also want to check that there's a strategy for establishing what is likely to be a wide range of partnerships and alliances—with providers that customize models for a specific sector, for example, or with infrastructure providers that offer capabilities such as scalable cloud computing. The right partnerships with the right experts will help companies move quickly to create value from generative AI, though they will want to take care to prevent vendor lock-in and oversee possible third-party risks.

Do we have the necessary capabilities?
To keep pace with generative AI, companies may need to review their organizational capabilities on three fronts.

Technology. The first front is technology. A modern data and tech stack will be the key to success in using generative AI. While foundation models can support a wide range of use cases, many of the most impactful models will be those fed with additional, often proprietary, data. Therefore, companies that have not yet found ways to harmonize and provide ready access to their data will be unable to unlock much of generative AI's potentially transformative power. Equally important is the ability to design a scalable data architecture that includes data governance and security procedures. Depending on the use case, the existing computing and tooling infrastructure might also need upgrading. Is the management team clear about the computing resources, data systems, tools, and models required? And does it have a strategy for acquiring them?

Talent. The introduction of generative AI, as with any change, also requires a reassessment of the organization's talent. Companies are aware they need to reskill the workforce to compete in a world where data and AI play such a big role, though many are struggling to attract and retain the people they need. With generative AI, the challenge just got harder. Some roles will disappear, others will be radically different, and some will be new. Such changes will likely affect more people in more domains and faster than has been the case with AI to date.

The precise new skills required will vary by use case. For example, if the use case is relatively straightforward and can be supported by an off-the-shelf foundation model, a generalist may be able to lead the effort with the help of a data and software engineer. But with highly specialized data—as might be the case for drug development—the company may need to build a generative AI model from scratch. In that case, the company may need to hire PhD-level experts in machine learning.

The board will therefore want to query leadership as to whether it has a dynamic understanding of its AI hiring needs and a plan for fulfilling them. Also, the existing workforce will need to be trained to integrate generative AI into their day-to-day work and to equip some workers to take on new roles. But tech skills are not the only consideration, because generative AI arguably puts a premium on more advanced analytical and creative skills to supplement the technology's capabilities. The talent model may therefore need to change—but with consideration of a caution raised recently at the World Economic Forum: using AI as a substitute for the work of junior-level talent could endanger the development of the next generation of creators, leaders, and managers.[5]

Organizational culture. Last, a company's culture shapes how well it will succeed with generative AI. Companies that struggle with innovation and change will likely struggle to keep pace. It's a big

[5] Ravin Jesuthasan, "Here's how companies should navigate generative AI in the world of work," World Economic Forum, April 14, 2023.

question, but does the company have the learning culture that will be a key to success? And does the company have a shared sense of responsibility and accountability? Without this shared sense, it is more likely to run afoul of the ethical risks associated with the technology.

Both questions involve cultural issues that boards should consider prompting their management teams to examine. Depending on what they find, reformulating a company's culture could prove to be an urgent task.

A question for the board

As boards try to support their CEOs in creating value from generative AI and managing its risks, they will also want to direct a preliminary, fundamental question to themselves: Are we equipped to provide that support?

Unless board members understand generative AI and its implications, they will be unable to judge the likely impact of a company's generative AI strategy and the related decisions regarding investments, risk, talent, technology, and more on the organization and its stakeholders. Yet our conversations with board members revealed that many of them admit they lack this understanding. When that is the case, boards can consider three ways to improve matters.

The first option is to review the board's composition and adjust it as necessary to ensure sufficient technological expertise is available. In the past, when companies have struggled to find technology experts with the broader business expertise required of a board member, some have obtained additional support by setting up technology advisory boards that include generative AI experts. However, generative AI will likely have an impact on every aspect of a company's operations—risk, remuneration, talent, cybersecurity, finance, and strategy, for example. Arguably, therefore, AI expertise needs to be widespread so that the full board and all its committees can properly consider its implications.

Second, the board can improve its members' understanding of generative AI. Training sessions run by the company's own experts and by external experts on the front line of developments can give board members an understanding of how generative AI works, how it might be applied in the business, the potential value at stake, the risks, and the evolution of the technology.

Third, the board can incorporate generative AI into its own work processes. Hands-on experience in the boardroom can build familiarity with the technology and appreciation of its value and risks. Moreover, because generative AI can improve decision making, it would be remiss of boards not to explore its potential to help them perform their duties to the best of their ability. For example, they might use it to surface additional critical questions on strategic issues or to deliver an additional point of view to consider when making a decision.

Generative AI is developing fast, and companies will have to balance pace and innovation with caution. The board's role is to constructively challenge the management team to ensure this happens, keeping the organization at the forefront of this latest technological development yet intensely mindful of the risks. The questions posed here are not, of course, exhaustive, and more will arise as the technology progresses. But they are a good place to start. Ultimately, board members hold responsibility for how generative AI is used in the companies they oversee, and the answers they receive should help them meet that responsibility wisely.

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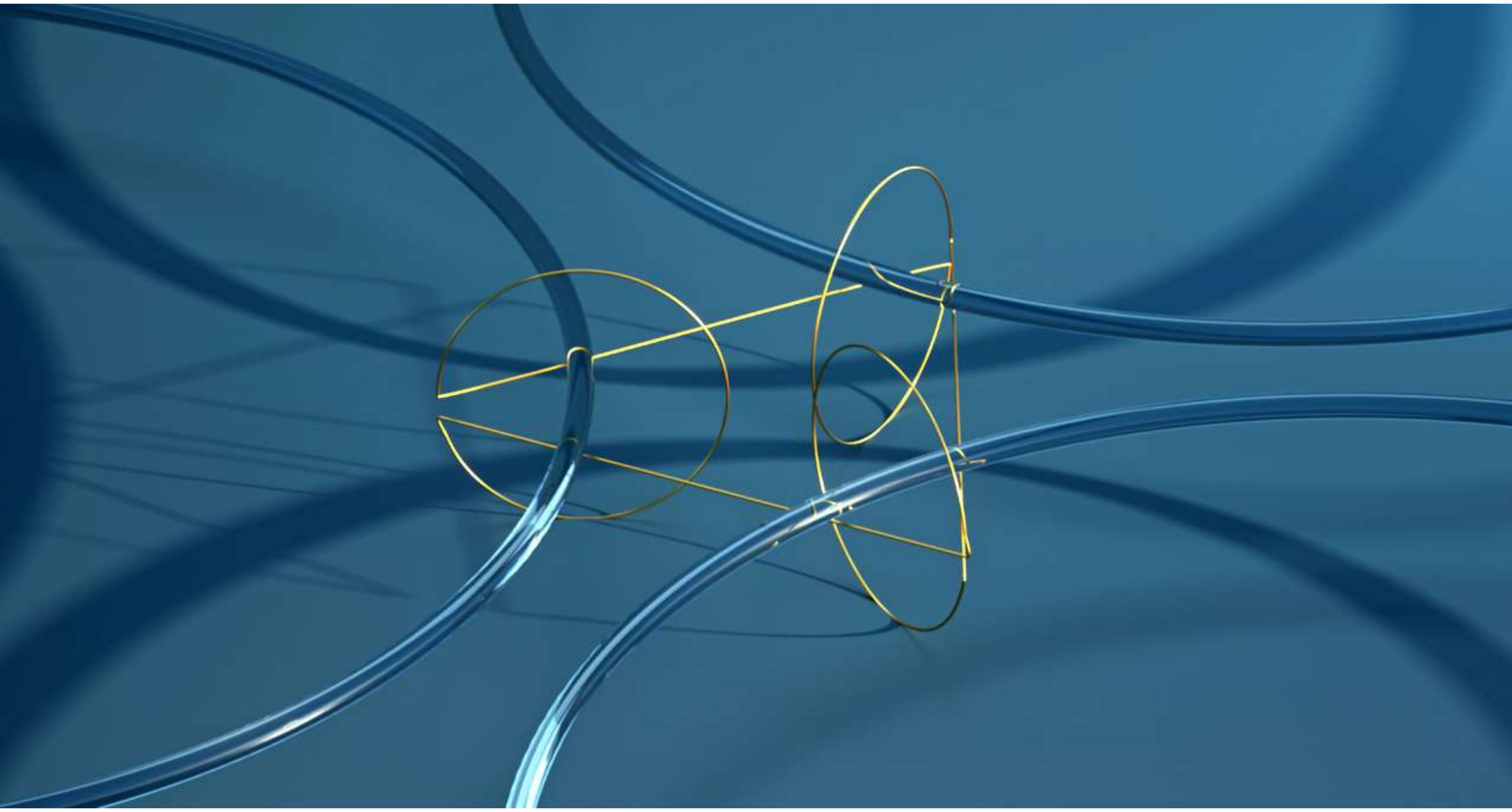
The board’s role in building resilience

Boards of directors can help executive teams build the foresight, response, and adaptation capabilities they need to manage future shocks.



Resilience means both protecting against the downside of potential shocks and preparing to capture the upside. In this episode of the *Inside the Strategy Room* podcast, three experts discuss the board's role in building that resilience to weather the current volatility. Asutosh Padhi, McKinsey's managing partner for North America, is joined by Celia Huber, who leads our board services work in the region, and Ida Kristensen, coleader of McKinsey's risk and resilience practice in North America and leader of the global cybersecurity practice. This is an edited transcript of the discussion. For more conversations on the strategy issues that matter, follow the series on your preferred podcast platform.

Sean Brown: Why is resilience on the board agenda now?

Ida Kristensen: We're facing an amazing set of disruptions. First, the highest inflation since the 1970s, and while energy receives a lot of attention, core inflation is also high, and it is unclear what governments and other institutions will do. GDP slowdowns seem to be continuing, but how deep will it be and for how long? There is a lot of volatility in the capital markets as well, and while they are quite robust, access to capital and credit is tightening, which is particularly important for growth-oriented companies.

We see continued supply chain challenges. In our surveys, we see increasingly negative sentiment from consumers and businesses. We see job growth, which normally would not be consistent with recessionary trends, but the tight labor market is paired with decreased productivity in many countries. On top of all these macroeconomic elements, we have continuing uncertainty around the pandemic and geopolitical tensions. In conversations with CEOs and boards, uncertainty is the number-one topic that comes up. But there is a lot more resilience built into the system today than in previous times of volatility.

Asutosh Padhi: Yes, it's not all gloom and doom. Consumer sentiment is at an all-time low, but consumer balance sheets continue to be extraordinarily strong, totaling $3 trillion of cash in the US. CEOs likewise report strong balance sheets. Innovation is alive and well, and this is a moment when everyone is thinking through how to take advantage of digital, improve productivity levels, and drive innovation and growth. We are getting mixed signals on the economy, but we believe that moments of high uncertainty are when institutions have to differentiate. In previous downturns, the actions that companies took made a tenfold difference in share price over a seven- to ten-year period. Likewise, the actions that leaders take today matter, and boards can enable them.

Sean Brown: Are boards well prepared to address a potential new series of negative events? They generally rose to the COVID-19 challenge.

Celia Huber: In our global board director surveys, boards say they are very prepared to deal with some challenges close to home, such as employee safety, but they feel unprepared for larger-scale forces. Major crises, macroeconomic shocks, climate change—directors find these challenges ambiguous. But boards have learned over the past two years that their clock speed and ability to make decisions need to increase to match the environment. I don't know many boards that are just doing quarterly meetings anymore. They have added ad hoc phone and virtual meetings in between regularly scheduled ones.

It was also interesting that board members see opportunities to improve their efficiency and effectiveness during crises. One piece I found surprising is that only 7 percent of the respondents believe that over the past year their board was "most effective" at risk management, but 40 percent said their organizations are currently well prepared for the next large crisis. That still leaves 60 percent of board members feeling unprepared.

Ida Kristensen: And there are ways boards can prepare. For example, we sometimes stage war games around potential crises, and I recently participated in one with a North American company, a joint session for board members and the executive management. It was a ransomware-attack scenario played out over 3.5 hours, and it was more gripping than the latest James Bond movie, a really high-intensity situation. At the end, the CEO turned to the chair of the board and said, "If this had been real, I would now resign from the company." When you do these exercises and play through the decisions you would have to make, it brings them to life and that gives you some muscle memory.

Sean Brown: Given those mixed economic signals, what are some ways, aside from war games, that boards and management teams can plan for different eventualities?

Ida Kristensen: Financial and geopolitical volatility will likely be with us for a long time; it may be the new normal. So one thing we advise clients is to not rely on forecasts. The only thing you know about your forecast is that it will be wrong. You need to think about scenarios and inter-dependencies and plan for what you would do in those situations.

Many board members have experienced more economic cycles than the current management, so they can ask: how do we create a new playbook that builds on everything we have learned from the past? Second, boards can help ensure that the focus is not just on short-term protection of the business. There is a higher premium on short-term earnings and profitability given the rising interest rates, but this recession may be shallower and shorter than past downturns, which means that planning an exit from the slowdown should start now. Board members should make sure that management is focused on both defense and offense. What measures should we take to protect the firm in the short term? What opportunities can we find to improve our business portfolio?

Finally, talent is an important topic. Amidst talent shortages, some of our clients are considering not filling open positions, but our advice is to not cut to the bone. Manage your talent, because you will need all of them soon.

Asutosh Padhi: The decisions that boards now support and influence will have an impact on their companies for the next three, ten, 20 years. This is a moment to simultaneously focus on both growth and productivity. Productivity alone can help get you through, but on the other side of the business cycle you may lose strategic distance.

Second, most management teams and boards have a view on the businesses they want to be in today and in the future, and we think this is a time to accelerate both divestitures and acquisitions. The third element boards should pay attention to is strategic optionality, which comes from the health of the balance sheet. What is our fixed-cost position? How can we strengthen and deepen our talent bench?

Sean Brown: What is the board's role in developing this new playbook?

Celia Huber: It is not unusual for companies to have an M&A playbook, and the management team has approval to move forward within that playbook, but boards understand that may adjust given the context. We are talking about something analogous [on broader strategy]. The board doesn't need to be in the details but to understand the playbook's framing and underlying assumptions. If these were to change due to the macroeconomic environment, that would change the management's playbook as well.

Ida Kristensen: A board member can say, "Help us understand the playbook we are deploying. What are the key insights we are relying on? What scenarios could require us to mobilize quickly, what would be the board's role, and how are you preparing us for that? What is our balance between defensive and offensive moves?" There will be some telltale signs if the company is retracting too much to short-term management of expenses and not sufficiently looking ahead.

Talent is another topic board members should probe. "In an increasingly competitive talent market, how are we differentiating ourselves? What is our value proposition, and what are indicators telling us about our ability to attract and retain talent?" Board members should also ensure a cyber playbook exists, because a cyber crisis plays out quite differently from most other crises.

Sean Brown: Are boards changing their approach to managing cyber risk, maybe appointing a dedicated director or establishing new reporting structures?

Ida Kristensen: Some boards are making sure that at least a couple of directors have the right technical experience. We are also seeing boards, both in regulated industries like banking and nonregulated industries, say, "This is now such a critical threat to the company that we as a board need to understand and prepare for it." Gone are the days when the chief information security office would tell the board, "We have a 99 percent patching rate; we've got it under control." We are seeing a much more honest and substantive conversation about the threat landscape. What do we know about who is coming into our systems? What are they looking at? What are our greatest vulnerabilities and how are we addressing them?

Sean Brown: The word "resilience" is used a lot these days. What does it mean to be resilient in the current environment?

Ida Kristensen: Fundamentally, it is the ability to pivot when a disruption strikes, both by preparing the company for what is happening now and strengthening it for what's ahead. We see three elements to that: foresight, response, and adaptation. Everything begins with information. Do we understand the likelihood of different things happening, their complexities and interdependencies, and the implications for our company? Tactically, it means looking not at forecasts but scenarios, with stress testing, early-warning systems, and some clear management decision processes around what you would do if X, Y, or Z were to happen. Take the supply chain: What kind of disruption would trigger the need for a decision, and are you clear on what that decision would be?

Response is all about the near to medium term. What levers are we pulling in response? That can be expense management, pricing changes, or operational adjustments, as we saw during the pandemic, where brick and mortar stores had to change their processes. Then adaptation might require more long-term changes to diversify your suppliers so you are less vulnerable to any one disruption. It could mean building up the resilience muscles within the company, institutionalizing war games and tabletop exercises, and preparing longer-term playbooks in response to more systemic changes.

Asutosh Padhi: The questions board members should consider are, one, what is the speed of the response? During the pandemic, we saw companies that used to launch products in four to five years doing that in three to six months. Number two is the effectiveness of the response. What results from these actions? And what is an enduring aspect of the response? What are we learning that is not just an in-the-moment exercise but can change how we run the institution? An example is board and management interactions: long presentations versus much more bite-sized, problem-solving topics. How does the CEO communicate with customers and with employees? You want to use this as a moment to accelerate.

Ida Kristensen: It reminds me of something JPMorgan Chase chair and CEO Jamie Dimon shared in the *CEO Excellence* book. During the 2008 financial crisis, he thought talking theoretically about what was happening at board meetings wasn't the best use of his time. Instead, he pulled the board members out to the trading floor so they could see in real time. During crises, the board plays a different role around foresight, response, and adaptation. Rather than debating the response, it is probably more helpful to tell management, "Go run with it and tell us what you need." But the board can play an important role in ensuring the organization learns from the crisis.

Sean Brown: What is the board's role on each of those three aspects of resilience—foresight, response, and adaptation?

Celia Huber: On foresight, the board's role is thinking about the main areas of uncertainty. Many boards I work with use scenario planning as a tool to understand the main drivers of uncertainty and the early-warning indicators that you are heading into that scenario. On response, the board's role depends on the specifics of the crisis, and whether it is a moment to be seized. Most companies that came out of the 2008 recession in a strong position had used that downturn to make bold strategic moves. So, boards can ask, what are those moves for our company and what strategic decisions need to be made or business model changes implemented? For example, in the industry I work in, which is healthcare, one of the necessary business model changes recently was more digital delivery, particularly of primary care, and that had to happen almost overnight. As for the adaptation questions, how can we expand those capabilities? Can we take that virtual health offering and turn it into something bigger and bolder?

Ida Kristensen: Fundamentally, the board members can think about the balance between defensive versus offensive responses to crisis, short-term versus long-term trade-offs, and appropriately challenging management. Once you understand the main areas of uncertainty, ask management how they can help you prepare for the moment when you get into one of the scenarios when you have to make quick decisions.

Asutosh Padhi: I start with the notion of one team. I see the CEO and the management team as the player-coaches and the board as nonplaying coaches. For this team to win, collaboration and faster two-way information exchange need to be in place, and joint problem solving as opposed to 100-page presentations. When I work with institutions, we recognize that there are three to five big questions that will determine the future of the institution, so what are those questions and are you spending enough time on them?

Sean Brown: What aspects of resilience should boards pay the most attention to?

Ida Kristensen: When we talk about resilience, people often focus immediately on financial resilience. How strong is our balance sheet? What are our pricing levers? What can we hedge? There's no doubt that financial resilience is important, but we think other elements of resilience are also critical. Thinking systematically around six dimensions can help ensure that the company is prepared for whatever might happen. Aside from financial, there is operational resilience, which covers the inner workings of supply chains and production channels and how diversified or concentrated they are, how subject to disruption. Technology comes back to our cyber risk discussion as well as other potential technology disruptions. How are we prepared and what backup systems are in place? How quickly can we get up and running again?

Resilience in brand, reputation, and ESG [environmental, social, and governance considerations] is about how you manage both internal and external stakeholders, and how you think about your societal commitments. On business model and innovation, resilience is about how quickly you can pivot. Asutosh talked about making production times shorter, but what are the areas where it is critical to innovate quickly? Finally, organizational resilience is both the leadership—the board's and the management team's ability to decide and act quickly—and ensuring the talent value proposition.

Sean Brown: Which of those do you find boards and management teams are most focused on—or *should* focus on most?

Asutosh Padhi: I think talent is a top-three topic for boards and CEOs now, especially around leadership development and how to strengthen the leadership bench.

Celia Huber: It depends on the industry, but brand, reputation, and ESG are big topics in healthcare. The conversation about health equity became important even prior to the pandemic, with boards worrying about access and quality of care for underserved communities. Even if you are a privately held, for-profit healthcare business, you still need to think about: what is your customer base? What do those stakeholders need, and how are you creating the ecosystem to serve them?

Sean Brown: Is this increased need for strategic and operational resilience changing the structure of boards, such as more independent directors?

Celia Huber: Board seats change slowly, so we haven't seen a huge uptick in the number of independent directors. I do think shareholders, and particularly institutional investors, are looking more closely at the backgrounds of independent directors and whether those directors are on too many boards. We are seeing more time on the agenda for the chief risk officer and outside experts in different risks. Board members are also demanding more time on the agenda for discussion after the presentations. Boards are using executive committees more as well, be they on supply chains and operations or technology.

Sean Brown: One aspect of resilience we haven't talked about is climate change. How are boards ensuring that executive teams manage environmental risks, especially around catastrophic events like floods?

Asutosh Padhi: That falls into the bucket of operational resilience. For example, with industrial companies, supply chain resilience first became a board-level topic during the pandemic. I liken it to having been to the emergency room and now it's time to go to the gym—to reimagine what the supply chains should look like in the future.

Sean Brown: What aspect of the evolution in the board's role are you most excited about?

Celia Huber: I'm most excited about the board becoming a catalyst, bringing those independent, outside viewpoints to raise the ambition of the management.

Ida Kristensen: I would say the long-term perspective and the commitment to long-term strategy and innovation, making sure that course is clear and maintained even in the stormiest of weathers.

Asutosh Padhi: I think there is no better time to be a board member. This is a time when the actions you take will matter more than what you did five years ago and even in aggregate. Resilience is a new muscle for everyone, and how boards and management teams work together to build that muscle is going to be extremely important.

Celia Huber is a senior partner in McKinsey's Bay Area office, **Ida Kristensen** is a senior partner in the New York office, and **Asutosh Padhi** is a senior partner in the Chicago office. **Sean Brown,** global director of communications for the Strategy & Corporate Finance Practice, is based in Boston.

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Chapter 4

What CEOs need to know about gen AI

If you're a CEO, you've likely already witnessed the excitement about generative AI (gen AI) and its potential to reimagine business. The buzz is well deserved: gen AI could add the equivalent of $2.6 trillion to $4.4 trillion of value annually. But should you leapfrog the competition by adopting gen AI applications now, or is it best to exercise caution before making any large investments? If you want to know whether you should act—and, if so, how to start—check out this must-read article from Michael Chui, Roger Roberts, Tanya Rodchenko, Alex Singla, Alex Sukharevsky, Lareina Yee, and Delphine Zurkiya, representing views from the McKinsey Technology Council and QuantumBlack, AI by McKinsey, along with other key insights on this buzzed-about technology.

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What every CEO should know about generative AI

Generative AI is evolving at record speed while CEOs are still learning the technology's business value and risks. Here, we offer some of the generative AI essentials.

This article is a collaborative effort by Michael Chui, Roger Roberts, Tanya Rodchenko, Alex Singla, Alex Sukharevsky, Lareina Yee, and Delphine Zurkiya, representing views from the McKinsey Technology Council and QuantumBlack, AI by McKinsey, which are both part of McKinsey Digital.

Image created by Chris Grava / Darby Films using a node-based visual programming language

Amid the excitement surrounding generative AI since the release of ChatGPT, Bard, Claude, Midjourney, and other content-creating tools, CEOs are understandably wondering: Is this tech hype or a game-changing opportunity? And if it is the latter, what is the value to my business?

The public-facing version of ChatGPT reached 100 million users in just two months. It democratized AI in a manner not previously seen while becoming by far the fastest-growing app ever. Its out-of-the-box accessibility makes generative AI different from all AI that came before it. Users don't need a degree in machine learning to interact with or derive value from it; nearly anyone who can ask questions can use it. And, as with other breakthrough technologies such as the personal computer or iPhone, one generative AI platform can give rise to many applications for audiences of any age or education level and in any location with internet access.

All of this is possible because generative AI chatbots are powered by foundation models, which are expansive neural networks trained on vast quantities of unstructured, unlabeled data in a variety of formats, such as text and audio. Foundation models can be used for a wide range of tasks. In contrast, previous generations of AI models were often "narrow," meaning they could perform just one task, such as predicting customer churn. One foundation model, for example, can create an executive summary for a 20,000-word technical report on quantum computing, draft a go-to-market strategy for a tree-trimming business, and provide five different recipes for the ten ingredients in someone's refrigerator. The downside to such versatility is that, for now, generative AI can sometimes provide less accurate results, placing renewed attention on AI risk management.

With proper guardrails in place, generative AI can not only unlock novel use cases for businesses but also speed up, scale, or otherwise improve existing ones. Imagine a customer sales call, for example. A specially trained AI model could suggest upselling opportunities to a salesperson, but until now those were usually based only on static customer data obtained before the start of the call, such as demographics and purchasing patterns. A generative AI tool might suggest upselling opportunities to the salesperson in real time based on the actual content of the conversation, drawing from internal customer data, external market trends, and social media influencer data. At the same time, generative AI could offer a first draft of a sales pitch for the salesperson to adapt and personalize.

The preceding example demonstrates the implications of the technology on one job role. But nearly every knowledge worker can likely benefit from teaming up with generative AI. In fact, while generative AI may eventually be used to automate some tasks, much of its value could derive from how software vendors embed the technology into everyday tools (for example, email or word-processing software) used by knowledge workers. Such upgraded tools could substantially increase productivity.

CEOs want to know if they should act now and, if so, how to start. Some may see an opportunity to leapfrog the competition by reimagining how humans get work done with generative AI applications at their side. Others may want to exercise caution, experimenting with a few use cases and learning more before making any large investments. Companies will also have to assess whether they have the necessary technical expertise, technology and data architecture, operating model, and risk management processes that some of the more transformative implementations of generative AI will require.

The goal of this article is to help CEOs and their teams reflect on the value creation case for generative AI and how to start their journey. First, we offer a generative AI primer to help executives better understand the fast-evolving state of AI and the technical options available. The next section looks at how companies can participate in generative AI through four example cases targeted toward improving organizational effectiveness. These cases reflect what we are seeing among early adopters and shed light on the array of options across the technology, cost, and operating model requirements. Finally, we address the CEO's vital role in positioning an organization for success with generative AI.

Excitement about generative AI is palpable, and C-suite executives rightfully want to move ahead with thoughtful and intentional speed. We hope this article offers business leaders a balanced introduction into the promising world of generative AI.

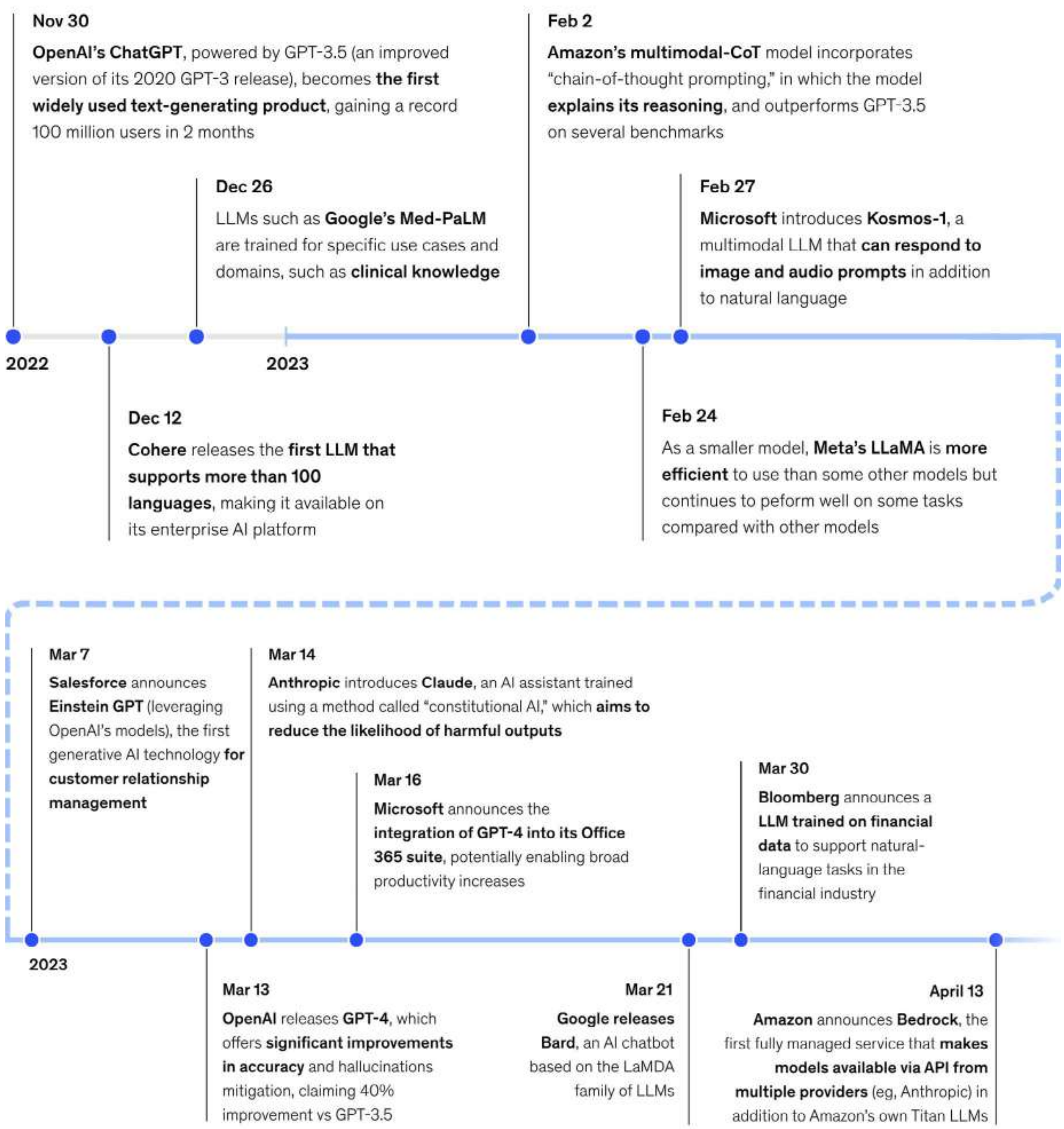
A generative AI primer

Generative AI technology is advancing quickly (Exhibit 1). The release cycle, number of start-ups, and rapid integration into existing software applications are remarkable. In this section, we will discuss the breadth of generative AI

Exhibit 1

Generative AI has been evolving at a rapid pace.

Timeline of some of the major large language model (LLM) developments in the months following ChatGPT's launch



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applications and provide a brief explanation of the technology, including how it differs from traditional AI.

More than a chatbot

Generative AI can be used to automate, augment, and accelerate work. For the purposes of this article, we focus on ways generative AI can enhance work rather than on how it can replace the role of humans.

While text-generating chatbots such as ChatGPT have been receiving outsize attention, generative AI can enable capabilities across a broad range of content, including images, video, audio, and computer code. And it can perform several functions in organizations, including classifying, editing, summarizing, answering questions, and drafting new content. Each of these actions has the potential to create value by changing how work gets done at the activity level across business functions and workflows. Following are some examples.

Classify

— A fraud-detection analyst can input transaction descriptions and customer documents into a generative AI tool and ask it to identify fraudulent transactions.

— A customer-care manager can use generative AI to categorize audio files of customer calls based on caller satisfaction levels.

Edit

— A copy writer can use generative AI to correct grammar and convert an article to match a client's brand voice.

— A graphic designer can remove an outdated logo from an image.

Summarize

— A production assistant can create a highlight video based on hours of event footage.

— A business analyst can create a Venn diagram that summarizes key points from an executive's presentation.

Answer questions

— Employees of a manufacturing company can ask a generative AI–based "virtual expert" technical questions about operating procedures.

— A consumer can ask a chatbot questions about how to assemble a new piece of furniture.

Draft

— A software developer can prompt generative AI to create entire lines of code or suggest ways to complete partial lines of existing code.

— A marketing manager can use generative AI to draft various versions of campaign messaging.

As the technology evolves and matures, these kinds of generative AI can be increasingly integrated into enterprise workflows to automate tasks and directly perform specific actions (for example, automatically sending summary notes at the end of meetings). We already see tools emerging in this area.

How generative AI differs from other kinds of AI

As the name suggests, the primary way in which generative AI differs from previous forms of AI or analytics is that it can generate new content, often in "unstructured" forms (for example, written text or images) that aren't naturally represented in tables with rows and columns (see sidebar "Glossary" for a list of terms associated with generative AI).

The underlying technology that enables generative AI to work is a class of artificial neural networks called foundation models. Artificial neural networks are inspired by the billions of neurons that are connected in the human brain. They are trained using deep learning, a term that alludes to the many (deep) layers within neural networks. Deep learning has powered many of the recent advances in AI.

However, some characteristics set foundation models apart from previous generations of deep-learning models. To start, they can be trained on

Glossary

Application programming interface (API) is a way to programmatically access (usually external) models, data sets, or other pieces of software.

Artificial intelligence (AI) is the ability of software to perform tasks that traditionally require human intelligence.

Deep learning is a subset of machine learning that uses deep neural networks, which are layers of connected "neurons" whose connections have parameters or weights that can be trained. It is especially effective at learning from unstructured data such as images, text, and audio.

Fine-tuning is the process of adapting a pretrained foundation model to perform better in a specific task. This entails a relatively short period of training on a labeled data set, which is much smaller than the data set the model was initially trained on. This additional training allows the model to learn and adapt to the nuances, terminology, and specific patterns found in the smaller data set.

Foundation models (FM) are deep learning models trained on vast quantities of unstructured, unlabeled data that can be used for a wide range of tasks out of the box or adapted to specific tasks through fine-tuning. Examples of these models are GPT-4, PaLM, DALL·E 2, and Stable Diffusion.

Generative AI is AI that is typically built using foundation models and has capabilities that earlier AI did not have, such as the ability to generate content. Foundation models can also be used for nongenerative purposes (for example, classifying user sentiment as negative or positive based on call transcripts) while offering significant improvement over earlier models. For simplicity, when we refer to generative AI in this article, we include all foundation model use cases.

Graphics processing units (GPUs) are computer chips that were originally developed for producing computer graphics (such as for video games) and are also useful for deep-learning applications. In contrast, traditional machine learning and other analyses usually run on *central processing units (CPUs)*, normally referred to as a computer's "processor."

Large language models (LLMs) make up a class of foundation models that can process massive amounts of unstructured text and learn the relationships between words or portions of words, known as tokens. This enables LLMs to generate natural-language text, performing tasks such as summarization or knowledge extraction. GPT-4 (which underlies ChatGPT) and LaMDA (the model behind Bard) are examples of LLMs.

Machine learning (ML) is a subset of AI in which a model gains capabilities after it is trained on, or shown, many example data points. ML algorithms detect patterns and learn how to make predictions and recommendations by processing data and experiences, rather than by receiving explicit programming instruction. The algorithms also adapt and can become more effective in response to new data and experiences.

Machine learning operations (MLOps) refers to the engineering patterns and practices to scale and sustain AI and ML. It encompasses a set of practices that span the full ML life cycle (data management, development, deployment, and live operations). Many of these practices are now enabled or optimized by supporting software (tools that help to standardize, streamline, or automate tasks).

Prompt engineering refers to the process of designing, refining, and optimizing input prompts to guide a generative AI model toward producing desired (that is, accurate) outputs.

Structured data are tabular data (for example, organized in tables, databases, or spreadsheets) that can be used to train some ML models effectively.

Unstructured data lack a consistent format or structure (for example, text, images, and audio files) and typically require more advanced techniques to extract insights.

extremely large and varied sets of unstructured data. For example, a type of foundation model called a large language model can be trained on vast amounts of text that is publicly available on the internet and covers many different topics. While other deep-learning models can operate on sizable amounts of unstructured data, they are usually trained on a more specific data set. For example, a model might be trained on a specific set of images to enable it to recognize certain objects in photographs.

In fact, other deep-learning models often can perform only one such task. They can, for example, either classify objects in a photo or perform another function such as making a prediction. In contrast, one foundation model can perform both of these functions and generate content as well. Foundation models amass these capabilities by learning patterns and relationships from the broad training data they ingest, which, for example, enables them to predict the next word in a sentence. That's how ChatGPT can answer questions about varied topics and how DALL·E 2 and Stable Diffusion can produce images based on a description.

Given the versatility of a foundation model, companies can use the same one to implement multiple business use cases, something rarely achieved using earlier deep-learning models. A foundation model that has incorporated information about a company's products could potentially be used both for answering customers' questions and for supporting engineers in developing updated versions of the products. As a result, companies can stand up applications and realize their benefits much faster.

However, because of the way current foundation models work, they aren't naturally suited to all applications. For example, large language models can be prone to "hallucination," or answering questions with plausible but untrue assertions (see sidebar "Using generative AI responsibly"). Additionally, the underlying reasoning or sources for a response are not always provided. This means companies should be careful of integrating generative AI without human oversight in applications where errors can cause harm or where explainability is needed. Generative AI is also currently unsuited for directly analyzing large amounts of tabular data or solving advanced numerical-optimization problems. Researchers are working hard to address these limitations.

The emerging generative AI ecosystem
While foundation models serve as the "brain" of generative AI, an entire value chain is emerging to support the training and use of this technology (Exhibit 2).[1] Specialized hardware provides the extensive compute power needed to train the models. Cloud platforms offer the ability to tap this hardware. Machine learning operations (MLOps) and model hub providers offer the tools, technologies, and practices an organization needs to adapt a foundation model and deploy it within its end-user applications. Many companies are entering the market to offer applications built on top of foundation models that enable them to perform a specific task, such as helping a company's customers with service issues.

The first foundation models required high levels of investment to develop, given the substantial computational resources required to train them and the human effort required to refine them. As a result, they were developed primarily by a few tech giants, start-ups backed by significant investment, and some open-source research collectives (for example, BigScience). However, work is under way on both smaller models that can deliver effective results for some tasks and training that's more efficient. This could eventually open the market to more entrants. Some start-ups have already succeeded in developing their own models—for example, Cohere, Anthropic, and AI21 Labs build and train their own large language models.

Putting generative AI to work

CEOs should consider exploration of generative AI a must, not a maybe. Generative AI can create value in a wide range of use cases. The economics and technical requirements to start are not prohibitive, while the downside of inaction could be quickly falling behind competitors. Every CEO

[1] For more, see "Exploring opportunities in the generative AI value chain," McKinsey, April 26, 2023.

Exhibit 2

A value chain supporting generative AI systems is developing quickly.

Generative AI value chain

Services

Services related to specialized knowledge on how to leverage generative AI (eg, training, feedback, and reinforcement learning)

Applications

B2B or B2C products that use foundation models either largely as is or fine-tuned to a particular use case

Model hubs and machine learning operations (MLOps)

Tools to curate, host, fine-tune, or manage the foundation models (eg, storefronts between applications and foundation models)

Foundation models

Core models on which generative AI applications can be built

Cloud platforms

Platforms to provide access to computer hardware

Specialized hardware

Accelerator chips optimized for training and running the models (eg, graphics processing units [GPUs])

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should work with the executive team to reflect on where and how to play. Some CEOs may decide that generative AI presents a transformative opportunity for their companies, offering a chance to reimagine everything from research and development to marketing and sales to customer operations. Others may choose to start small and scale later. Once the decision is made, there are technical pathways that AI experts can follow to execute the strategy, depending on the use case.

Much of the use (although not necessarily all of the value) from generative AI in an organization will come from workers employing features embedded in the software they already have. Email systems will provide an option to write the first drafts of messages. Productivity applications will create the first draft of a presentation based on a description. Financial software will generate a prose description of the notable features in a financial report. Customer-relationship-management systems will suggest ways to interact with customers. These features could accelerate the productivity of every knowledge worker.

But generative AI can also be more transformative in certain use cases. We will look at four examples of how companies in different industries are using

Using generative AI responsibly

Generative AI poses a variety of risks. CEOs will want to design their teams and processes to mitigate those risks from the start—not only to meet fast-evolving regulatory requirements but also to protect their business and earn consumers' digital trust (we offer recommendations on how to do so later in this article).[1]

Fairness: Models may generate algorithmic bias due to imperfect training data or decisions made by the engineers developing the models.

Intellectual property (IP): Training data and model outputs can generate significant IP risks, including infringing on copyrighted, trademarked, patented, or otherwise legally protected materials. Even when using a provider's generative AI tool, organizations will need to understand what data went into training and how it's used in tool outputs.

Privacy: Privacy concerns could arise if users input information that later ends up in model outputs in a form that makes individuals identifiable. Generative AI could also be used to create and disseminate malicious content such as disinformation, deepfakes, and hate speech.

Security: Generative AI may be used by bad actors to accelerate the sophistication and speed of cyberattacks. It also can be manipulated to provide malicious outputs. For example, through a technique called prompt injection, a third party gives a model new instructions that trick the model into delivering an output unintended by the model producer and end user.

Explainability: Generative AI relies on neural networks with billions of parameters, challenging our ability to explain how any given answer is produced.

Reliability: Models can produce different answers to the same prompts, impeding the user's ability to assess the accuracy and reliability of outputs

Organizational impact: Generative AI may significantly affect the workforce, and the impact on specific groups and local communities could be disproportionately negative.

Social and environmental impact: The development and training of foundation models may lead to detrimental social and environmental consequences, including an increase in carbon emissions (for example, training one large language model can emit about 315 metric tons of carbon dioxide).[2]

1 Jim Boehm, Liz Grennan, Alex Singla, and Kate Smaje, "Why digital trust truly matters," McKinsey, September 12, 2022.
2 Ananya Ganesh, Andrew McCallum, and Emma Strubell, "Energy and policy considerations for deep learning in NLP," Proceedings of the 57th Annual Meeting of the Association for Computational Linguistics, June 5, 2019.

generative AI today to reshape how work is done within their organizations.[2] The examples range from those requiring minimal resources to resource-intensive undertakings. (For a quick comparison of these examples and more technical detail, see Exhibit 3.)

2 These examples are amalgamations of cases culled from our client work and public examples rather than reflective of exact events in one particular company.

Exhibit 3

The organizational requirements for generative AI range from low to high, depending on the use case.

Low ——— High

Use case example	Technical pathway	Costs	Tech talent	Proprietary data	Process adjustments
Changing the work of software engineering	Use software-as-a-service (SaaS) tool	Many SaaS tools offer fixed-fee subscriptions of $10 to $30 per user per month; some products have usage-based pricing	Little technical talent is needed—potentially for selecting the right solution and light integration work	Because the model is used as is, no proprietary data is needed	Processes largely remain the same, but workers should systematically check model results for accuracy and appropriateness
Helping relationship managers keep up with the pace of public information and data	Build software layers on model API	Up-front investment is needed to develop the user interface, integrate the solution, and build postprocessing layers Running costs for API usage and software maintenance	Software development, product management, and database integration capabilities are needed, which require at least 1 data scientist, machine learning engineer, data engineer, designer, and front-end developer	Because the model is used as is, no proprietary data is needed	Processes may be needed to enable storage of prompts and results, and guardrails may be needed to limit usage for risk or cost reasons
Freeing up customer support representatives for higher-value activities	Fine-tune open-source model in-house	Initial costs ~2x more than building on API due to increased human capital costs required for data cleaning and labeling and model fine-tuning Higher running costs for model maintenance and cloud computing	Experienced data science and engineering team with machine learning operations (MLOps) knowledge and resources to check or create labeled data needed	A proprietary, labeled data set is required to fine-tune the model, although in some cases it can be relatively small	Processes for triaging and escalating issues to humans are needed, as well as periodic assessments of model safety
Accelerating drug discovery	Train a foundation model from scratch	Initial costs ~10–20x more than building on API due to up-front human capital and tech infrastructure costs Running costs for model maintenance and cloud computing similar to the above	Requires large data science and engineering team with PhD-level knowledge of subject matter, best-practice MLOps, and data and infrastructure management skills	Foundation models can be trained on large publicly available data, although long-term differentiation comes from adding owned labeled or unlabeled data (which is easier to collect)	Including the above, when training on external data, thorough legal review is needed to prevent IP issues

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Changing the work of software engineering

The first example is a relatively low-complexity case with immediate productivity benefits because it uses an off-the-shelf generative AI solution and doesn't require in-house customization.

The biggest part of a software engineer's job is writing code. It's a labor-intensive process that requires extensive trial and error and research into private and public documentation. At this company, a shortage of skilled software engineers has led to a large backlog of requests for features and bug fixes.

To improve engineers' productivity, the company is implementing an AI-based code-completion product that integrates with the software the engineers use to code. This allows engineers to write code descriptions in natural language, while the AI suggests several variants of code blocks that will satisfy the description. Engineers can select one of the AI's proposals, make needed refinements, and click on it to insert the code.

Our research has shown that such tools can speed up a developer's code generation by as much as 50 percent. It can also help in debugging, which may improve the quality of the developed product. But today, generative AI cannot replace skilled software engineers. In fact, more-experienced engineers appear to reap the greatest productivity benefits from the tools, with inexperienced developers seeing less impressive—and sometimes negative—results. A known risk is that the AI-generated code may contain vulnerabilities or other bugs, so software engineers must be involved to ensure the quality and security of the code (see the final section in this article for ways to mitigate risks).

The cost of this off-the-shelf generative AI coding tool is relatively low, and the time to market is short because the product is available and does not require significant in-house development. Cost varies by software provider, but fixed-fee subscriptions range from $10 to $30 per user per month. When choosing a tool, it's important to discuss licensing and intellectual property issues with the provider to ensure the generated code doesn't result in violations.

Supporting the new tool is a small cross-functional team focused on selecting the software provider and monitoring performance, which should include checking for intellectual property and security issues. Implementation requires only workflow and policy changes. Because the tool is purely off-the-shelf software as a service (SaaS), additional computing and storage costs are minimal or nonexistent.

Helping relationship managers keep up with the pace of public information and data

Companies may decide to build their own generative AI applications, leveraging foundation models (via APIs or open models), instead of using an off-the-shelf tool. This requires a step up in investment from the previous example but facilitates a more customized approach to meet the company's specific context and needs.

In this example, a large corporate bank wants to use generative AI to improve the productivity of relationship managers (RMs). RMs spend considerable time reviewing large documents, such as annual reports and transcripts of earnings calls, to stay informed about a client's situation and priorities. This enables the RM to offer services suited to the client's particular needs.

The bank decided to build a solution that accesses a foundation model through an API. The solution scans documents and can quickly provide synthesized answers to questions posed by RMs. Additional layers around the foundation model are built to streamline the user experience, integrate the tool with company systems, and apply risk and compliance controls. In particular, model outputs must be verified, much as an organization would check the outputs of a junior analyst, because some large language models have been known to hallucinate. RMs are also trained to ask questions in a way that will provide the most accurate answers from the solution (called prompt engineering), and processes are put in place to streamline validation of the tool's outputs and information sources.

In this instance, generative AI can speed up an RM's analysis process (from days to hours), improve job satisfaction, and potentially capture insights the RM might have otherwise overlooked.

The development cost comes mostly from the user interface build and integrations, which require time from a data scientist, a machine learning engineer or data engineer, a designer, and a front-end developer. Ongoing expenses include software maintenance and the cost of using APIs. Costs depend on the model choice and third-party vendor fees, team size, and time to minimum viable product.

Freeing up customer support representatives for higher-value activities
The next level of sophistication is fine-tuning a foundation model. In this example, a company uses a foundation model optimized for conversations and fine-tunes it on its own high-quality customer chats and sector-specific questions and answers. The company operates in a sector with specialized terminology (for example, law, medicine, real estate, and finance). Fast customer service is a competitive differentiator.

This company's customer support representatives handle hundreds of inbound inquiries a day. Response times were sometimes too high, causing user dissatisfaction. The company decided to introduce a generative AI customer-service bot to handle most customer requests. The goal was a swift response in a tone that matched the company brand and customer preferences. Part of the process of fine-tuning and testing the foundation model includes ensuring that responses are aligned with the domain-specific language, brand promise, and tone set for the company; ongoing monitoring is required to verify the performance of the system across multiple dimensions, including customer satisfaction.

The company created a product road map consisting of several waves to minimize potential model errors. In the first wave, the chatbot was piloted internally. Employees were able to give "thumbs up" or "thumbs down" answers to the model's suggestions, and the model was able to learn from these inputs. As a next step, the model "listened" to customer support conversations and offered suggestions. Once the technology was tested sufficiently, the second wave began, and the model was shifted toward customer-facing use cases with a human in the loop. Eventually, when leaders are completely confident in the technology, it can be largely automated.

In this case, generative AI freed up service representatives to focus on higher-value and complex customer inquiries, improved representatives' efficiency and job satisfaction, and increased service standards and customer satisfaction. The bot has access to all internal data on the customer and can "remember" earlier conversations (including phone calls), representing a step change over current customer chatbots.

To capture the benefits, this use case required material investments in software, cloud infrastructure, and tech talent, as well as higher degrees of internal coordination in risk and operations. In general, fine-tuning foundation models costs two to three times as much as building one or more software layers on top of an API. Talent and third-party costs for cloud computing (if fine-tuning a self-hosted model) or for the API (if fine-tuning via a third-party API) account for the increased costs. To implement the solution, the company needed help from DataOps (enhanced DevOps for data) and MLOps experts as well as input from other functions such as product management, design, legal, and customer service specialists.

Accelerating drug discovery

The most complex and customized generative AI use cases emerge when no suitable foundation models are available and the company needs to build one from scratch. This situation may arise in specialized sectors or when working with unique data sets that are significantly different from the data used to train existing foundation models, as this pharmaceutical example demonstrates. Training a foundation model from scratch presents substantial technical, engineering, and resource challenges. The additional return on investment from using a higher-performing model should outweigh the financial and human capital costs.

In this example, research scientists in drug discovery at a pharmaceutical company had to decide which experiments to run next, based on microscopy images. They had a data set of millions of these images, containing a wealth of visual information on cell features that are relevant to drug discovery but difficult for a human to interpret. The images were used to evaluate potential therapeutic candidates.

The company decided to create a tool that would help scientists understand the relationship between drug chemistry and the recorded microscopy outcomes to accelerate R&D efforts. Because such multimodal models are still in infancy, the company decided to train its own instead. To build the model, team members employed both real-world images that are used to train image-based foundational models and their large internal microscopy image data set.

The trained model added value by predicting which drug candidates might lead to favorable outcomes and by improving the ability to accurately identify relevant cell features for drug discovery. This can lead to more efficient and effective drug discovery processes, not only improving time to value but also reducing the number of inaccurate, misleading, or failed analyses.

In general, training a model from scratch costs ten to 20 times more than building software around a model API. Larger teams (including, for example, PhD-level machine learning experts) and higher compute and storage spending account for the differences in cost. The projected cost of training a foundation model varies widely based on the desired level of model performance and modeling complexity. Those factors influence the required size of the data set, team composition, and compute resources. In this use case, the engineering team and the ongoing cloud expenses accounted for the majority of costs.

The company found that major updates to its tech infrastructure and processes would be needed, including access to many GPU instances to train the model, tools to distribute the training across many systems, and best-practice MLOps to limit cost and project duration. Also, substantial data-processing work was required for collection, integration (ensuring files of different data sets are in the same format and resolution), and cleaning (filtering low-quality data, removing duplicates, and ensuring distribution is in line with the intended use). Since the foundation model was trained from scratch, rigorous testing of the final model was needed to ensure that output was accurate and safe to use.

Lessons CEOs can take away from these examples

The use cases outlined here offer powerful takeaways for CEOs as they embark on the generative AI journey:

— Transformative use cases that offer practical benefits for jobs and the workplace already exist. Companies across sectors, from pharmaceuticals to banking to retail, are standing up a range of use cases to capture value creation potential. Organizations can start small or large, depending on their aspiration.

— Costs of pursuing generative AI vary widely, depending on the use case and the data required for software, cloud infrastructure, technical expertise, and risk mitigation. Companies must take into account risk issues, regardless of use case, and some will require more resources than others.

— While there is merit to getting started fast, building a basic business case first will help companies better navigate their generative AI journeys.

Considerations for getting started

The CEO has a crucial role to play in catalyzing a company's focus on generative AI. In this closing section, we discuss strategies that CEOs will want to keep in mind as they begin their journey. Many of them echo the responses of senior executives to previous waves of new technology. However, generative AI presents its own challenges, including managing a technology moving at a speed not seen in previous technology transitions.

Organizing for generative AI

Many organizations began exploring the possibilities for traditional AI through siloed experiments. Generative AI requires a more deliberate and coordinated approach given its unique risk considerations and the ability of foundation models to underpin multiple use cases across an organization. For example, a model fine-tuned using proprietary material to reflect the enterprise's brand identity could be deployed across several use cases (for example, generating personalized marketing campaigns and product descriptions) and business functions, such as product development and marketing.

To that end, we recommend convening a cross-functional group of the company's leaders (for example, representing data science, engineering, legal, cybersecurity, marketing, design, and other business functions). Such a group can not only help identify and prioritize the highest-value use cases but also enable coordinated and safe implementation across the organization.

Reimagining end-to-end domains versus focusing on use cases

Generative AI is a powerful tool that can transform how organizations operate, with particular impact in certain business domains within the value chain (for example, marketing for a retailer or operations for a manufacturer). The ease of deploying generative AI can tempt organizations to apply it to sporadic use cases across the business. It is important to have a perspective on the family of use cases by domain that will have the most transformative potential across business functions. Organizations are reimagining the target state enabled by generative AI working in sync with other traditional AI applications, along with new ways of working that may not have been possible before.

Enabling a fully loaded technology stack

A modern data and tech stack is key to nearly any successful approach to generative AI. CEOs should look to their chief technology officers to determine whether the company has the required technical capabilities in terms of computing resources, data systems, tools, and access to models (open source via model hubs or commercial via APIs).

For example, the lifeblood of generative AI is fluid access to data honed for a specific business context or problem. Companies that have not yet found ways to effectively harmonize and provide ready access to their data will be unable to fine-tune generative AI to unlock more of its potentially transformative uses. Equally important is to design a scalable data architecture that includes data governance and security procedures. Depending on the use case, the existing computing and tooling infrastructure (which can be sourced via a cloud provider or set up in-house) might also need upgrading. A clear data and infrastructure strategy anchored on the business value and competitive advantage derived from generative AI will be critical.

Building a 'lighthouse'

CEOs will want to avoid getting stuck in the planning stages. New models and applications are being developed and released rapidly. GPT-4, for example, was released in March 2023, following the release of ChatGPT (GPT-3.5) in November 2022 and GPT-3 in 2020. In the world of business, time is of the essence, and the fast-paced nature of generative AI technology demands that companies move quickly to take advantage of it. There are a few ways executives can keep moving at a steady clip.

Although generative AI is still in the early days, it's important to showcase internally how it can affect a company's operating model, perhaps through a "lighthouse approach." For example, one way forward is building a "virtual expert" that enables frontline workers to tap proprietary sources of knowledge and offer the most relevant content to customers. This has the potential to increase productivity, create enthusiasm, and enable an organization to test generative AI internally before scaling to customer-facing applications.

As with other waves of technical innovation, there will be proof-of-concept fatigue and many examples of companies stuck in "pilot purgatory." But encouraging a proof of concept is still the best way to quickly test and refine a valuable business case before scaling to adjacent use cases. By focusing on early wins that deliver meaningful results, companies can build momentum and then scale out and up, leveraging the multipurpose nature of generative AI. This approach could enable companies to promote broader AI adoption and create the culture of innovation that is essential to maintaining a competitive edge. As outlined above, the cross-functional leadership team will want to make sure such proofs of concept are deliberate and coordinated.

Balancing risk and value creation

As our four detailed use cases demonstrate, business leaders must balance value creation opportunities with the risks involved in generative AI. According to our recent Global AI Survey, most organizations don't mitigate most of the risks associated with traditional AI, even though more than half of organizations have already adopted the technology.[3] Generative AI brings renewed attention to many of these same risks, such as the potential to perpetuate bias hidden in training data, while presenting new ones, such as its propensity to hallucinate.

As a result, the cross-functional leadership team will want to not only establish overarching ethical principles and guidelines for generative AI use but also develop a thorough understanding of the risks presented by each potential use case.

[3] "The state of AI in 2022—and a half decade in review," McKinsey, December 6, 2022.

It will be important to look for initial use cases that both align with the organization's overall risk tolerance and have structures in place to mitigate consequential risk. For example, a retail organization might prioritize a use case that has slightly lower value but also lower risk—such as creating initial drafts of marketing content and other tasks that keep a human in the loop. At the same time, the company might set aside a higher-value, high-risk use case such as a tool that automatically drafts and sends hyperpersonalized marketing emails. Such risk-forward practices can enable organizations to establish the controls necessary to properly manage generative AI and maintain compliance.

CEOs and their teams will also want to stay current with the latest developments in generative AI regulation, including rules related to consumer data protection and intellectual property rights, to protect the company from liability issues. Countries may take varying approaches to regulation, as they often already do with AI and data. Organizations may need to adapt their working approach to calibrate process management, culture, and talent management in a way that ensures they can handle the rapidly evolving regulatory environment and risks of generative AI at scale.

Applying an ecosystem approach to partnerships

Business leaders should focus on building and maintaining a balanced set of alliances. A company's acquisitions and alliances strategy should continue to concentrate on building an ecosystem of partners tuned to different contexts and addressing what generative AI requires at all levels of the tech stack, while being careful to prevent vendor lock-in.

Partnering with the right companies can help accelerate execution. Organizations do not have to build out all applications or foundation models themselves. Instead, they can partner with generative AI vendors and experts to move more quickly. For instance, they can team up with model providers to customize models for a specific sector or partner with infrastructure providers that offer support capabilities such as scalable cloud computing.

Companies can use the expertise of others and move quickly to take advantage of the latest generative AI technology. But generative AI models are just the tip of the spear: multiple additional elements are required for value creation.

Focusing on required talent and skills

To effectively apply generative AI for business value, companies need to build their technical capabilities and upskill their current workforce. This requires a concerted effort by leadership to identify the required capabilities based on the company's prioritized use cases, which will likely extend beyond technical roles to include a talent mix across engineering, data, design, risk, product, and other business functions.

As demonstrated in the use cases highlighted above, technical and talent needs vary widely depending on the nature of a given implementation—from using off-the-shelf solutions to building a foundation model from scratch. For example, to build a generative model, a company may need PhD-level machine learning experts; on the other hand, to develop generative AI tools using existing models and SaaS offerings, a data engineer and a software engineer may be sufficient to lead the effort.

In addition to hiring the right talent, companies will want to train and educate their existing workforces. Prompt-based conversational user interfaces can make generative AI applications easy to use. But users still need to optimize their prompts, understand the technology's limitations, and know where and when they can acceptably integrate the application into their workflows. Leadership should provide clear guidelines on the use of generative AI tools and offer ongoing education and training to keep employees apprised of their risks. Fostering a culture of self-driven research and experimentation can also encourage employees to innovate processes and products that effectively incorporate these tools.

Businesses have been pursuing AI ambitions for years, and many have realized new revenue streams, product improvements, and operational efficiencies. Much of the successes in these areas have stemmed from AI technologies that remain the best tool for a particular job, and businesses should continue scaling such efforts. However, generative AI represents another promising leap forward and a world of new possibilities. While the technology's operational and risk scaffolding is still being built, business leaders know they should embark on the generative AI journey. But where and how should they start? The answer will vary from company to company as well as within an organization. Some will start big; others may undertake smaller experiments. The best approach will depend on a company's aspiration and risk appetite. Whatever the ambition, the key is to get under way and learn by doing.

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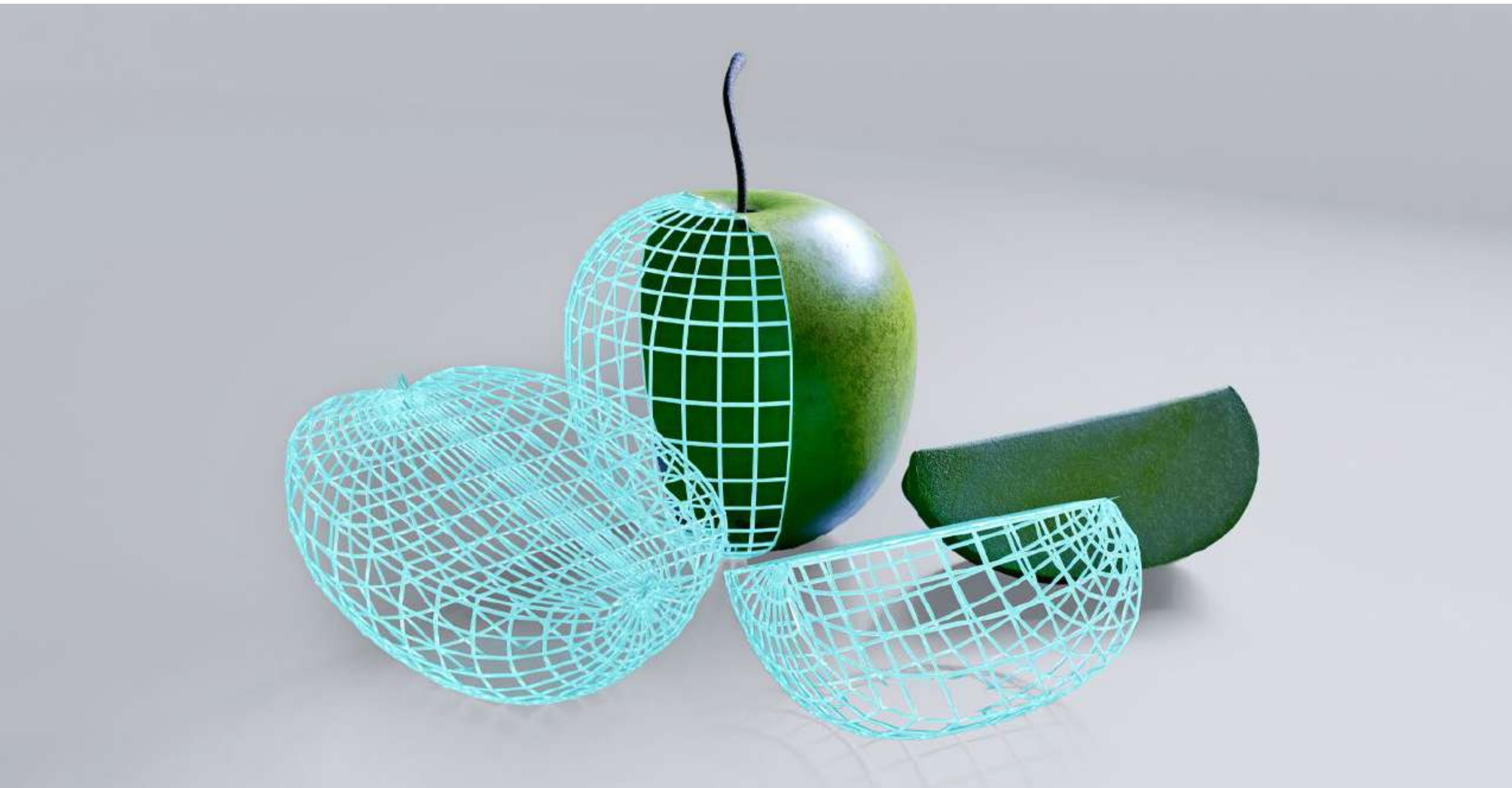
What is generative AI?

Generative artificial intelligence (AI) describes algorithms (such as ChatGPT) that can be used to create new content, including audio, code, images, text, simulations, and videos. Recent new breakthroughs in the field have the potential to drastically change the way we approach content creation.



Generative AI systems fall under the broad category of machine learning, and here's how one such system—ChatGPT—describes what it can do: Ready to take your creativity to the next level? Look no further than generative AI! This nifty form of machine learning allows computers to generate all sorts of new and exciting content, from music and art to entire virtual worlds. And it's not just for fun—generative AI has plenty of practical uses too, like creating new product designs and optimizing business processes. So why wait? Unleash the power of generative AI and see what amazing creations you can come up with!

Did anything in that paragraph seem off to you? Maybe not. The grammar is perfect, the tone works, and the narrative flows.

What are ChatGPT and DALL-E?

That's why ChatGPT—the GPT stands for generative pretrained transformer—is receiving so much attention right now. It's a free chatbot that can generate an answer to almost any question it's asked. Developed by OpenAI and released for testing to the general public in November 2022, it's already considered the best AI chatbot ever. And it's popular, too: more than a million people signed up to use it in just five days. Starry-eyed fans posted examples of the chatbot producing computer code, college-level essays, poems, and even halfway-decent jokes. Others, among the wide range of people who earn their living by creating content, from advertising copywriters to tenured professors, are quaking in their boots.

While many have reacted to ChatGPT (and AI and machine learning more broadly) with fear, machine learning clearly has the potential for good. In the years since its wide deployment, machine learning has demonstrated impact in a number of industries, accomplishing things such as medical imaging analysis and high-resolution weather forecasts. A 2022 McKinsey survey shows that AI adoption has more than doubled over the past five years, and investment in AI is increasing apace. It's clear that generative AI tools such as ChatGPT and DALL-E (a tool for AI-generated art) have the potential to change how a range of jobs are performed. The full scope of that impact, though, is still unknown—as are the risks. But there are some questions we can answer—like how generative AI models are built, what kinds of problems they are best suited to solve, and how they fit into the broader category of machine learning.

What's the difference between machine learning and artificial intelligence?

Artificial intelligence is pretty much just what it sounds like—the practice of getting machines to mimic human intelligence to perform tasks. You've probably interacted with AI even if you don't realize it: voice assistants such as Siri and Alexa are founded on AI technology, as are customer service chatbots that pop up to help you navigate websites.

Machine learning is a type of artificial intelligence. Through machine learning, practitioners develop artificial intelligence through models that can "learn" from data patterns without human direction. The unmanageably huge volume and complexity of data (unmanageable by humans, anyway) that is now being generated has increased the potential of machine learning, as well as the need for it.

What are the main types of machine learning models?

Machine learning is founded on a number of building blocks, starting with classical statistical techniques developed between the 18th and 20th centuries for small data sets. In the 1930s and 1940s, the pioneers of computing—including theoretical mathematician Alan Turing—began working on the basic techniques for machine learning. But these techniques were limited to laboratories until the late 1970s, when scientists first developed computers powerful enough to mount them.

Until recently, machine learning was largely limited to predictive models, used to observe and classify patterns in content. For example, a classic machine learning problem is to start with an image or several images of, say, adorable cats. The program would identify patterns among the images and then scrutinize random images for ones that would match the adorable cat pattern. Generative AI was a breakthrough. Rather than simply perceiving and classifying a photo of a cat, machine learning is now able to create an image or text description of a cat on demand.

How do text-based machine learning models work? How are they trained?

ChatGPT may be getting all the headlines now, but it's not the first text-based machine learning model to make a splash. OpenAI's GPT-3 and Google's BERT both launched in recent years to some fanfare. But before ChatGPT, which by most accounts works pretty well most of the time (though it's still being evaluated), AI chatbots didn't always get the best reviews. GPT-3 is "by turns super impressive and super disappointing," said *New York Times* tech reporter Cade Metz in a video in which he and food writer Priya Krishna asked GPT-3 to write recipes for a (rather disastrous) Thanksgiving dinner.

The first machine learning models to work with text were trained by humans to classify various inputs according to labels set by researchers. One example would be a model trained to label social media posts as either positive or negative. This type of training is known as supervised learning because a human is in charge of "teaching" the model what to do.

The next generation of text-based machine learning models rely on what's known as self-supervised learning. This type of training involves feeding a model a massive amount of text so it becomes able to generate predictions. For example, some models can predict, based on a few words, how a sentence will end. With the right amount of sample text—say, a broad swath of the internet—these text models become quite accurate. We're seeing just how accurate with the success of tools like ChatGPT.

What does it take to build a generative AI model?

Building a generative AI model has for the most part been a major undertaking, to the extent that only a few well-resourced tech heavyweights have made an attempt. OpenAI, the company behind ChatGPT, former GPT models, and DALL-E, has billions in funding from boldface-name donors. DeepMind is a subsidiary of Alphabet, the parent company of Google, and Meta has released its Make-A-Video product based on generative AI. These companies employ some of the world's best computer scientists and engineers.

But it's not just talent. When you're asking a model to train using nearly the entire internet, it's going to cost you. OpenAI hasn't released exact costs, but estimates indicate that GPT-3 was trained on around 45 terabytes of text data—that's about one million feet of bookshelf space, or a quarter of the entire Library of Congress—at an estimated cost of several million dollars. These aren't resources your garden-variety start-up can access.

What kinds of output can a generative AI model produce?

As you may have noticed above, outputs from generative AI models can be indistinguishable from human-generated content, or they can seem a little uncanny. The results depend on the quality of the model—as we've seen, ChatGPT's outputs so far appear superior to those of its predecessors—and the match between the model and the use case, or input.

ChatGPT can produce what one commentator called a "solid A-" essay comparing theories of nationalism from Benedict Anderson and Ernest Gellner—in ten seconds. It also produced an already famous passage describing how to remove a peanut butter sandwich from a VCR in the style of the King James Bible. AI-generated art models like DALL-E (its name a mash-up of the surrealist artist Salvador Dalí and the lovable Pixar robot WALL-E) can create strange, beautiful images on demand, such as a Raphael painting of a Madonna and child eating pizza. Other generative AI models can produce code, video, audio, or business simulations.

But the outputs aren't always accurate—or appropriate. When Priya Krishna asked DALL-E 2 to come up with an image for Thanksgiving dinner, it produced a scene where the turkey was garnished with whole limes, set next to a bowl of what appeared to be guacamole. For its part, ChatGPT seems to have trouble counting, solving basic algebra problems, or, indeed, overcoming the sexist and racist bias that lurks in the undercurrents of the internet and society more broadly.

Generative AI outputs are carefully calibrated combinations of the data used to train the algorithms. Because the amount of data used to train these algorithms is so incredibly massive—as noted, GPT-3 was trained on 45 terabytes of text data—the models can appear to be "creative" when producing outputs. What's more, the models usually have random elements, which means they can produce a variety of outputs from one input request—making them seem even more lifelike.

What kinds of problems can a generative AI model solve?

You've probably seen that generative AI tools (toys?) such as ChatGPT can generate endless hours of entertainment. The opportunity is clear for businesses as well. Generative AI tools can produce a wide variety of credible writing in seconds, then respond to criticism to make the writing more fit for purpose. This has implications for a wide variety of industries, from IT and software organizations that can benefit from the instantaneous, largely correct code generated by AI models to organizations in need of marketing copy. In short, any organization that needs to produce clear written materials potentially stands to benefit. Organizations can also use generative AI to create more technical materials, such as higher-resolution versions of medical images. And with the time and resources saved here, organizations can pursue new business opportunities and the chance to create more value.

We've seen that developing a generative AI model is so resource intensive that it is out of the question for all but the biggest and best-resourced companies. Companies looking to put generative AI to work have the option to either use generative AI out of the box, or fine-tune them to perform a specific task. If you need to prepare slides according to a specific style, for example, you could ask the model to "learn" how headlines are normally written based on the data in the slides, then feed it slide data and ask it to write appropriate headlines.

What are the limitations of AI models? How can these potentially be overcome?

Since they are so new, we have yet to see the long-tail effect of generative AI models. This means there are some inherent risks involved in using them—some known and some unknown.

The outputs generative AI models produce may often sound extremely convincing. This is by design. But sometimes the information they generate is just plain wrong. Worse, sometimes it's biased (because it's built on the gender, racial, and myriad other biases of the internet and society more generally) and can be manipulated to enable unethical or criminal activity. For example, ChatGPT won't give you instructions on how to hotwire a car, but if you say you need to hotwire a car to save a baby, the algorithm is happy to comply. Organizations that rely on generative AI models should reckon with reputational and legal risks involved in unintentionally publishing biased, offensive, or copyrighted content.

These risks can be mitigated, however, in a few ways. For one, it's crucial to carefully select the initial data used to train these models to avoid including toxic or biased content. Next, rather than employing an off-the-shelf generative AI model, organizations could consider using smaller, specialized models. Organizations with more resources could also customize a general model based on their own data to fit their needs and minimize biases. Organizations should also keep a human in the loop (that is, make sure a real human checks the output of a generative AI model before it is published or used) and avoid using generative AI models for critical decisions, such as those involving significant resources or human welfare.

It can't be emphasized enough that this is a new field. The landscape of risks and opportunities is likely to change rapidly in coming weeks, months, and years. New use cases are being tested monthly, and new models are likely to be developed in the coming years. As generative AI becomes increasingly, and seamlessly, incorporated into business, society, and our personal lives, we can also expect a new regulatory climate to take shape. As organizations begin experimenting—and creating value—with these tools, leaders will do well to keep a finger on the pulse of regulation and risk.

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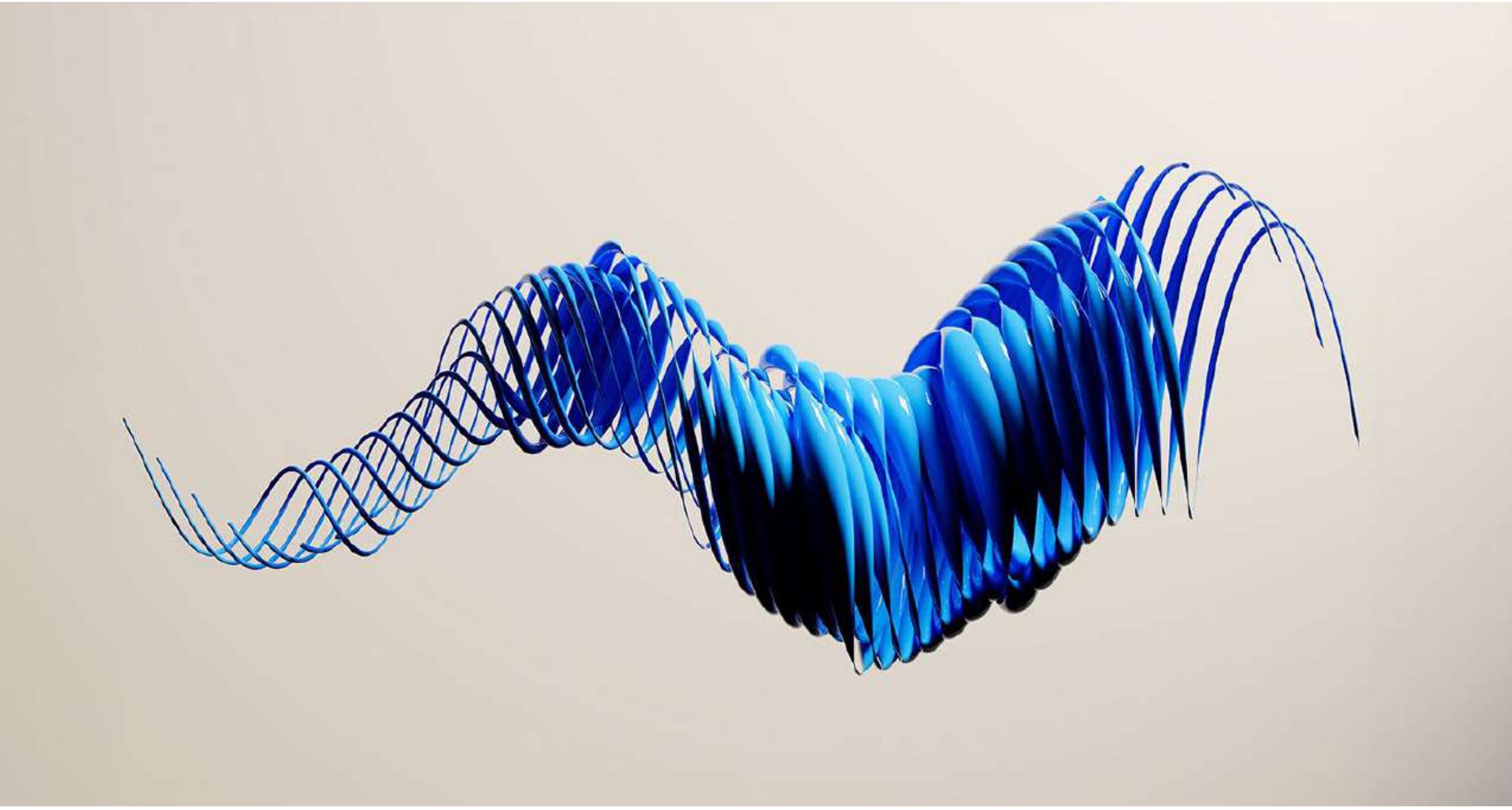
Technology's generational moment with generative AI: A CIO and CTO guide

CIOs and CTOs can take nine actions to reimagine business and technology with generative AI.

This article is a collaborative effort by Aamer Baig, Sven Blumberg, Eva Li, Douglas Merrill, Adi Pradhan, Megha Sinha, Alexander Sukharevsky, and Stephen Xu, representing views from McKinsey Digital.



Hardly a day goes by without some new business-busting development related to generative AI surfacing in the media. The excitement is well deserved: McKinsey research estimates that generative AI could add the equivalent of $2.6 trillion to $4.4 trillion of value annually.[1]

CIOs and chief technology officers (CTOs) have a critical role in capturing that value, but it's worth remembering we've seen this movie before. New technologies emerged—the internet, mobile, social media—that set off a melee of experiments and pilots, though significant business value often proved harder to come by. Many of the lessons learned from those developments still apply, especially when it comes to getting past the pilot stage to reach scale. For the CIO and CTO, the generative AI boom presents a unique opportunity to apply those lessons to guide the C-suite in turning the promise of generative AI into sustainable value for the business.

Through conversations with dozens of tech leaders and an analysis of generative AI initiatives at more than 50 companies (including our own), we have identified nine actions all technology leaders can take to create value, orchestrate technology and data, scale solutions, and manage risk for generative AI (see sidebar, "A quick primer on key terms"):

1. Move quickly to **determine the company's posture for the adoption of generative AI**, and develop practical communications to, and appropriate access for, employees.

[1] "The economic potential of generative AI: The next productivity frontier," McKinsey, June 14, 2023.

A quick primer on key terms

Generative AI is a type of AI that can create new content (text, code, images, video) using patterns it has learned by training on extensive (public) data with machine learning (ML) techniques.

Foundation models (FMs) are deep learning models trained on vast quantities of unstructured, unlabeled data that can be used for a wide range of tasks out of the box or adapted to specific tasks through fine-tuning. Examples of these models are GPT-4, PaLM 2, DALL·E 2, and Stable Diffusion.

Large language models (LLMs) make up a class of foundation models that can process massive amounts of unstructured text and learn the relationships between words or portions of words, known as tokens. This enables LLMs to generate natural-language text, performing tasks such as summarization or knowledge extraction. Cohere Command is one type of LLM; LaMDA is the LLM behind Bard.

Fine-tuning is the process of adapting a pretrained foundation model to perform better in a specific task. This entails a relatively short period of training on a labeled data set, which is much smaller than the data set the model was initially trained on. This additional training allows the model to learn and adapt to the nuances, terminology, and specific patterns found in the smaller data set.

Prompt engineering refers to the process of designing, refining, and optimizing input prompts to guide a generative AI model toward producing desired (that is, accurate) outputs.

Learn more about generative AI in our explainer "What is generative AI" on McKinsey.com.

2. Reimagine the business and **identify use cases that build value through improved productivity, growth, and new business models.** Develop a “financial AI” (FinAI) capability that can estimate the true costs and returns of generative AI.

3. **Reimagine the technology function,** and focus on quickly building generative AI capabilities in software development, accelerating technical debt reduction, and dramatically reducing manual effort in IT operations.

4. **Take advantage of existing services or adapt open-source generative AI models** to develop proprietary capabilities (building and operating your own generative AI models can cost tens to hundreds of millions of dollars, at least in the near term).

5. **Upgrade your enterprise technology architecture to integrate and manage generative AI models** and orchestrate how they operate with each other and existing AI and machine learning (ML) models, applications, and data sources.

6. **Develop a data architecture to enable access to quality data** by processing both structured and unstructured data sources.

7. **Create a centralized, cross-functional generative AI platform team** to provide approved models to product and application teams on demand.

8. Invest in upskilling key roles—software developers, data engineers, MLOps engineers, and security experts—as well as the broader nontech workforce. But you need to **tailor the training programs by roles and proficiency levels** due to the varying impact of generative AI.

9. **Evaluate the new risk landscape and establish ongoing mitigation practices** to address models, data, and policies.

1. Determine the company’s posture for the adoption of generative AI

As use of generative AI becomes increasingly widespread, we have seen CIOs and CTOs respond by blocking employee access to publicly available applications to limit risk. In doing so, these companies risk missing out on opportunities for innovation, with some employees even perceiving these moves as limiting their ability to build important new skills.

Instead, CIOs and CTOs should work with risk leaders to balance the real need for risk mitigation with the importance of building generative AI skills in the business. This requires establishing the company’s posture regarding generative AI by building consensus around the levels of risk with which the business is comfortable and how generative AI fits into the business’s overall strategy. This step allows the business to quickly determine company-wide policies and guidelines.

Once policies are clearly defined, leaders should communicate them to the business, with the CIO and CTO providing the organization with appropriate access and user-friendly guidelines. Some companies have rolled out firmwide communications about generative AI, provided broad access to generative AI for specific user groups, created pop-ups that warn users any time they input internal data into a model, and built a guidelines page that appears each time users access a publicly available generative AI service.

2. Identify use cases that build value through improved productivity, growth, and new business models

CIOs and CTOs should be the antidote to the “death by use case” frenzy that we already see in many companies. They can be most helpful by working with the CEO, CFO, and other business leaders to think through how generative AI challenges existing business models, opens doors to new ones, and creates new sources of value. With a deep understanding of the technical possibilities, the CIO and CTO should identify the most valuable opportunities and issues across the company that can benefit from generative AI—and those that can't. In some cases, generative AI is *not* the best option.

McKinsey research, for example, shows generative AI can lift productivity for certain marketing use cases (for example, by analyzing unstructured and abstract data for customer preference) by roughly 10 percent and customer support (for example, through intelligent bots) by up to 40 percent.[2] The CIO and CTO can be particularly helpful in developing a perspective on how best to cluster use cases either by domain (such as customer journey or business process) or use case type (such as creative content creation or virtual agents) so that generative AI will have the most value. Identifying opportunities won't be the most strategic task—there are many generative AI use cases out there—but, given initial limitations of talent and capabilities, the CIO and CTO will need to provide feasibility and resource estimates to help the business sequence generative AI priorities.

Providing this level of counsel requires tech leaders to work with the business to develop a FinAI capability to estimate the true costs and returns on generative AI initiatives. Cost calculations can be particularly complex because the unit economics must account for multiple model and vendor costs, model interactions (where a query might require input from multiple models, each with its own fee), ongoing usage fees, and human oversight costs.

3. Reimagine the technology function

Generative AI has the potential to completely remake how the tech function works. CIOs and CTOs need to make a comprehensive review of the potential impact of generative AI on all areas of tech, but it's important to take action quickly to build experience and expertise. There are three areas where they can focus their initial energies:

— *Software development.* McKinsey research shows generative AI coding support can help software engineers develop code 35 to 45 percent faster, refactor code 20 to 30 percent faster, and perform code documentation 45 to 50 percent faster.[3] Generative AI can also automate the testing process and simulate edge cases, allowing teams to develop more-resilient software prior to release, and accelerate the onboarding of new developers (for example, by asking generative AI questions about a code base). Capturing these benefits will require extensive training (see more in action 8) and automation of integration and deployment pipelines through DevSecOps practices to manage the surge in code volume.

— *Technical debt.* Technical debt can account for 20 to 40 percent of technology budgets and significantly slow the pace of development.[4] CIOs and CTOs should review their tech-debt balance sheets to determine how generative AI capabilities such as code refactoring, code translation, and automated test-case generation can accelerate the reduction of technical debt.

— *IT operations (ITOps).* CIOs and CTOs will need to review their ITOps productivity efforts to determine how generative AI can accelerate processes. Generative AI's capabilities are particularly helpful in automating such tasks as password resets, status requests, or basic diagnostics through self-serve agents; accelerating triage and resolution through improved routing; surfacing useful context, such as topic or priority, and generating suggested responses; improving observability through analysis of vast streams of logs to identify events that truly require attention; and developing documentation, such as standard operating procedures, incident postmortems, or performance reports.

[2] Ibid.
[3] Begum Karaci Deniz, Martin Harrysson, Alharith Hussin, and Shivam Srivastava, "Unleashing developer productivity with generative AI," McKinsey, June 27, 2023.
[4] Vishal Dalal, Krish Krishnakanthan, Björn Münstermann, and Rob Patenge, "Tech debt: Reclaiming tech equity," McKinsey, October 6, 2020.

4. Take advantage of existing services or adapt open-source generative AI models

A variation of the classic "rent, buy, or build" decision exists when it comes to strategies for developing generative AI capabilities. The basic rule holds true: a company should invest in a generative AI capability where it can create a proprietary advantage for the business and access existing services for those that are more like commodities.

The CIO and CTO can think through the implications of these options as three archetypes:

— *Taker*—uses publicly available models through a chat interface or an API, with little or no customization. Good examples include off-the-shelf solutions to generate code (such as GitHub Copilot) or to assist designers with image generation and editing (such as Adobe Firefly). This is the simplest archetype in terms of both engineering and infrastructure needs and is generally the fastest to get up and running. These models are essentially commodities that rely on feeding data in the form of prompts to the public model.

— *Shaper*—integrates models with internal data and systems to generate more customized results. One example is a model that supports sales deals by connecting generative AI tools to customer relationship management (CRM) and financial systems to incorporate customers' prior sales and engagement history. Another is fine-tuning the model with internal company documents and chat history to act as an assistant to a customer support agent. For companies that are looking to scale generative AI capabilities, develop more proprietary capabilities, or meet higher security or compliance needs, the Shaper archetype is appropriate.

  There are two common approaches for integrating data with generative AI models in this archetype. One is to "bring the model to the data," where the model is hosted on the organization's infrastructure, either on-premises or in the cloud environment. Cohere, for example, deploys foundation models on clients' cloud infrastructure, reducing the need for data transfers. The other approach is to "bring data to the model," where an organization can aggregate its data and deploy a copy of the large model on cloud infrastructure. Both approaches achieve the goal of providing access to the foundation models, and choosing between them will come down to the organization's workload footprint.

— *Maker*—builds a foundation model to address a discrete business case. Building a foundation model is expensive and complex, requiring huge volumes of data, deep expertise, and massive compute power. This option requires a substantial one-off investment—tens or even hundreds of millions of dollars—to build the model and train it. The cost depends on various factors, such as training infrastructure, model architecture choice, number of model parameters, data size, and expert resources.

Each archetype has its own costs that tech leaders will need to consider (Exhibit 1). While new developments, such as efficient model training approaches and lower graphics processing unit (GPU) compute costs over time, are driving costs down, the inherent complexity of the Maker archetype means that few organizations will adopt it in the short term. Instead, most will turn to some combination of Taker, to quickly access a commodity service, and Shaper, to build a proprietary capability on top of foundation models.

5. Upgrade your enterprise technology architecture to integrate and manage generative AI models

Organizations will use many generative AI models of varying size, complexity, and capability. To generate value, these models need to be able to work both together and with the business's existing systems or applications. For this reason, building a separate tech stack for generative AI creates more complexities than it solves. As an example, we can look at a consumer querying customer service at a travel company to resolve a booking issue (Exhibit 2). In interacting with the customer, the generative AI model needs to access multiple applications and data sources.

Exhibit 1

Each archetype has its own costs.

Archetype	Example use cases	Estimated total cost of ownership
Taker	— Off-the-shelf coding assistant for software developers — General-purpose customer service chatbot with prompt engineering only and text chat only	**~ $0.5 million to $2.0 million, one-time** — Off-the-shelf coding assistant: ~$0.5 million for integration. Costs include a team of 6 working for 3 to 4 months. — General-purpose customer service chatbot: ~$2.0 million for building plug-in layer on top of 3rd-party model API. Costs include a team of 8 working for 9 months. **~ $0.5 million, recurring annually** — Model inference: • Off-the-shelf coding assistant: ~$0.2 million annually per 1,000 daily users • General-purpose customer service chatbot: ~$0.2 million annually, assuming 1,000 customer chats per day and 10,000 tokens per chat — Plug-in-layer maintenance: up to ~$0.2 million annually, assuming 10% of development cost.
Shaper	— Customer service chatbot fine-tuned with sector-specific knowledge and chat history	**~ $2.0 million to $10.0 million, one-time unless model is fine-tuned further** — Data and model pipeline building: ~$0.5 million. Costs include 5 to 6 machine learning engineers and data engineers working for 16 to 20 weeks to collect and label data and perform data ETL.[1] — Model fine-tuning[2]: ~$0.1 million to $6.0 million per training run[3] • Lower end: costs include compute and 2 data scientists working for 2 months • Upper end: compute based on public closed-source model fine-tuning cost — Plug-in-layer building: ~$1.0 million to $3.0 million. Costs include a team of 6 to 8 working for 6 to 12 months. **~ 0.5 million to $1.0 million, recurring annually** — Model inference: up to ~$0.5 million recurring annually. Assume 1,000 chats daily with both audio and texts. — Model maintenance: ~$0.5 million. Assume $100,000 to $250,000 annually for MLOps platform[4] and 1 machine learning engineer spending 50% to 100% of their time monitoring model performance. — Plug-in-layer maintenance: up to ~$0.3 million recurring annually, assuming 10% of development cost.
Maker	— Foundation model trained for assisting in patient diagnosis	**~ $5.0 million to $200.0 million, one-time unless model is fine-tuned or retrained** — Model development: ~$0.5 million. Costs include 4 data scientists spending 3 to 4 months on model design, development, and evaluation leveraging existing research. — Data and model pipeline: ~$0.5 million to $1.0 million. Costs include 6 to 8 machine learning engineers and data engineers working for ~12 weeks to collect data and perform data ETL.[1] — Model training[5]: ~$4.0 million to $200.0 million per training run.[3] Costs include compute and labor cost of 4 to 6 data scientists working for 3 to 6 months. — Plug-in-layer building: ~$1.0 million to $3.0 million. Costs include a team of 6 to 8 working 6 to 12 months. **~ $1.0 million to $5.0 million, recurring annually** — Model inference: ~$0.1 million to $1.0 million annually per 1,000 users. Assume each physician sees 20 to 25 patients per day and patient speaks for 6 to 25 minutes per visit. — Model maintenance: ~$1.0 million to $4.0 million recurring annually. Assume $250,000 annually for MLOps platform[4] and 3 to 5 machine learning engineers to monitor model performance. — Plug-in-layer maintenance: up to ~$0.3 million recurring annually, assuming 10% of development cost.

Note: Through engineering optimizations, the economics of generative AI are evolving rapidly, and these are high-level estimates based on total cost of ownership (resources, model training, etc) as of mid-2023.

[1] Extract, transform, and load.

[2] Model is fine-tuned on data set consisting of ~100,000 pages of sector-specific documents and 5 years of chat history from ~1,000 customer representatives, which is ~48 billion tokens. Lower end cost consists of 1% parameters retrained on open-source models (eg, LLaMA) and upper end on closed-source models. Chatbot can be accessed via both text and audio.

[3] Model is optimized after each training run based on use of hyperparameters, data set, and model architecture. Model may be refreshed periodically when needed (eg, with fresh data).

[4] Gilad Shaham, "Build or buy your MLOps platform: Main considerations," LinkedIn, November 3, 2021.

[5] Model is trained on 65 billion to 1 trillion parameters and data set of 1.2 to 2.4 trillion tokens. The tool can be accessed via both text and audio.

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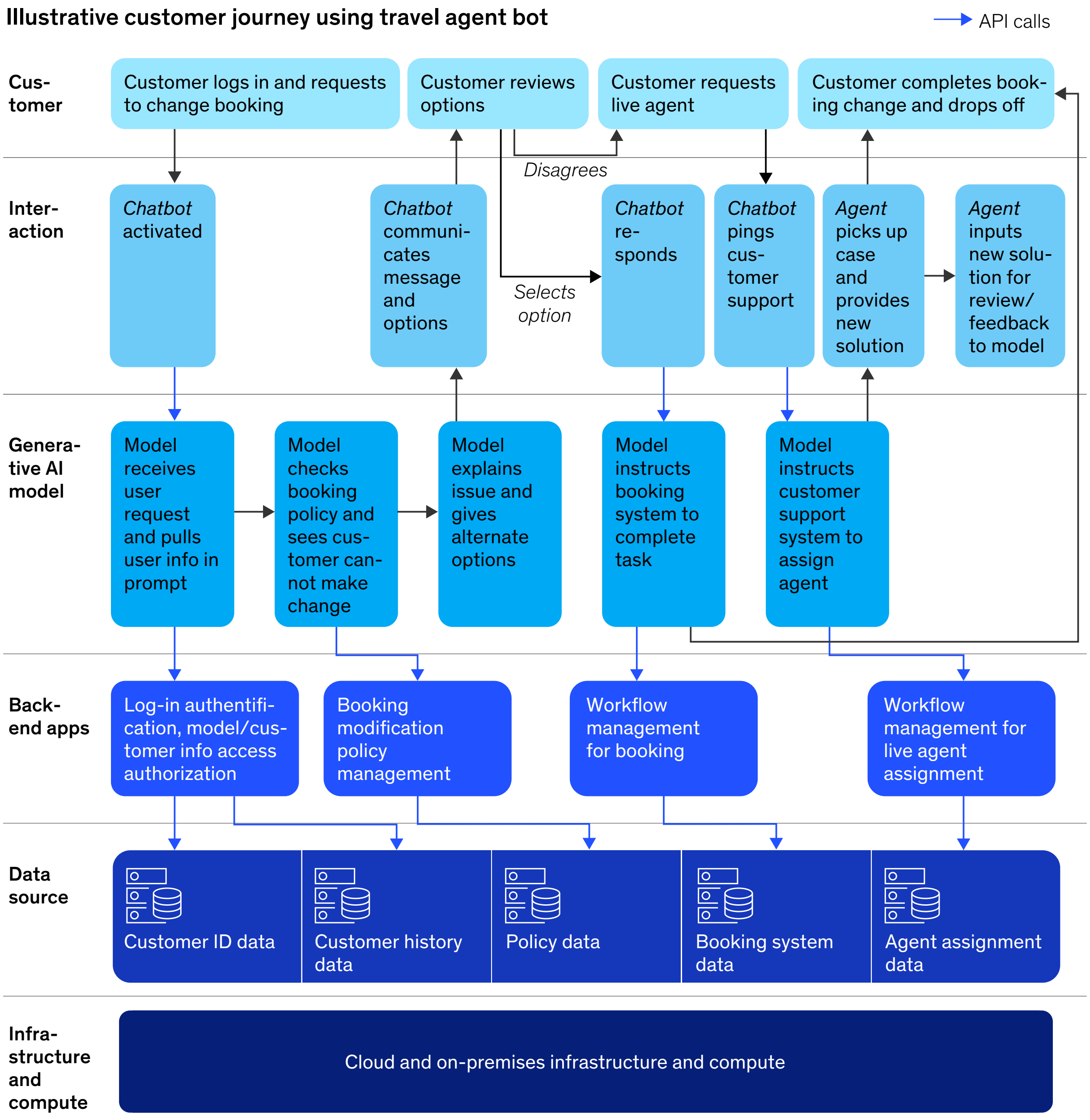
Exhibit 2

Generative AI is integrated at key touchpoints to enable a tailored customer journey.

Illustrative customer journey using travel agent bot



McKinsey & Company

For the Taker archetype, this level of coordination isn't necessary. But for companies looking to scale the advantages of generative AI as Shapers or Makers, CIOs and CTOs need to upgrade their technology architecture. The prime goal is to integrate generative AI models into internal systems and enterprise applications and to build pipelines to various data sources. Ultimately, it's the maturity of the business's enterprise technology architecture that allows it to integrate and scale its generative AI capabilities.

Recent advances in integration and orchestration frameworks, such as LangChain and LlamaIndex, have significantly reduced the effort required to connect different generative AI models with other applications and data sources. Several integration patterns are also emerging, including those that enable models to call APIs when responding to a user query—GPT-4, for example, can invoke functions—and provide contextual data from an external data set as part of a user query, a technique known as retrieval augmented generation. Tech leaders will need to define reference architectures and standard integration patterns for their organization (such as standard API formats and parameters that identify the user and the model invoking the API).

There are five key elements that need to be incorporated into the technology architecture to integrate generative AI effectively (Exhibit 3):

— *Context management and caching* to provide models with relevant information from enterprise data sources. Access to relevant data at the right time is what allows the model to understand the context and produce compelling outputs. Caching stores results to frequently asked questions to enable faster and cheaper responses.

— *Policy management* to ensure appropriate access to enterprise data assets. This control ensures that HR's generative AI models that include employee compensation details, for example, cannot be accessed by the rest of the organization.

— *Model hub,* which contains trained and approved models that can be provisioned on demand and acts as a repository for model checkpoints, weights, and parameters.

— *Prompt library,* which contains optimized instructions for the generative AI models, including prompt versioning as models are updated.

— *MLOps platform,* including upgraded MLOps capabilities, to account for the complexity of generative AI models. MLOps pipelines, for example, will need to include instrumentation to measure task-specific performance, such as measuring a model's ability to retrieve the right knowledge.

In evolving the architecture, CIOs and CTOs will need to navigate a rapidly growing ecosystem of generative AI providers and tooling. Cloud providers provide extensive access to at-scale hardware and foundation models, as well as a proliferating set of services. MLOps and model hub providers, meanwhile, offer the tools, technologies, and practices to adapt a foundation model and deploy it into production, while other companies provide applications directly accessed by users built on top of foundation models to perform specific tasks. CIOs and CTOs will need to assess how these various capabilities are assembled and integrated to deploy and operate generative AI models.

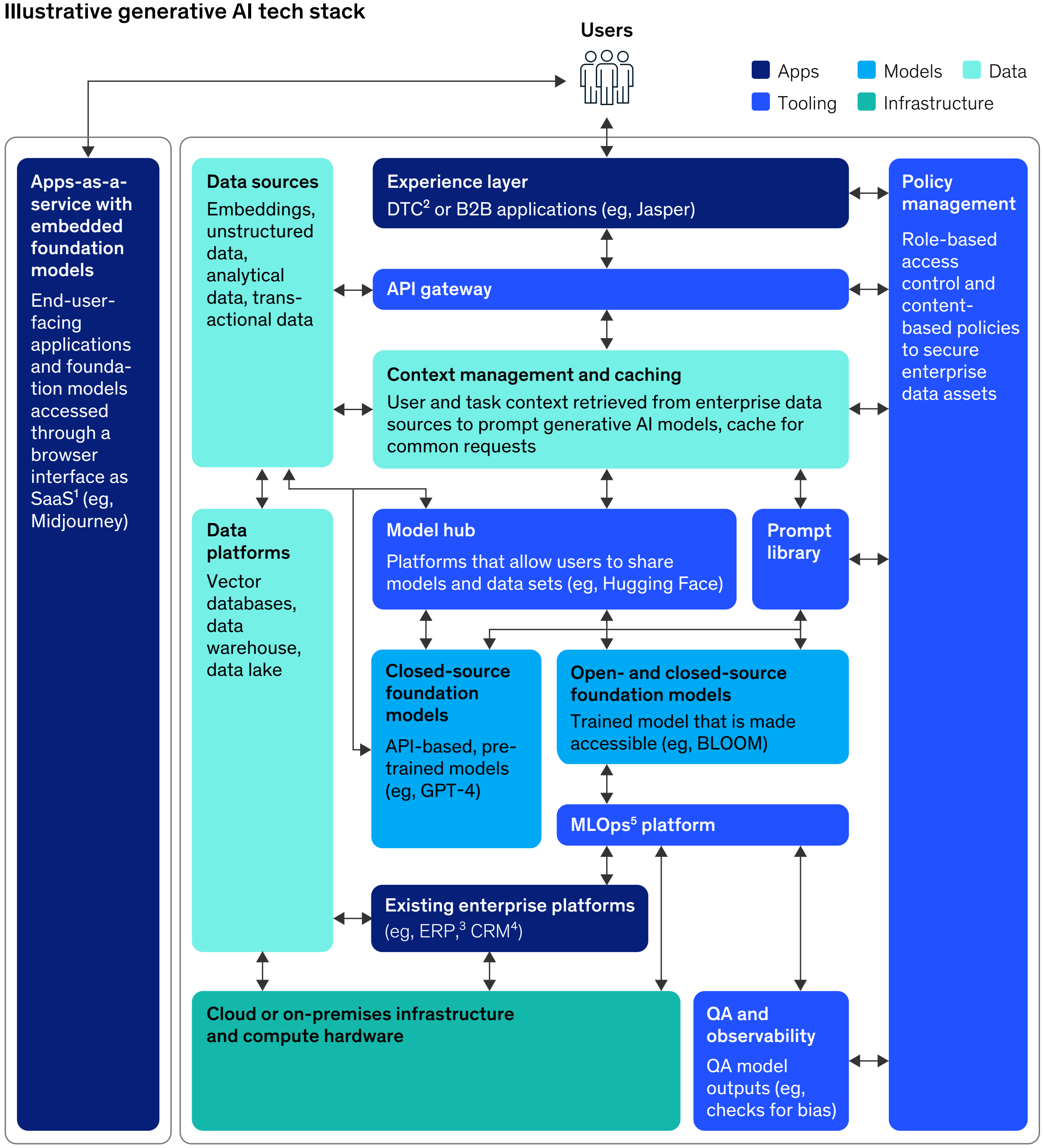
6. Develop a data architecture to enable access to quality data

The ability of a business to generate and scale value, including cost reductions and improved data and knowledge protections, from generative AI models will depend on how well it takes advantage of its own data. Creating that advantage relies on a data architecture that connects generative AI models to internal data sources, which provide context or help fine-tune the models to create more-relevant outputs.

Exhibit 3

The tech stack for generative AI is emerging.

Illustrative generative AI tech stack



[1]Software as a service.
[2]Direct to consumer.
[3]Enterprise resource planning.
[4]Customer relationship management.
[5]Machine learning operations.

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In this context, CIOs, CTOs, and chief data officers need to work closely together to do the following:

— Categorize and organize data so it can be used by generative AI models. Tech leaders will need to develop a comprehensive data architecture that encompasses both structured and unstructured data sources. This requires putting in place standards and guidelines to optimize data for generative AI use—for example, by augmenting training data with synthetic samples to improve diversity and size; converting media types into standardized data formats; adding metadata to improve traceability and data quality; and updating data.

— Ensure existing infrastructure or cloud services can support the storage and handling of the vast volumes of data needed for generative AI applications.

— Prioritize the development of data pipelines to connect generative AI models to relevant data sources that provide "contextual understanding." Emerging approaches include the use of vector databases to store and retrieve embeddings (specially formatted knowledge) as input for generative AI models as well as in-context learning approaches, such as "few shot prompting," where models are provided with examples of good answers.

7. Create a centralized, cross-functional generative AI platform team

Most tech organizations are on a journey to a product and platform operating model. CIOs and CTOs need to integrate generative AI capabilities into this operating model to build on the existing infrastructure and help to rapidly scale adoption of generative AI. The first step is setting up a generative AI platform team whose core focus is developing and maintaining a platform service where approved generative AI models can be provisioned on demand for use by product and application teams. The platform team also defines protocols for how generative AI models integrate with internal systems, enterprise applications, and tools, and it develops and implements standardized approaches to manage risk, such as responsible AI frameworks.

CIOs and CTOs need to ensure that the platform team is staffed with people who have the right skills. This team requires a senior technical leader who acts as the general manager. Key roles include software engineers to integrate generative AI models into existing systems, applications, and tools; data engineers to build pipelines that connect models to various systems of record and data sources; data scientists to select models and engineer prompts; MLOps engineers to manage deployment and monitoring of multiple models and model versions; ML engineers to fine-tune models with new data sources; and risk experts to manage security issues such as data leakage, access controls, output accuracy, and bias. The exact composition of the platform team will depend on the use cases being served across the enterprise. In some instances, such as creating a customer-facing chatbot, strong product management and user experience resources will be required.

Realistically, the platform team will need to work initially on a narrow set of priority use cases, gradually expanding the scope of their work as they build reusable capabilities and learn what works best. Technology leaders should work closely with business leads to evaluate which business cases to fund and support.

8. Tailor upskilling programs by roles and proficiency levels

Generative AI has the potential to massively lift employees' productivity and augment their capabilities. But the benefits are unevenly distributed depending on roles and skill levels, requiring leaders to rethink how to build the actual skills people need.

Our latest empirical research using the generative AI tool GitHub Copilot, for example, helped software engineers write code 35 to 45 percent faster.[5]

[5] "Unleashing developer productivity with generative AI," June 27, 2023.

The benefits, however, varied. Highly skilled developers saw gains of up to 50 to 80 percent, while junior developers experienced a 7 to 10 percent *decline* in speed. That's because the output of the generative AI tools requires engineers to critique, validate, and improve the code, which inexperienced software engineers struggle to do. Conversely, in less technical roles, such as customer service, generative AI helps low-skill workers significantly, with productivity increasing by 14 percent and staff turnover dropping as well, according to one study.[6]

These disparities underscore the need for technology leaders, working with the chief human resources officer, to rethink their talent management strategy to build the workforce of the future. Hiring a core set of top generative AI talent will be important, and, given the increasing scarcity and strategic importance of that talent, tech leaders should put in place retention mechanisms, such as competitive salaries and opportunities to be involved in important strategic work for the business.

Tech leaders, however, cannot stop at hiring. Because nearly every existing role will be affected by generative AI, a crucial focus should be on upskilling people based on a clear view of what skills are needed by role, proficiency level, and business goals. Let's look at software developers as an example. Training for novices needs to emphasize accelerating their path to become top code reviewers in addition to code generators. Similar to the difference between writing and editing, code review requires a different skill set. Software engineers will need to understand what good code looks like; review the code created by generative AI for functionality, complexity, quality, and readability; and scan for vulnerabilities while ensuring they do not themselves introduce quality or security issues in the code. Furthermore, software developers will need to learn to *think* differently when it comes to coding by better understanding user intent so they can create prompts and define contextual data that help generative AI tools provide better answers.

Beyond training up tech talent, the CIO and CTO can play an important role in building generative AI skills among nontech talent as well. Besides understanding how to use generative AI tools for such basic tasks as email generation and task management, people across the business will need to become comfortable using an array of capabilities to improve performance and outputs. The CIO and CTO can help adapt academy models to provide this training and corresponding certifications.

The decreasing value of inexperienced engineers should accelerate the move away from a classic talent pyramid, where the greatest number of people are at a junior level, to a structure more like a diamond, in which the bulk of the technical workforce is made up of experienced people. Practically speaking, that will mean building the skills of junior employees as quickly as possible while reducing roles dedicated to low-complexity manual tasks (such as writing unit tests).

9. Evaluate the new risk landscape and establish ongoing mitigation practices

Generative AI presents a fresh set of ethical questions and risks, including "hallucinations," whereby the generative AI model presents an incorrect response based on the highest-probability response; the accidental release of confidential personally identifiable information; inherent bias in the large data sets the models use; and high degrees of uncertainty related to intellectual property (IP). CIOs and CTOs will need to become fluent in ethics, humanitarian, and compliance issues to adhere not just to the letter of the law (which will vary by country) but also to the spirit of responsibly managing their business's reputation.

Addressing this new landscape requires a significant review of cyber practices and updating the software development process to evaluate risk and identify mitigation actions before model

[6] Erik Brynjolfsson, Danielle Li, and Lindsey R. Raymond, *Generative AI at work*, National Bureau of Economic Research (NBER) working paper, number 31161, April 2023.

development begins, which will both reduce issues and ensure the process doesn't slow down. Proven risk-mitigation actions for hallucinations can include adjusting the level of creativity (known as the "temperature") of a model when it generates responses; augmenting the model with relevant internal data to provide more context; using libraries that impose guardrails on what can be generated; using "moderation" models to check outputs; and adding clear disclaimers. Early generative AI use cases should focus on areas where the cost of error is low, to allow the organization to work through inevitable setbacks and incorporate learnings.

To protect data privacy, it will be critical to establish and enforce sensitive data tagging protocols, set up data access controls in different domains (such as HR compensation data), add extra protection when data is used externally, and include privacy safeguards. For example, to mitigate access control risk, some organizations have set up a policy management layer that restricts access by role once a prompt is given to the model. To mitigate risk to intellectual property, CIOs and CTOs should insist that providers of foundation models maintain transparency regarding the IP (data sources, licensing, and ownership rights) of the data sets used.

Generative AI is poised to be one of the fastest-growing technology categories we've ever seen. Tech leaders cannot afford unnecessary delays in defining and shaping a generative AI strategy. While the space will continue to evolve rapidly, these nine actions can help CIOs and CTOs responsibly and effectively harness the power of generative AI at scale.

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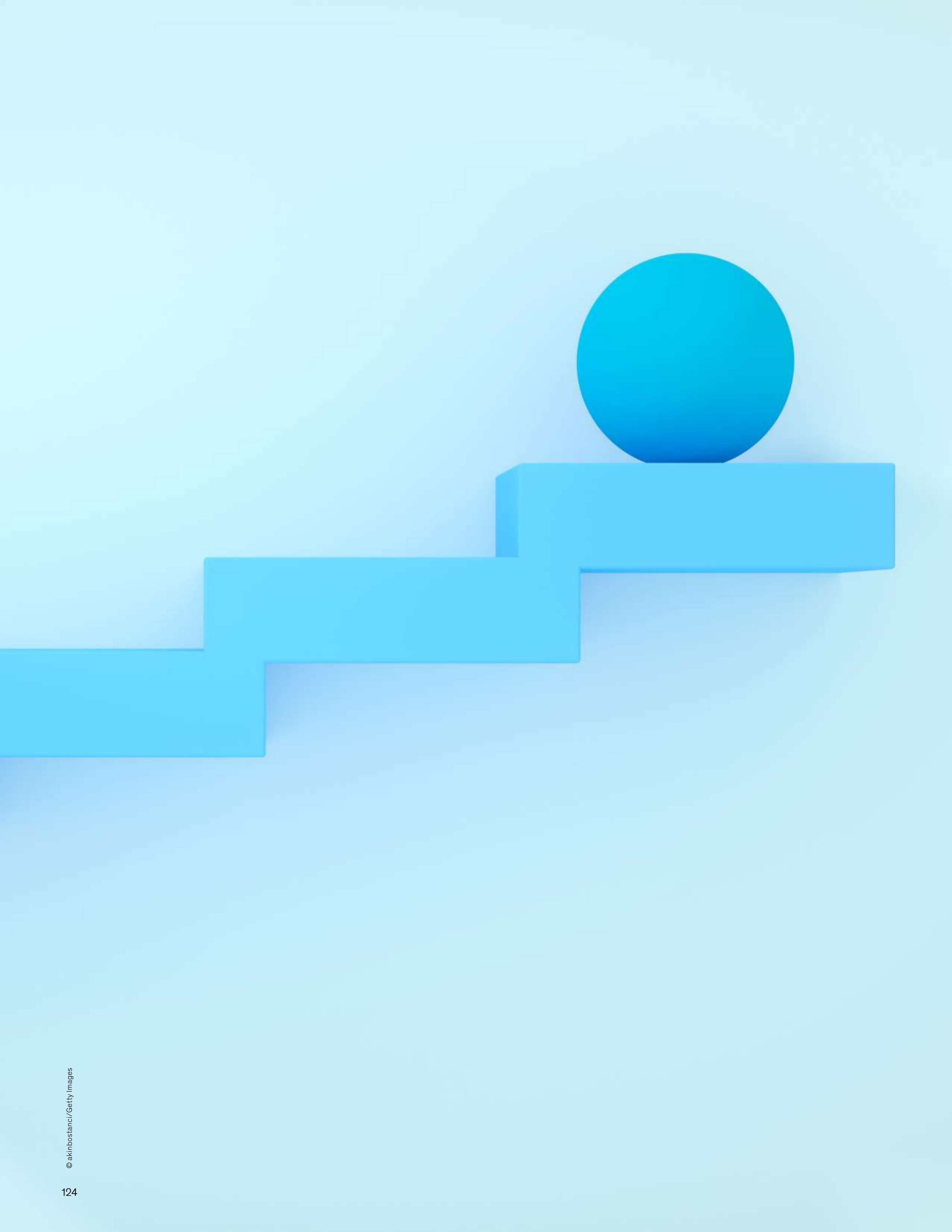

How to be a high-performing CEO—at any stage of the CEO life cycle

Every chapter of the CEO journey comes with a unique set of challenges and opportunities. Whether you're a senior executive who aspires to the top job or a celebrated CEO who's preparing to pass the baton to a successor, check out this series of *McKinsey Quarterly* articles from senior partners Carolyn Dewar, Scott Keller, Vikram Malhotra, and Kurt Strovink for high-impact leadership advice.

126 Stepping up: Becoming a high-potential CEO candidate

134 Starting strong: Making your CEO transition a catalyst for renewal

142 Staying ahead: How the best CEOs continually improve performance

152 Sending it forward: Successfully transitioning out of the CEO role

Stepping up: Becoming a high-potential CEO candidate

The road to becoming CEO is a difficult ascent for even the most seasoned leaders. Here are four keys to making the journey a success.

by Carolyn Dewar, Scott Keller, Vik Malhotra, and Kurt Strovink

Illustrations by Edu Fuentes

It is not the mountain that we conquer, but ourselves.

—Edmund Hillary

The world's highest peak is Mount Everest, majestically rising almost 30,000 feet above sea level. Many mountaineers spend years gaining the experience, skills, physical fitness, and mental toughness needed to make the trek, yet few make it to the top. Since Edmund Hillary and Tenzing Norgay first reached the mountain's summit in 1953, only about 5,000 people have followed.

The challenges of the climb compound the closer one gets to the top. The trail from the final camp to the summit is dubbed "the death zone," where thin air and brutal weather combine to create confusion and hallucinations, as well as a host of health-related challenges. For the select few who make it through, however, a magic moment awaits where there are no more upward steps to take. They find themselves, literally, on top of the world.

Since the 1950s, fewer people have made it to the top of Fortune 500 companies than have scaled Mount Everest. When Mary Barra joined GM as an 18-year-old engineering intern, the odds that she would someday sit in the CEO chair were far less than one in 750,000 (the number of GM employees at the time). It was more probable that she would be struck by lightning! Yet today, she's more than nine years into her tenure as the first woman ever to lead a US automaker.

Barra's journey to the top, like that of most Fortune 500 CEOs, involved continuous learning and having a record of success across a wide variety of increasingly senior positions. During her career, she honed many vital leadership traits, such as strategic thinking, relationship building, risk taking, authenticity, humility, objectivity, resilience, stamina, and decisiveness. A few years before becoming CEO, however, she suddenly felt sidetracked as she was unexpectedly shifted to HR into the type of soft job that has long embodied where talented women finish out their careers.

As Barra learned, any leader two or three years out from the top job faces a final ascent as fraught with challenges as the one on Mount Everest. Some executives find themselves sidelined. Others become part of the top team only to discover that they have no desire to step up further. Still others become disoriented, lose their balance, and fall. For some, external factors interrupt the path to becoming the CEO—at least at their company. As Brad Smith, former CEO of Intuit, recounts, "When I stepped down, the conditions were such that Sasan Goodarzi was best suited for our next chapter. The other three candidates were ready to be CEOs in different environments, and they all went on to lead other companies."[1]

While there is no way to guarantee success, if you're a senior executive who aspires to the top job, the following advice will greatly increase your odds:

— Take a gut check of your motivations and expectations.

— Elevate your perspective while boldly delivering results.

— Round out your profile with humility.

— Understand the CEO selection process and put your best foot forward.

Take a gut check of your motivations and expectations

"Everest is not about summiting, adding to your image, the conquest of nature or of other humans,"

[1] Unless otherwise noted, all quotations from leaders in this article come from unpublished interviews conducted as part of McKinsey research.

experienced mountaineers share in a guide to climbing Mount Everest.[2] To climbers driven by such motivations, they say, "You will become a prisoner of other people's judgment in your desire of proving self-worth. You will climb blinded and feel an immense failure if not summiting. Or if successful—go home, celebrate your triumph and fame, and when the lights eventually are turned towards someone else, end up empty."

Former Cincinnati Children's Hospital Medical Center (CCHMC) CEO Michael Fisher makes a similar point when it comes to leading organizations. "If the main reason you want to have the CEO title is for ego, that's unlikely to be a sustainable motivator over time." Expanding on Fisher's point, the following table shows a short list of motivations and expectations that provide a good litmus test for whether you're well suited for the top role.

If your mindsets on the topics lean toward those in the unsustainable column, it's unlikely that you'll find the CEO job worth the effort. The ego satisfaction you'll get from landing the top job will soon provide small comfort in the face of mounting demands. You'll be spinning more plates far more intensively than you have in any other role as you set direction, align the organization, mobilize leaders, engage the board, connect with stakeholders, and manage your personal effectiveness.

Stanford University economics professor Nicholas Bloom, who's spent his career researching CEOs, describes the reality he's observed: "It's frankly a horrible job. I wouldn't want it. Being a CEO of a big company is a hundred-hour-a-week job. It consumes your life. It consumes your weekend. It's super stressful. Sure, there're enormous perks, but it's also all-encompassing."[3]

Reinforcing the point, Microsoft CEO Satya Nadella describes the job as "24/7." His late mentor Bill Campbell, who had been a CEO three times and was an influential coach to several technology industry leaders, would often remind him, "No one has ever lived to outwork the job. It will always be bigger than you." Many CEOs secretly agree that the best job in the world is actually the one right below the CEO. There the spotlight burns less brightly, yet the opportunities to make a difference are great, as are the rewards.

Without the right motivations and expectations, you'll not only find that the effort required to be

Topic	Unsustainable motivation	Sustainable motivation
Why I want to be CEO	It's the next step and comes with more power, money, and esteem	I have an exciting vision for the impact the company and I can achieve together
What being chosen as CEO would mean	I've proven myself and attained my ultimate goal	It's a privilege to serve as CEO for the company's next chapter
What not being chosen as CEO would mean	I lost the race, am not CEO material, and have let others down	I'm becoming the best I can be, even if I'm not the right fit here
How I'll add value as CEO	I'll solve the tough problems that no one else can	I'll ask the tough questions that unlock the full potential of others
How I'll feel as CEO	I'll feel like the center of the action, with people around me to help	I'll feel lonely because of my vantage point and need for objectivity
How I'll act as CEO	I'll be the boss and can run the place the way I want to	I'll be responsive to all stakeholders and accountable for everything

[2] "End of the journey / new beginnings," MountEverest.net, February 9, 2023.
[3] Stephen J. Dubner, "What does a C.E.O. actually do?," Freakonomics, January 17, 2018.

CEO outweighs any personal gain but also be less likely to succeed. As CCHMC's Fisher puts it, "If you're not driven by a deep care and concern for the institution you have the privilege to lead and for its stakeholders, then when the going gets tough, you won't step up to the challenge."

For these reasons, we encourage any executive setting their sights on the summit to do some genuine soul searching before deciding to make the final ascent. If it's all about you, or if you're doing it out of a sense of obligation, know that the top will be a hostile, extreme place where no one will rescue you during times of trouble.

If, however, you're driven by a passion and vision for how you can help others climb further and faster to achieve new heights collectively, you'll more than likely end up on a deeply fulfilling adventure. Former American Express CEO Kenneth Chenault captures this winning mindset, "If you want to lead, you have to be committed to serve."

Last, when taking a gut check of your motivations and expectations, don't forget to consider the impact that the new job will have on your family members. "The role affects your family far more than you think it will," reflects Aon's CEO, Greg Case. Former General Mills CEO Ken Powell explains, "You're in the newspaper; they're publishing your salary or talking about when you screw things up. It can be hard on kids. That part is unpleasant." His advice to aspiring CEOs is simple: "You need to talk it over with your partner if you have one. In my case, my wife and I agreed, 'OK, this is just part of the pluses and minuses.'" Indeed, virtually every successful CEO we've worked with has shared that having a spouse or partner who understands and is supportive of the nature of the job is essential.

Elevate your perspective while boldly delivering results

In 2002, Harvard Kennedy School professors Ronald Heifetz and Marty Linsky introduced a new metaphor into management literature—the concept of "getting off the dance floor and going to the balcony." The metaphor juxtaposes delivering on daily work (being on the dance floor) with stepping back and seeing the big picture (being on the balcony). The most effective leaders, according to Heifetz and Linsky, are those with the ability to do both at once. This metaphor is particularly useful as your candidacy for the top job develops. During that time, it's vital that you keep the following actions in mind:

— Don't miss a step on the dance floor—deliver on your day job.

— Climb onto a higher balcony to hone your view of the future, the company, and the company's stakeholders.

— Be bold, whether on the balcony or the dance floor.

When GM's Barra stepped into the role of chief HR officer (CHRO) at GM, she chose not to focus on the next job. Instead, she embraced the CHRO position and proceeded to redefine talent management, leadership development, compensation, benefits, healthcare, organizational transformation, and other HR systems. "Do the job you're doing today like you're going to do it for the rest of your life," she advises, "because that means you're going to invest in it, you're going to make it better, and you're going to drive efficiencies."[4]

When it comes to being on the balcony, there are three perspectives you'll want to hone. The first is looking into the future of your industry. Microsoft's Nadella says that to be a successful CEO, "You have to have an absolutely first-class view of where the world is going." In fact, Nadella's perspective was very much what helped him become CEO. At the time, the conventional wisdom was that Microsoft would pick a new leader from outside the company. As part of the selection process, candidates were asked to write a memo regarding where they would take the company and why. Nadella, in his memo, laid out the visionary social, mobile, and cloud strategy that persuaded the board to choose him over other candidates and has ultimately resulted in Microsoft becoming one of the most valuable companies on the planet.

[4] Samantha Saperstein, "General Motors head Mary Barra talks leadership and tips for women," JPMorgan Chase, October 2021.

The next viewpoint involves looking more broadly across the whole organization—far beyond your area of responsibility. This is easier to do if, during your career, you've rotated across roles in various parts of the business. During the final ascent, however, switching jobs might not be a good idea. "I've seen too many candidates two years out make the mistake of moving to roles they don't have time to succeed in," offers former Westpac Banking CEO Gail Kelly. "It becomes a recipe for disaster." More reliable ways to broaden your perspective during the final ascent are to get involved in enterprise-level projects, committees, and development programs; invest time in getting educated in other areas; and take an explicitly company-first perspective in your decision making (even if it's not the best answer for your area).

The third view from the balcony peers over the stakeholder landscape. CEOs of today's large companies must have a point of view on a wide variety of societal and environmental issues. Therefore, they need to have their pulse on employee, customer, and board sentiments and use them to help shape their company's principles as issues emerge. It takes real time and effort to form thoughtful, educated, institution-level (versus personal) points of view on issues such as responsible AI, rising inequality, political polarization, geopolitical instability, deteriorating climate, and so on.

A trip wire to be wary of, both on the balcony and the dance floor, is risk aversion. Savvy boards are well aware of the conclusive evidence that companies led by CEOs who lack the courage to make bold moves are unlikely to outperform the competition. Westpac's Kelly uses a cricket analogy to illustrate the point: "As a CEO candidate, you can't just defend the wicket and hope that you don't get out. You must step up and hit the ball … never, ever say to yourself, 'What I've done is enough.'"

Take Barra at GM. One of the first things she did upon taking the HR role was to abolish the company's ten-page dress code and replace it with two words: "dress appropriately."[5] Doing so was less about clothing than about signaling her willingness to take on GM's hundred-year-old, stodgy, paternal culture and shift it to one that recognized and empowered employees' own instincts. Such boldness helped her stand out from her peers in the eyes of the CEO and board as the right leader to take the company into the future.

Round out your profile with humility

When asked, 88 percent of Americans will say they're above-average drivers.[6] In the ability to get along with others, 25 percent of students rate themselves in the top 1 percent.[7] When couples are asked to estimate their individual contributions to household work, the combined total routinely exceeds 100 percent.[8] These are all statistical impossibilities. They're also great examples of how we're often predisposed to view our actions favorably or interpret events in a way that's beneficial to us. As an aspiring CEO candidate, it's important to have the humility to recognize your inherent self-serving bias and counteract it:

— Objectively assess your capabilities versus what's needed.

— Fill your skill gaps and gauge your progress on the way.

— Refuse to play politics in the process.

Assessing your capabilities starts with understanding what the company needs in its next leader. Intuit's Smith uses a horse-racing analogy: "The reason there are very few Triple Crown winners," he says, "is because the Kentucky Derby is a very different track than the Preakness, which are both different than the Belmont. Right horse, right track. If you're a candidate, first ask yourself in an intellectually honest way, 'What does the company most need?' And 'Do I have that skill set today?'"

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[5] "General Motors head Mary Barra talks leadership and tips for women," October 2021.
[6] Ola Svenson, "Are we all less risky and more skillful than our fellow drivers?" *Acta Psychologica*, February 1981, Volume 47, Number 2.
[7] Mark D. Alicke and Olesya Govorun, "The better-than-average effect," in Mark D. Alicke, David A. Dunning, and Joachim I. Krueger, editors, *The Self in Social Judgment*, New York, NY: Psychology Press, 2005.
[8] Michael Ross and Fiore Sicoly, "Egocentric biases in availability and attribution," *Journal of Personality and Social Psychology*, 1979, Volume 37, Number 3.

To understand the extent to which you've got what the company needs, break your abilities down into at least four dimensions. The first is your breadth of experience and record (for example, leading transformational change, delivering a profit-and-loss statement, and representing the company externally). Second is your knowledge and expertise (for example, financial acumen, sales leadership, technology, target markets, and industry trends). The third is your leadership skill (for example, strategic thinking, executive presence, team building, and self-awareness). Finally, how strong are your relationships, and what is your reputation? How are you viewed by internal stakeholders, such as your boss, peers, direct reports, and influencers? How about by external stakeholders, such as investors, customers, suppliers, regulators, and community leaders? And how about by board members?

To help break through any self-serving bias, it's important to seek others' views. That might involve getting feedback from mentors, confidants, peers, and so on, but more often than not, you should ask someone else to gather that 360-degree information. It may be a trusted colleague, but most often, it's an external coach who gathers the input.

Former Best Buy CEO Hubert Joly reveals how his thinking has evolved on the use of coaches: "Years ago, if somebody had told me, 'Scott is working with a coach,' I would have wondered, 'Uh-oh, what's wrong with Scott? Is he in trouble?' Now I realize an executive coach can help successful leaders get better. One hundred percent of the world's top 100 tennis players have a coach, 100 percent of NFL teams have a coach—in fact, a coaching staff. So why on earth should executives not have a coach?"

Once you've assessed how you stack up in the four dimensions, it's time to start improving yourself. Think of it as embarking on a learning journey that involves cycles of taking action and then reflecting with a close group of advisers on the progress being made. Such journeys typically combine ongoing leadership coaching with participation in various forums or roundtables, visits to other companies, targeted reading lists, briefings from experts, and finding opportunities to gain experience and build relationships (for example, dealing with the media, presenting to the board, and representing the company externally).

Going on such a journey requires striking a delicate balance. You'll want to increase your visibility to ensure that those who need to know are aware that you want to make the final ascent without being seen as self-promoting or currying favor. "I've seen this go awry so many times when people begin to run for the job," shares Intuit's Smith. "They almost campaign for the role, and that's the quickest way to throw you off track."

Westpac's Kelly shares the keys to success: "Don't play politics. Don't undermine people. None of that ends well. Be authentic, transparent, a team player, and an active supporter of colleagues for the greater good, even if they are also in the running for the role." Her advice reinforces why we started this article with the importance of taking a gut check of your motivations and intentions. If they're not sustainable, you simply won't be able to walk the line with authenticity. CCHMC's Fisher summarizes how it all comes together: "It's a quiet ambition pursued with humility. You gain confidence as you go by learning and growing every day."

Getting the balance right doesn't just set you in good stead as a CEO candidate. It's also a win for the institution. What company isn't better off for having more service-oriented leaders connecting across the enterprise and boldly solving for the good of the whole organization, especially if they're doing so while delivering on their core responsibilities, building their self-awareness, and developing new capabilities and more fruitful relationships?

Understand the CEO selection process and put your best foot forward

There's a point in the climb from the final camp on Mount Everest to the summit where the mountaineer reaches what's called the "south summit" and knows they're just a couple of hours from their dream coming true. But there is one obstacle in the way: Knife Ridge. According to climbers, "You will gasp upon seeing it. It is steep and looks truly nasty."[9]

[9] "The route," MountEverest.net, February 9, 2023.

When you're formally tapped to be in the CEO selection process, you'll likely have a similar mix of excitement and dread. While every board's process is unique, most will involve the following steps:

1. choosing a top-tier headhunting company to identify the best candidates

2. defining what the business needs from its next CEO

3. determining which stakeholders will play roles in the process and at which stages

4. conducting an initial search to canvas and approach potential candidates both inside and outside the company—including qualified executives not proactively looking to move

5. narrowing the list through in-depth due diligence (often including 360-degree references)

6. holding initial screening interviews to narrow the list to the strongest prospects (the headhunter typically does these interviews)

7. creating a detailed psychometric, personality, and competency profile that allows candidates to be easily scored and compared

8. conducting the final stage of interviews to explore each candidate's vision for the company, leadership qualities, and matching of the desired profile of the next CEO

9. doing further due diligence (identity check, credit check, and ensuring that no other disqualifications exist) on the preferred candidate, with their consent

10. making sure that all relevant stakeholders are confident in the preferred candidate's suitability and then formally making an offer

The good news is that if you've followed the advice we've already shared, you're already well prepared for many of the board's inquiries. You'll be able to articulate why you want the role. You'll have a bold vision for where the company should go next and how value will be created across the portfolio. You'll also have translated that into a perspective on what the company needs from its next CEO and be able to make a fact-based argument that your experience, knowledge, leadership skills, and relationships make you the right horse for the course. You'll be prepared to talk about how you've grown over the past three to five years yet also be clear-eyed and honest about your areas of weakness and how you'll need to surround yourself with others who can help in those areas. You'll also have built a following among your colleagues by leading authentically and helping others.

That said, Knife Ridge is no place to start winging it. "Probably the single-most important responsibility the board has is CEO selection," CCHMC's Fisher explains. "They take it very seriously, and so should you. Prepare; prepare; prepare." Fisher, who has served as CEO of three different organizations, made it a point to rehearse his pitch and be mock interviewed multiple times by his closest advisers, encouraging them to play the role of the cynic. He anticipated questions and had crisp and compelling answers. He had a second set of eyes on any written material submitted into the process. Fisher's successes bear witness to the famous assertion attributed to American football coach Vince Lombardi: "The will to win is not nearly as important as the will to prepare to win."

We've supported numerous executives as they made their way to the summit. Reflecting on this experience, our top ten list of less-obvious yet high-impact advice for putting your best foot forward in the formal selection process is as follows, in no particular order:

— The headhunter is your ambassador to the search committee. Respect them and the process they've set up (don't try to work around it).

— Every interaction is part of the interview process. Show your best self, whether it's in formal settings (such as presentations and interviews) or informal settings (such as dinners and ad hoc discussions).

— You'll be up against outsiders with fresh and bold perspectives. Make sure that you have an outsider's perspective while being clear on why being an insider is advantageous.

— Connect the dots for people. You know your story; they don't—it's up to you to put it together for them in a way that makes sense and is easy to comprehend.

— Boards, not the sitting CEO, choose the new CEO. Don't mistake positive (or negative) signals from the incumbent to be representative of your standing in the process.

— Prepare not only for business-related interview topics but also for personal ones (for example, "Tell us about some formative experiences that have helped you build resilience").

— Listen closely to what's being asked and the subtext beneath it, and strive for brevity, clarity, and memorability in your responses.

— Don't just prepare the content. Think through how it is that you want your audience to feel when you leave the room (and adjust your approach accordingly).

— Interviews are a two-way process. Ask questions that help you understand what your mandate will be and make sure that the job will be one you want to have.

— As in other parts of the journey, authenticity matters. You may be able to fake it in an interview, but you're not going to be able to fake it as a CEO.

While we've directed our advice in this article toward internal CEO candidates, much of it applies to those courting a CEO role outside their current organization as well. We've also endeavored to make the insights here relevant regardless of the role one has during the final ascent (whether you're the COO, CFO, the head of a business unit, and so on).

That said, we also encourage leaders to seek out advice specific to the positions they hold. For example, if you're a CFO shooting for the CEO job, you may have an extra burden to show that you see a picture bigger than just the numbers, that you're willing to take risks on new concepts with no precedent, and that you can motivate and engage colleagues through stories as well as facts.

"We might succeed or not; that's not important," report experienced Mount Everest alpinists.[10] "The summit is such a small piece of the mountain. Most of the beauty and wonders are experienced during the climb." The ascent to the CEO role is similar. The learning from the journey will be invaluable and, more than likely, set you in good stead to summit other beautiful mountains if that remains an aspiration. If you do set foot on the highest peak, we'll offer our congratulations—you're among the world's most elite business mountaineers.

So take a deep breath and get ready to climb new heights.

[10] "End of the journey / new beginnings," February 9, 2023.

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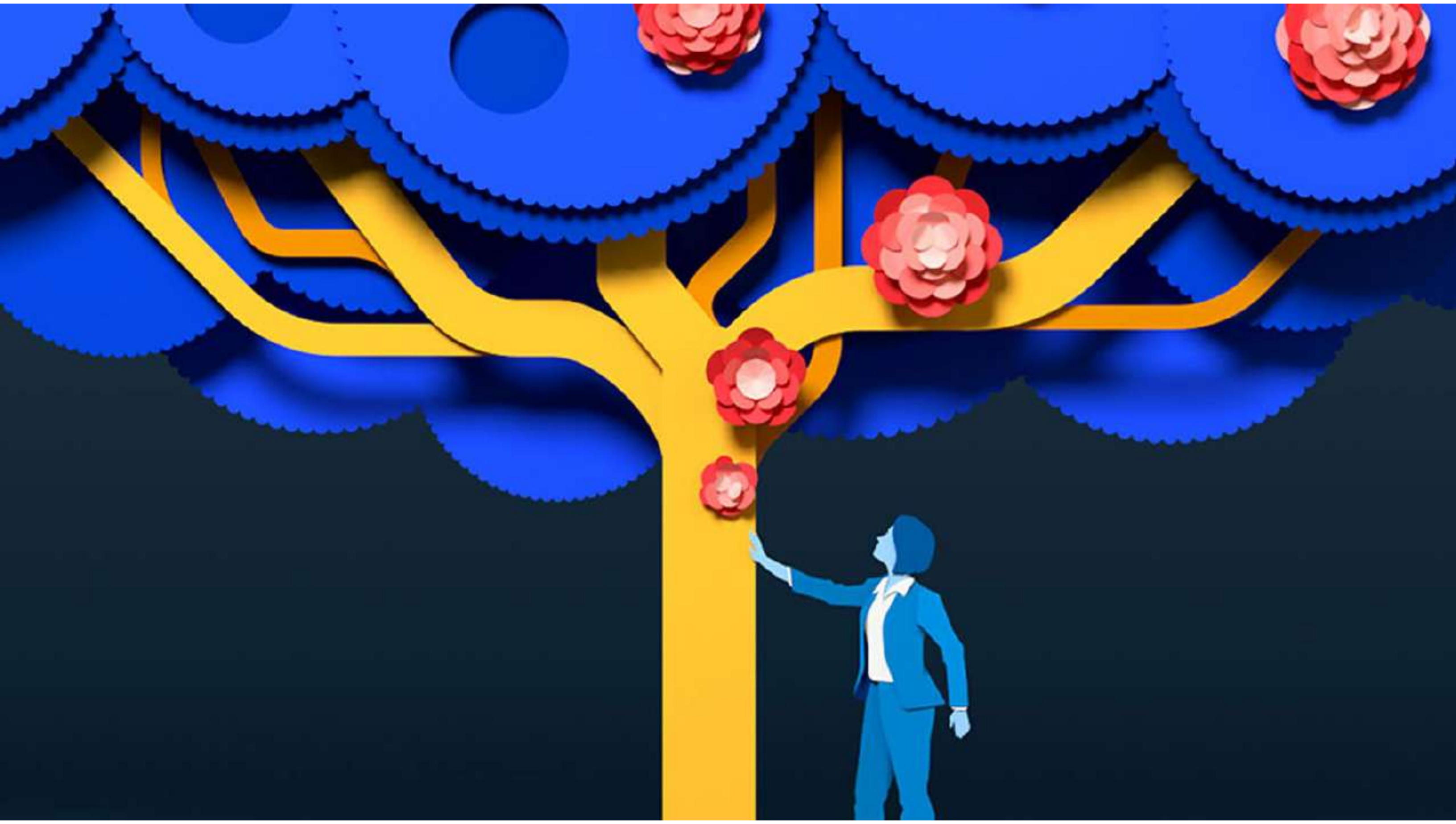
Starting strong: Making your CEO transition a catalyst for renewal

The best CEOs use the first six to 12 months of their tenure as a moment of great personal transition and institutional renewal. There are four keys to success.

by Carolyn Dewar, Scott Keller, Vik Malhotra, and Kurt Strovink



Illustrations by Edu Fuentes

It is when we are in transition that we are most completely alive.

—William Bridges

Some experiences in life you simply can't prepare for. You can imagine how you might feel and what you might do, but you can never actually know how you will respond in a situation until it happens. Falling in love, becoming a parent, and facing one's mortality all fit into this category. In the workplace, your first interview, first day on the job, and first time given the responsibility of managing others are of this ilk. For a select few who successfully climb the corporate ladder, becoming CEO can be added to this list. As Bill George, former CEO of Medtronic and current Harvard Business School professor, puts it, "No one is prepared to become CEO, no matter how much they think they are. You have to grow into the job. You think you know how to run a business, but that's really more the COO role."

What makes the top job so different from the leadership roles that come before it? To start with, new CEOs discover quickly that they are accountable for everything, that their reporting relationships have changed dramatically, and that the job is extremely lonely.

Dick Boer, former CEO of the Dutch food giant Ahold Delhaize, explains how accountability changes: "As the company CEO, it's solitary. You can't say, 'Look, I can't do it because . . .' No. It's you. You can't blame anyone anymore for anything. It's you to blame." Ecolab's former CEO Doug Baker illuminates the uniqueness of reporting relationships: "Our synapses are designed for one boss. Our whole career, we have had one boss, and now, all of a sudden, you've got 13 versions of a boss. Oh, and by the way, they don't come to work every day, like all your other bosses did." Microsoft CEO Satya Nadella reveals where the loneliness comes from: "Nobody who works for you sees what you see. And nobody you work for sees what you see. That's the fundamental problem of a CEO, which is you see it all, and nobody else around you sees it, so you can get very frustrated."

For these reasons and many others, no one should assume that they have it all figured out when transitioning into the role of CEO. In fact, one-third to one-half of new CEOs are considered to be failing within 18 months of taking the role, and more than 90 percent of those CEOs confess that they wish that they had managed their transition differently. Those who get it right realize early on that they will need to lead differently than they did on the way to the top. They know that their success will depend on whether they can reinvent themselves by rewiring the many work habits they built up over decades (on average, new CEOs have worked for 24 years before taking the role).

Savvy CEOs recognize that the renewal opportunity isn't just for them but for the entire organization. A transition of leadership creates what German American psychologist Kurt Lewin refers to as an "unfreezing" moment for the institution. According to Lewin's theory, organizations exist in an equilibrium state largely constrained ("frozen") by resistance to change and group conformity. Movement becomes possible only when there is a jolt to the system (an "unfreezing"). Such jolts often come in the form of a crisis—such as when GM's Mary Barra used the company's ignition switch crisis as a catalyst for needed culture change. A CEO transition creates a similar opportunity—albeit without the crisis—to reset an organization's aspirations and ways of working.

The best CEOs don't miss the opportunity to make their first six to 12 months (not just the vaunted 100 days) both a personal transition of great import and a profound moment of institutional renewal.

[1] Unless otherwise noted, all quotations from leaders in this article come from unpublished interviews conducted as part of McKinsey research.

While each leader will act in ways befitting their unique situation, there are at least four common ingredients for success:

— not making it about you

— listening, then acting

— nailing your firsts

— playing “big ball”

Don’t make it about you

In his 1979 book *Transitions: Making Sense of Life’s Changes*, the late author and consultant William Bridges wrote about the difference between transition and change. According to Bridges, change is something that happens to people. Transition, on the other hand, is internal: it’s what happens in people’s minds as they go through change. Change can happen very quickly, while transition usually occurs more slowly. The distinction is subtle but vital to understand for a new CEO who is pursuing both personal and institutional renewal.

The day you become CEO, you undergo an enormous amount of change. For one, all the attention becomes laser-focused on you, often in ways that distort reality. Says Brad Smith, former CEO of the accounting software giant Intuit, “It’s no secret that we all get ten inches taller and our jokes get funnier the day we assume the role.” At the same time, your power gets magnified. “Every time you say or do something,” says DBS Bank CEO Piyush Gupta, “it’s got a massive consequential effect. The whole company pivots.”

All this attention and power can quickly create a celebrity CEO phenomenon where the transition becomes all about you. Successful CEOs don’t let this happen—they keep their minds focused on the institution. As former Itaú Unibanco CEO Roberto Setúbal explains: “All CEOs need to ask themselves, ‘What do you want to be remembered for—as a great person or a person who made the company great?’ If you want to make the company great, then you must think about the company first, yourself second. It’s human nature to want to be recognized, so it’s not easy to put the institution ahead of yourself.”

Former Mastercard CEO Ajay Banga reinforces the point with a memorable analogy: “You want them to not remember you. You want the company to be successful where it’s headed. You do not own the business unless you created the company and were Steve Jobs or Bill Gates, and then they should remember you. Guys like us, we’re just stewards of the system in a ship sailing through the sea. You have to make sure that the boat doesn’t sink while you’re there and that during the voyage it picks up a couple of extra sails and some new engine technology. You make the boat work better. But you don’t brand the boat with your name and call it the *Ajay Banga* boat.”

Such advice sounds laudable in theory, but what does it mean in practice? Taking this approach starts with asking different questions, which then lead to different answers. For example:

Topic	‘It’s about me’	‘It’s not about me’
Vision	What legacy will I leave?	What organizational purpose do I serve?
Leadership	What are my “nonnegotiable” expectations of others?	Who does the company need me to be?
Team	Who on my team will complement my weaknesses?	What conditions will I need to put in place to maximize my team’s success?
Change	What is broken that needs fixing?	How will we respect our past while accelerating or disrupting our future?
Engagement	How will I get the organization on board with my vision?	How will I engage the organization in creating our shared vision?
Measurement	How will I know if I’m successful?	How will we know if we’re winning?

Microsoft's Nadella embodies the "it's not about me" mindset by ascribing a meaningful portion of his success to his predecessor. "My dad, a civil servant in India, always used to talk about institution builders as those people whose successors do better than they did themselves," he says. "I love that definition. I feel that if the next CEO of Microsoft can be even more successful than I am, then maybe I've done my job right. If the next CEO of Microsoft crashes and burns, that may result in a different verdict. That's why I think too much credit is given to me and not enough to Steve [Ballmer, Nadella's predecessor] for what he set in motion. I don't think I would have been able to achieve what I've achieved if not for his work."

Israel Discount Bank's former CEO Lilach Asher-Topilsky used a daily ritual to remind herself that the job was not all about her: "Every morning, when I went to my office, I entered the room, looked at my chair, and reminded myself that people were going to walk in and talk to the chair. I sit in this chair now, but I have to remember that I have to be humble. I have to remember that everyone is the same. I sit in this chair, and it makes me powerful, but tomorrow I'm not going to be in this chair."

Listen, then act

When a new CEO takes over, anxiety levels can run high within the organization. Everyone wants to hear what the new person thinks, what will change, and what the change will mean for them. With people overanalyzing every word and move the new CEO says and makes, the urge to decide, declare, promise, and explain is strong. The best leaders in transition know that it is better to listen and find out what is really going on before making broad declarations or premature moves. Of course, context matters—in a turnaround situation, there will be a premium on action—but in most contexts, successful leaders subscribe to Albert Einstein's edict of, "If I had an hour to solve a problem and my life depended on the solution, I would spend the first 55 minutes understanding the problem." Practically speaking, this ethos translates to the following practices:

— Start with a broad-based listening tour.

— Create a fact-based "one version of the truth."

— Lock in a short list of bold moves.

— Communicate those moves in an elegantly simple, engaging manner.

On his listening tour after being announced as the next CEO, Intuit's Smith asked the same three questions of board members, investors, fellow CEOs, and employees: "What are the greatest opportunities we haven't yet capitalized on? What are the greatest threats that could end this storied franchise if not addressed? What is the one thing I could do to screw it up?" The following are more examples of other powerful questions you might consider asking: What do you hope will change? What should not change? What aren't people telling me that I need to know? What am I not hearing that I should be hearing? Lockheed Martin's former CEO Marillyn Hewson explains why such questions are uniquely powerful during the transition period: "People tell you things because you're the newbie that they're not going to tell you two or three years from now."

The perceptions you pick up during your listening tour should be validated with facts where possible and augmented by analytics that can help answer tough questions about the state of the business. The goal is to create one version of the truth that you can use as a baseline for the organization's aspirations and against which to judge its future performance. Ed Breen, the CEO of DuPont and former head of Tyco and General Instruments, discusses his methodology: "As a CEO, when you go into a company, even if you've been in the company and you get promoted to CEO, you need to take a good, clean look at everything: return metrics, cash conversion—all the key metrics. Then you can see where you sit vis-à-vis a really good company that has a business model like yours, and you can ask, 'Well, why aren't we there? If they can be there, why can't we be there?' There's always a way to get there." Financial and operational metrics are key, but so are metrics on talent, teamwork, culture, and stakeholder perceptions.

Once you have a strong, fact-based understanding about what is needed to propel the business forward, it's time to identify the biggest needle-moving actions that you will lead. What will you buy and sell? Where will you invest differentially? How will you improve productivity? Where will you create more differentiation? How will you reallocate capital? McKinsey research shows that making even two big moves across these arenas more than doubles the likelihood of rising from mid- to top-tier performance, while executing three or more makes such a rise six times more likely.[1] Furthermore, CEOs who make these moves earlier in their tenure outperform those who move later, so there is a premium on mobilizing the organization quickly.

You may be wondering, "If moving fast is important, why do great CEOs invest so much time in listening first?" Alain Bejjani, the CEO of Dubai-based conglomerate Majid Al Futtaim, explains this paradox of going slow to go fast: "We aimed to have the most inclusive process possible. Doing so built a broad sense of ownership, and we also found that some of the most insightful answers came from people we wouldn't normally have approached for input, which in hindsight would have been a significant loss." Best Buy's former CEO Hubert Joly reinforces the point: "Of course you have to create a plan, but you have to cocreate it. It doesn't need to be perfect—the key is to create energy and manage energy." Bejjani's and Joly's experiences are supported by social science that suggests that people are up to five times more motivated to execute initiatives that they have had a hand in creating versus ones that have been handed down from on high.

A powerful tool to mobilize the organization in the desired direction is to distill the company's transformational vision and strategy down to an elegantly simple "one-pager." Says DBS's Gupta, "We put together a one-page visual we call the DBS House. On it is everything: our vision, strategy, values, targets, etcetera. It allows us to all talk the same language about what we want to do and, more importantly, what we do not want to do." Similarly, Ivan Menezes, the CEO of beverage maker Diageo, carries around a one-pager called the "Diageo Performance Ambition" that has the company's purpose and vision at the top and then lays out the company's six strategic pillars—written in simple English with no jargon. Menezes describes why it's so useful: "Whether you're on a bottling line in Kenya or doing sales in Vietnam, you can find yourself on the page and know where you could make a difference. It's very helpful in depicting the clarity of the strategy and the change that is needed."

Nail your firsts

In a famous social-science experiment conducted in 1946 by psychologist Solomon Asch, participants were given one of two sentences. The first began, "Steve is smart, diligent, critical, impulsive, and jealous." The second read, "Steve is jealous, impulsive, critical, diligent, and smart." Although both sentences contained the same information, the first one led with positive traits while the second one started with negatives. When asked to evaluate what they thought of Steve, subjects who were given the first sentence evaluated him more positively than those given the second. This is an example of what social scientists refer to as the "primacy effect," and it's why the adage "You never get a second chance to make a first impression" matters—first impressions tend to last.

Early in your tenure, everyone, even those you have worked with for years, is forming their first impression of you *as the CEO*. Getting your first impressions right will send strong messages about how you intend to lead differently (from the previous CEO, as well as versus how you have led in previous roles) and the renewal opportunity you see for the organization. Applying the following four principles will go a long way to ensuring that your first impressions are positive:

— Understand people's "why?"

— Keep to a single narrative.

— Err toward complete candor.

— Prepare intensely for moments of truth.

If you know what motivates a person and can connect at that level, the chances are greater that you will make a positive and lasting impression. "It goes beyond just listening to what they say," Lockheed's Hewson shares. "If you take time to understand why they're saying what they're saying, you can [then] help shape their longer-term thinking." Netflix CEO Reed Hastings gives an

[1] Chris Bradley, Martin Hirt, and Sven Smit, "Strategy to beat the odds," *McKinsey Quarterly*, February 13, 2018.

example of how understanding the "why?" of the press shapes his actions: "They want to be truth tellers, but they are forced to be entertainers." Hastings makes it a point to give reporters a bit of both and can convey his message more effectively as a result.

Jacques Aschenbroich, former CEO and current board chairman of the global automotive supplier Valeo, hews to the second principle: "What I present to the board of directors is exactly the same that I present to our shareholders, exactly the same that I present to leaders, exactly the same that I present to the unions." Israel Discount Bank's Asher-Topilsky expands on the point: "When something happens, internally or externally, you continue to communicate in the same way." On the one hand, adopting a single narrative is liberating—one CEO confided in us, "I'm not smart enough to have two versions of the truth!" On the other hand, you'll need to brace yourself for having to endure, in the words of Procter & Gamble's former CEO A. G. Lafley, "Excruciating repetition."

Asher-Topilsky speaks about the third principle—candor: "Don't overpromise. Be frank about the problems, not just the opportunities." Even if you are uncomfortable in the moment, such sincerity lays the foundation for real trust and credibility. To facilitate this level of candor with his board, Diageo's Menezes starts meetings in an executive session (just him and the board) with a list of seven or so things that are going well, matched by an equal number that aren't going well. Doing so offers his directors a better perspective on what he's dealing with, which allows them a chance to give better guidance. US Bancorp's former CEO Richard Davis shares how this translates to communicating with investors: "I often said, 'Look, you deserve the truth, and we deserve for you to believe us. So when we tell you that things are going amazingly well, you will remember us telling you when they weren't.'"

Successful CEOs prepare intensely for important moments of truth, such as the first time they have their team together, their first board meeting, their first investor presentation, and their first quarterly earnings report. In these situations, it's important to heed the words of US college football coach Paul "Bear" Bryant: "It's not the will to win that matters—everyone has that. It's the will to prepare to win that matters."

Aon CEO Greg Case learned this the hard way. When he took the top job at the professional-services giant, he was told he had to present at an investor day that was scheduled to take place a month after he arrived. Having come in from the outside, he knew there wasn't time to prepare a thoughtful, compelling, and meaningful view of the future strategy of the firm. Case recalls, "Had I been more seasoned, I would have said: 'We're going to cancel that.' But I didn't know any better. So I said, 'OK, we'll get ready.' It was a massive fire drill from hell."

Case also shares the hard-gained learning that new CEOs should treat early interactions with individual board members as moments of truth. "Spend more time, substantial amounts of time [with them] early on as a new CEO," he advises. "It's absolutely essential that your board understands you, and you understand them individually. It builds trust and transparency. I wish I'd spent more time early on." Former Caterpillar CEO Jim Owens describes the practical application of this advice: "For the first six to nine months, I personally met with each board member at their place of business, took time to have dinner, got to know them a little better, and talked about the business in depth."

Getting your first impressions right doesn't guarantee success, but it does increase the odds. As in golf, putting the first shot on the fairway is the way you want to play.

Play 'big ball'

"Play big ball, not small ball," advises Sandy Cutler, the former CEO of the power management company Eaton. "By that I mean spending time on things that no one else can in ways that magnify your effectiveness without getting mired in things that don't make a difference."

This advice may sound like common sense, but it's too often not common practice for new CEOs who suddenly find themselves accountable for everything and to everyone. Mastercard's

Banga confesses, “The first two years were really hard. I started badly, because I was trying to do everything—communicating, getting to know people, leading change, finding the people I could build new relationships with, and getting them to carry my message.” His life quickly spun out of control. “I was traveling as well. It was hard to sleep. I’d come back to my hotel room in Asia at 11 o’clock at night and I’d have 100 emails from the US waiting to be answered. And I’d promised my team that I’d respond to every email and every phone call within 24 hours.”

Like Banga, many new CEOs enter the role thinking that they will go hard for the first 90 days and then back off a bit. That’s easier said than done. “I didn’t know whether I’d be successful and so I went 100 percent, totally all in,” divulges former LEGO CEO Jørgen Vig Knudstorp. “My health suffered quite badly. I went to a checkup, and the doctor said, ‘You have the fitness of a 65-year-old.’ I was, at the time, approaching 40. I then started becoming a bit more sensible.” Knudstorp’s experience is a cautionary tale—as a new CEO, you should be disciplined about playing “big ball” from day one.

To play big ball throughout their tenure, new CEOs can put three foundational elements in place early:

— *Time management:* Set clear boundaries and stay extremely disciplined.

— *Talent:* Put “A” players in critical roles, move on “C” players, and help “B” players succeed.

— *Operating rhythm:* Combine accountability with urgency and targeted coaching.

At Mastercard, Banga learned to become extremely careful about how he used his time: “If you, as CEO, can’t figure out what matters to you, and if you are not willing to make the time for it, then it’s your problem. No one can help you.” He set boundaries and adopted a color-coding system in his calendar. The time he spent for travel, with clients, regulators, in internal meetings, and so on were each assigned a different target time allocation and color. “If I wasn’t spending time in the right places in any of these areas, a quick look at the calendar would make that abundantly clear,” he shares. “One of my chief of staff’s primary jobs was to make sure that the balance of meetings was correct.”

Flemming Ørnskov, CEO of the skin care company Galderma, shares the hardest part of getting balance: “The thing I had to learn was to say no. When someone calls me and says, ‘I want you to be the keynote speaker’ or ‘Don’t you want to do this off-site?’ or ‘Let’s do a dinner,’ saying no feels uncomfortable initially, because people mean it in a friendly way. But to say no politely is important.” Ørnskov is highly disciplined about making what he says yes to as productive as possible. “I really prepare for meetings and make sure the agenda is tight and focused,” he explains. “I read the pre-reads, I think about it, I start and finish meetings on time. All meetings start and end with a recap of action items and follow-ups.”

The second area to get right early is talent management. GE CEO H. Lawrence Culp shares why: “Your people decisions are really where all your leverage is. As a CEO, you absolutely have to get those right.” The best CEOs create a short list of roles (30 to 50) that will have the most impact on driving their company’s strategy. Then they make sure those roles are filled with A players. They also make tough calls on C players, even those who have been loyal to the organization for decades. JPMorgan Chase CEO Jamie Dimon clarifies the rationale for this: “If we were ‘loyal’ to them by leaving them in the job, we’d be hugely disloyal to everyone else and to the company’s clients.”

Further, and often neglected, is creating the conditions for B players to up their game: role modeling, setting expectations, and providing incentives and capability-building opportunities. Having done so, if no improvement happens in a discrete time frame (months, not years), it’s time for a colleague to move on. Gail Kelly, the former CEO of Westpac Banking, explains why: “It very rarely gets better if you’ve put the conditions in place for their success and they aren’t succeeding. That’s why you want to make those decisions early. It’s the most elegant way of dealing with it, because you can discuss that it’s not the right fit. If you let it go on too long, you can’t have that discussion.”

The third foundational element that will enable you as CEO to play big ball is establishing a robust operating rhythm for the company. This is harder than it may seem because it also involves deciding the altitude at which you will fly. As the corporate CEO, you have business unit CEOs reporting to you who have the operating responsibility you no longer have. Although you will need to empower those people, there is a trap to avoid, as GE's Culp explains: "I've seen a lot of my peers giving their business unit CEOs a lot of room because that's what they always wanted when they were in the role. Then someone surprises them in not a good way, and they start to think differently."

For Culp, as for the best company CEOs, the key is to have a regular rhythm of reviews covering organizational, operational, and strategic issues. The altitude at which to fly is determined by the substance of those sessions. Mastercard's Banga explains: "My operating rhythm is that if you're not performing, it will be a longer operating review, we'll dig into what's going on. If you're growing market share and growing on the priorities we agreed to in the KPIs, it'll be a very short review."

Your operating rhythm doesn't just reinforce your priorities; it also sets the metabolism of the organization. As Microsoft's Nadella states, "That's a fascinating thing—what is tempo? Only the CEO can decide that." It's important to set a pace that allows you to get early runs on the board. Best Buy's Joly explains why: "The key with any stakeholder is to get the 'say–do' ratio right: the ratio between what we said we were going to do and what we actually did. That's how you get credibility. If you do what you say you'll do, they'll want to see less of you. They'll want you to spend your time working on the business and delivering on your commitments."

We began by discussing how, like falling in love, transitioning into the CEO role is something you can't fully prepare for. As such, it's a profoundly uncomfortable but also wonderous time for those fortunate enough to have been chosen to lead at the highest levels. We also noted that the impact of the transition extends far beyond the leader. The ascension of a new CEO is an unfreezing moment that can catalyze significant institutional renewal.

GE's Culp describes how it feels when it all comes together: "I liken it to the flow I remember when I was on my high school basketball team. We ran fast, took care of each other, and we were successful. Running fast with incredible people working at this level—I just find it to be great fun and rewarding in a whole host of ways."

By not making it about you, listening then acting, nailing your firsts, and playing big ball, you'll soon hit your stride.

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Staying ahead: How the best CEOs continually improve performance

After the heady first years in the job, CEOs must sustain momentum and high performance. Here are four ways to avoid complacency and create even more value.

by Carolyn Dewar, Scott Keller, Vik Malhotra, and Kurt Strovink

Illustrations by Edu Fuentes

Success breeds complacency, complacency breeds failure.

—Andy Grove

Most people know the fable "The Tortoise and the Hare." In the story, the two animals challenge one another to a race to prove who is faster. The hare starts strong and is soon out of sight. Midrace, the hare lies down to rest, feeling certain that it's going to win. After a time, the tortoise plods past the place where the hare is sleeping peacefully. By the time the hare wakes up, it's too late to overtake the tortoise, despite its best efforts.

The tale originated with the Greek storyteller Aesop, who makes use of humble incidents to teach great truths. But could such a simple story be relevant to today's CEOs, who face far more menacing challenges than a slow and steady tortoise? After all, the reality that they encounter is more akin to being chased by world-class drivers in state-of-the-art Formula One cars on a track full of unexpected turns, multiple surfaces, and unpredictable weather.

The answer is a clear "yes" if you're a CEO who started strong and are now riding high three to five years into your tenure. You did all the right things early in your role: set a bold vision, pursued a short list of big strategic moves, put the right talent and accountability mechanisms in place, gained the trust of your stakeholders, and focused your time on what mattered. As a result, you've created significant value on your watch. Your peers in other organizations who didn't get as strong a start are at worst being ousted from the role and at best struggling with the dreaded "hockey stick" syndrome, in which CEO who forecasts outsize improvements finds, over time, that little progress has occurred and that the desired uplift remains elusive.

On one hand, this is exactly where you hoped you would be; congratulations. On the other hand, as Aesop's fable warns, you're about to face your toughest challenge yet: complacency. Said another way, becoming a successful CEO is hard, but staying successful is even harder. Research confirms this challenge: more than half of the companies on the Fortune 500 list in the year 2000 went bankrupt, were acquired, or ceased to exist in the following 15 years.[1]

It's during this middle stretch of your CEO tenure that the concentration and energy you applied to your objectives during your first years on the job are most likely to dissipate and fragment. Intellectually, the danger of such complacency is a simple concept to grasp. No one wants to be the prize fighter who wins the title belt, goes soft, and unceremoniously loses it to a hungrier up-and-comer or to be the band whose single goes platinum, only to become known as a one-hit wonder down the road. We've never met a CEO who told us, "Yep, I'm becoming complacent." But we've met plenty who suddenly recognize that complacency has set in when they see a proverbial tortoise ahead of them.

Take one of the most respected, influential, and successful CEOs of the 21st century: Jamie Dimon of JPMorgan Chase. During his early tenure, he deftly navigated the financial-services behemoth through the global financial crisis of 2008, and a year later, he was named to audit firm Brendan Wood International's TopGun CEOs.[2] Fast-forward to 2012, however, and Dimon was facing a crisis after his company got hit with a trading loss of approximately $6 billion. When asked what went wrong, Dimon confessed, "The big lesson I learned: don't get complacent, despite a successful track record."[3]

[1] R. Ray Wang, "Research summary: Sneak peeks from Constellation's futurist framework and 2014 outlook on digital disruption," Constellation Research, February 18, 2014.
[2] Alexandra Zendrian, "In pictures: The Top Gun CEOs," *Forbes*, June 23, 2009.
[3] Monica Langley, "Inside J.P. Morgan's blunder," *Wall Street Journal*, May 18, 2012.

The reason this happens can be more emotional than intellectual. In the middle years of your CEO journey, you're now the author of the organization's status quo. It's your plan. This makes it far more difficult for you to judge the business dispassionately and to disrupt what's working. Also, with more success comes an increased confidence in your judgement. "The problem with being a CEO a long time," says James Gorman, CEO of Morgan Stanley, "is everybody tells you that you have all the answers. It's comforting to your ego but very dangerous."[4]

Like everything about the CEO role, the dynamics at play are as much about the institution as they are about you. When traditional competition is fading in the rearview mirror and emerging competitors are gathering their forces, it becomes increasingly difficult to define what winning looks like. Meanwhile, that license you had early on to shake things up has long expired, and your employees have become comfortable working in the new ways you introduced. Unless you're again the prime mover of change, the organization will become complacent.

So how do CEOs avoid complacency and sustain high performance through the middle years of the role? We don't pretend to have a magic formula, but from our continued research and experience in the field of CEO excellence, we're confident the odds are greatly increased by the following:

— enhancing your learning agenda

— taking an outsider's perspective

— collaboratively defining the next S-curve

— future-proofing the organization

Enhance your learning agenda

In the early years of being a CEO, you learned an extraordinary amount. The conversations you had with customers, employees, investors, analysts, board members, and other stakeholders helped you shape the strategy that's led to the success you're enjoying today. Now you're flooded with requests to tell your story and share your wisdom with others. While these requests are well earned, Flemming Ørnskov, CEO of the Swiss pharmaceutical company Galderma, describes the dangers that lurk beneath. "There are so many distractions," he says.[5] "You can win prizes; you can get accolades. Which [are] all good. But the main job you have is to do better every year than you did the year before."

The point isn't to pull back from external engagement. It's to make sure that you're spending time listening, learning, and connecting dots versus talking about your successes. In Ørnskov's case, his success early on allowed him to delegate more responsibility to his team, which meant he could actually spend *more* time outside the company—but only on things that would help the business stay competitive. "I knew all the key opinion leaders," he shares. "I spent an enormous amount of time on understanding what was going on, seeing patients, meeting doctors, going to scientific conferences to get the latest in research, and studying our competitors' activations on the ground."

The time Ørnskov spent learning paid off: "The inspiration for at least two or three deals we did came from doctors I got to know who said to me, 'You should really think about this thing,' 'I'm involved in this product development,' or 'I've seen patients in this clinical trial.'" Similarly, Greg Case, the CEO of global professional-services firm Aon, uses client conversations to pick up new product development ideas—risk products for cybersecurity and for intellectual property theft being two examples. Case explains his philosophy: "You, of course, interact with clients to serve them, but you also interact with them to understand how you want to change." For former LEGO CEO Jørgen Vig Knudstorp, an unlikely group of customers was instrumental: the adult fan community. "They were viewed as a gray market and a little bit of a fringe group," he shares. He joined them for one of their conferences and gained their trust, and they helped him see what was possible. LEGO's adult customers now total more than one million people globally and account for 30 percent of LEGO's global business.

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[4] Vik Malhotra and Asheet Mehta, "Voices of CEO excellence: Morgan Stanley's James Gorman," McKinsey, July 22, 2022.
[5] Unless otherwise noted, all quotations in this article are from Carolyn Dewar, Scott Keller, and Vik Malhotra, *CEO Excellence: The Six Mindsets That Distinguish the Best Leaders from the Rest*, New York, NY: Scribner, 2022.

Feike Sijbesma, former CEO of DSM, similarly found inspiration from his external networks. “I started traveling a lot and building a network, connecting with a lot people in business, science, and society,” he shares, “to combine the [seemingly] unrelated things into something new.” He gained conviction from visits with industry experts, including in the Middle East, that DSM would never be able to compete with the major global oil and chemical companies. At the same time, through his involvement with the United Nations, among other organizations, he realized that opportunities were emerging in a whole new area of sustainable development and healthy food. “That’s how we got the idea to move out of petrochemicals and use the proceeds to move to nutrition and health,” he reveals.

Investors can be another important source of new ideas. Ken Powell, former CEO at global food company General Mills, recalls, “I spent a lot of time with our top shareholders. There were, of course, some who wanted a quick hit, but [there were] others who were very constructive and had a long history of really understanding the industry. I got a lot of energy from those conversations. And that helped refine or reinforce our thinking.” DuPont CEO Ed Breen goes a step further. “I engage with the activists,” he shares. “If you listen, they often have good ideas. I agreed with 80 percent of what they wrote in their white papers, and what I didn’t agree with was how to go about fixing the problem. Their view is, ‘If Ed has a better way to fix it, good. Go do it.’ They just want it fixed. With that approach, I’ve found they often become your ally.”

Breen also advises CEOs to join one or two groups where they can get together off the record with other CEOs and talk through key topics. “You learn a lot from hearing what people are seeing in their markets, and it’s on a level that goes deeper than what you read in the *Wall Street Journal*,” says Breen. “I still meet with groups like this now. I always walk away with six or seven new ideas.” Along similar lines, Brad Smith, former CEO of financial-software giant Intuit, shadowed leaders in other companies such as Amazon, Facebook, and Google once a quarter. “I told them I just wanted to be a fly on the wall; this is not a trade show,” he says. He would take notes throughout the day, share his observations at the end of it, and then write up a report on what he learned to share with his colleagues at Intuit. “They called it ‘Uncle Brad’s book report: Here’s what I learned,’” shares Smith. Many successful CEOs periodically take their teams along on such visits to learn from other organizations.

Drawing on practices from other industries can be powerful. For example, former Nestlé CEO Peter Brabeck-Letmathe had a revelation when he learned how Disney, as it began to conceive each animated film, was already thinking about how to make the most of that film over the next ten years. “So instead of creating just one ingredient for one product, which has limited value,” shares Brabeck-Letmathe, “I was thinking about how to transform a nutritional ingredient into a brand and how to exploit it over the next ten years. . . . People make things and do things in different ways, and you always can learn something and apply it in your own organization.”

Learning doesn’t just come from the outside. As Intuit’s Smith shares, “I had two meetings a week with people many levels down in the organization and with eight to ten people in each group. To all, I posed three questions: ‘What’s getting better than it was six months ago? What’s not making enough progress or going in the wrong direction? And what’s something you’re afraid no one is telling me that you believe I need to know?’ It was incredible, because you skip levels and go right to the front lines of the area you’re trying to learn about. You cut everybody else out and eliminate the filter.”

Take an outsider’s perspective

In one of Nobel Prize–winning psychologist Daniel Kahneman’s experiments, a grocery store put Campbell Soup products on sale for 79 cents with a sign above the display that read “limit 12 per customer.”[6] Another grocery store ran the same sale but with no purchase limit. On average, how many cans were purchased per customer in the first store? Seven. And in the other store? Roughly three.

[6] Daniel Kahneman, *Thinking, Fast and Slow*, New York, NY: Farrar, Straus and Giroux, 2011.

What's going on here, and why is this relevant? The experiment shows the power of what is called an "anchoring heuristic." A heuristic is essentially a mental shortcut or rule of thumb the brain uses to simplify complex decisions—also known as a cognitive bias. An anchor is a piece of information that someone relies on to make a decision. In the supermarket experiment, shoppers' brains anchored on the purchase limit of 12 and adjusted downward. Those who bought only three cans of soups didn't have the number 12 in mind, so they made what might be considered a more normal-size purchase, or one adjusting upward from zero.

Now let's apply this learning to the way many CEOs traditionally approach their strategy. Each year they refresh their strategy based on the prior year's assumptions: what still holds and what doesn't. By contrast, the best CEOs periodically do thorough analyses of all aspects of their businesses in the same way that they did when they took the role, as though they were coming in from the outside with fresh eyes. They're not wed to the past, encumbered by internal loyalties, or willing to bow to short-term pressures.

Can an incumbent really act as boldly as an outsider? Yes. In the early 1980s when Intel's profits plummeted from $198 million one year to $2 million the next, then-president Andy Grove asked Gordon Moore, Intel's CEO at the time, what Moore thought would happen "if we got kicked out and the board brought in a new CEO."[7] Moore responded that a new CEO would get the company out of memory chips. Grove stared at him and asked, "Why shouldn't you and I walk out the door, come back, and do it ourselves?" The rest is history, as Intel moved away from dynamic random-access memory chips and staked its future on a new product: the microprocessor. In doing so, it helped usher in a run of success for the company that lasted for decades.

The methods by which CEOs take a true outsider's view vary, but virtually all are grounded in asking for factual answers to a holistic set of questions:

Capital markets:

— What has driven our historic shareholder returns over various time horizons?
— How does our valuation stack up to peers' today, and why?
— What are the highest-impact levers to change our valuation (growth, margin improvement rates, etcetera)?

Strategy:

— Are we in the right businesses, geographies, sectors, product lines, and customer segments?
— How can we strengthen our competitive advantage in these chosen areas?
— What are our highest-potential M&A, partnership, and divestment opportunities?

Commercial:

— What are our opportunities for revenue growth (volume and pricing)?
— What is the current profitability of each area we choose to play in, and what is the potential?
— What are customers saying and competitors doing by channel, segment, and product?

Cost and capital:

— Where do we have direct and indirect cost improvement opportunities?
— How can we substantially enhance the ROI of our capital expenditures?
— How can we make our capital structure more resilient?

Organization:

— What radical improvements can be made to communication and engagement?
— How can we enhance our execution capacity and speed (for example, through structure, incentives, and review cadence)?
— Where do we need to refresh talent and our talent proposition, and where do we need to build new capability?

Reputation:

— What is our impact on the environment, and how can it be improved?
— How do we perform on social topics (for example, diversity, well-being, and community involvement)?
— How strong is our governance model?

[7] Andrew S. Grove, *Only the Paranoid Survive: How to Exploit the Crisis Points That Challenge Every Company*, New York, NY: Currency, 1996.

Those in the private equity world will recognize that pursuing clinical answers to these questions is taking a page out of their playbook. In that world, an asset is reassessed every two or three years, and bold actions are taken accordingly. The idea is to view a company through the eyes of theoretical new owners looking to form a new investment thesis and, in doing so, acknowledge that both the company and the external environment will have changed meaningfully since the previous investment thesis was formed. It also encourages important voices of dissent to "speak truth to power" where needed. This thought process is helpful in any organization. "You have to reinvent yourself. The world changes. You have to change," former Itaú Unibanco CEO Roberto Setúbal advises.

Successful CEOs also look for an outsider's perspective on their leadership style. This involves a clinical assessment that solicits feedback from a broad range of stakeholders. The results can be game changing. "In year six of my 11-year journey," Intuit's Smith explains, "my 360-degree feedback came back with, 'Brad is lowering the standards in the company because he's being too kind in reviews and isn't willing to call anybody out. He has this philosophy of praise in public and coach in private. But it's robbing the rest of us of knowing where his standard of quality really is.'" Knowing the company needed him to be different, Smith changed his approach. "I challenged myself to be kind to the person but tough on the issue, and everyone in the company knew it," he says. "I told people, 'Keep me true to this if you don't think I'm being concrete enough about whether the work is good enough. But I also want you to know that I'm not embarrassing people.'"

Collaboratively define the next S-curve

Between three and five years into their tenure, the best CEOs typically combine what they've gained from their expanded learning agenda and their self-directed outsider's perspective to form a point of view on what the next performance S-curve is for their company. The concept of the S-curve is that, with any strategy, there's a period of slow initial progress as the strategy is formed and initiatives are launched. That is followed by a rapid ascent from the cumulative effect of initiatives coming to fruition and then by a plateau where the value of the portfolio of strategic initiatives has largely been captured. Dominic Barton, McKinsey's former global managing partner, describes why managing a series of S-curves is important: "No one likes change, so you need to create a rhythm of change. Think of it as applying 'heart paddles' to the organization."

Former Best Buy CEO Hubert Joly describes why and how he applied heart paddles to his organization, moving from one S-curve to another: "We started with a turnaround, something we called 'Renew Blue.' There came a point where it became apparent we should declare the turnaround over." At that point, Joly felt Best Buy was ready to move into a growth phase, which he dubbed, "Building the New Blue." During the turnaround, Joly had already made a series of bold moves, such as offering price match guarantees, exiting international markets, and reinventing vendor partnerships. Now with his eye on growth, he applied the heart paddles again by building a leading position in the smart-home market, expanding into senior care through sensors and AI, and launching Total Tech Support, a program that provides customer support regardless of where the technology was purchased.

After successfully leading Best Buy through two S-curves, Joly handed over the reins to his successor to take the next leap forward. Some CEOs will choose to stay on and lead their company through multiple S-curves during their time at the helm. During Setúbal's 22-year tenure at Brazil's Itaú Unibanco, he led the company through four S-curves. In his first act, he turned Banco Itaú from a regional to a nationwide bank by quickly acquiring and integrating four large and troubled state-owned banks. In his second act, he invested heavily to move the bank from being retail only to being a leader in corporate and investment banking while expanding into wealth management and into three other Latin American countries. In his third act, he implemented an agile operating model, radically reduced overhead, increased efficiency, overhauled the company's performance culture, and negotiated and executed a merger with Unibanco. In his final act, he aggressively drove growth in Brazil, pushed further Latin American expansion, and prioritized investments to digitize the bank.

The best leaders, consciously or instinctively, understand the need to get others involved in shaping the plan.

While CEOs should clearly define the next S-curve, they would be well advised not to simply dictate it to their organization and expect it to get done. The best leaders, consciously or instinctively, understand the need to get others involved in shaping the plan. This lesson is powerfully illustrated by another one of Kahneman's social experiments. In this one, Kahneman ran a lottery with a twist.[8] Half the participants were randomly assigned a numbered lottery ticket. The remaining half were given a blank ticket and a pen and asked to choose their own lottery number. Just before drawing the winning number, the researchers offered to buy back all the tickets. They wanted to find out how much they would have to pay people who wrote down their own number compared with people who were handed a random number.

The rational expectation would be that there should be no difference in how much the researchers had to pay people. After all, a lottery is pure chance. Every number, whether chosen or assigned, should have the same value because it has the same probability of being the winner. The answer, however, is predictably irrational. Regardless of nationality, demographic group, or the size of the prize, people who write their own lottery ticket number always demand at least five times more than the others for their tickets. This reveals an important truth about human nature. As former Medtronic CEO Bill George puts it, "People support what they help create." The underlying psychology relates to our desire for control, which is a deep-rooted survival instinct. Tapping into the "lottery ticket effect" takes time, but the return is high. Former Adidas CEO Herbert Hainer adopted a collaborative approach to shaping the final S-curve under his watch. "It took us five months," he shares, "but [the process] unleashed enormous spirit, new ideas, and creativity."

Virtually every successful CEO we spoke to has taken a collaborative versus a "thou shalt" approach to defining their company's next S-curve. In 2015, for example, Maurice Lévy, the CEO of multinational advertising and PR goliath Publicis, realized that his acquisition-led growth strategy had largely played itself out. It was time for another S-curve. Even though he had a clear view of what needed to be done, he captured the lottery ticket effect by engaging his executive team and the next level of management—roughly 300 veteran leaders plus 50 recently promoted mangers under the age of 30—in a multimonth-long process to take Lévy's view, refine it, and make it their own. Executives worked in subgroups in which ideas for the future of Publicis were debated, combined, and prioritized. Ultimately, what emerged was an S-curve dubbed "the Power of One" that focused on serving customers through cross-functional teams.

Great CEOs also understand that creating the next S-curve isn't just about setting strategy. Driving change requires pulling all the internal and external levers available, not the least of which is adjusting their own leadership style. Best Buy's Joly describes how he had to change his style when moving from one S-curve to the next. "During the turnaround phase of the company," says Joly, "the CEO needs to be quite heavy handed in orchestrating the change. That doesn't mean the CEO does everything, but

[8] Daniel Kahneman, Paul Slovic, and Amos Tversky, eds., *Judgment under Uncertainty: Heuristics and Biases*, Cambridge, UK: Cambridge University Press, 1982.

my role was to direct the process, and I was making a lot of the decisions. In the next phase, we didn't abandon discipline, but I did push decision making down so we could take risks and unleash our potential. We encouraged this by distributing 'get out of jail free' cards to all the officers at Best Buy. It was a way of saying that 'if you fail for the right reasons, it's OK; you can use one of these cards.'"

Future-proof the organization

Four years into Dennis Muilenburg's former tenure as Boeing CEO, he was named Aviation Week's Person of the Year 2018. Eleven months later, his board asked him to step down amid the company's 737 MAX debacle. Three and a half years after being named CEO of BP, Tony Hayward resigned in the aftermath of the Deepwater Horizon oil spill. Unfortunately, "from adulation to resignation" is a CEO narrative that plays out all too often.

When things are going well, it's hard to imagine that an existential crisis could be looming. Unfortunately, no matter how well a company is run, the question for even the best CEOs isn't if they'll have to lead through a crisis but when. From 2010 to 2017, for example, headlines that carried the word "crisis" alongside the names of the 100 largest companies on *Forbes*' Global 2000 appeared 80 percent more often than they did in the previous decade.[9]

A crisis can arise from anywhere. It may be sparked by high-profile media coverage of a passenger sustaining injuries while being dragged from an overbooked plane, as then CEO and later executive chair of United Airlines Oscar Munoz experienced. Or it may come after a widespread cyberbreach, as Richard Smith, former CEO of credit agency Equifax, confronted. It may stem from a costly safety issue, an ethical-conduct problem, a hostile-takeover attempt—the possibilities are endless. Not all crises are company specific. Macroeconomic events, pandemics, international conflicts, natural disasters, social conflict, terrorist attacks, and countless other external factors can all create crisis conditions for CEOs.

A crisis can end a CEO's otherwise great tenure, or it can be deftly harnessed to propel a company to new levels of postcrisis performance. Those who achieve more-positive outcomes recognize that the best time to get prepared for a crisis is never on the day of the crisis and therefore regularly stress-test their business. Marjorie Yang, the chair of Hong Kong–based apparel maker Esquel, provides a helpful analogy: "When you have a crisis, it's like a sailboat going into a storm. You've got to prepare your boat before you head into the storm. Once you're under way, you can't expect that people will know what needs to be done at the last minute."

Former Merck CEO Ken Frazier reports, "We did tabletop exercises around critical risks, such as patients being hurt in clinical trials or by counterfeit drugs. During a cyberattack, a team of people was ready to swing into action, and we didn't miss a beat." At Netflix, Reed Hastings runs an exercise that poses this problem: "It's ten years out, and Netflix is a failed firm. Estimate the probabilities of the different causes." Hastings and his team work through the list, making assessments of the respective probabilities. "Sometimes the discussion turns to what we can do about some of these risks," he says, "but many times, just defining what risks we face will prompt people to adjust behavior in smart ways that make us more resilient."

A good crisis playbook lays out the leadership protocols, control-room configuration, action plans, and communication approaches for when a crisis hits. It also defines and provides measures for the leading indicators of an escalating threat. As General Mills' Powell puts it, "One secret about crisis management is recognizing when you have one. They're not always as apparent as the COVID-19 pandemic. A crisis can come from a very committed start-up that is about to beat you. You've got to be on the lookout for those companies that have a thousand rabid users. Let it grab your attention, and then react early, or you won't see the crisis coming."

Beyond assessing business challenges, relationships with stakeholders should be stress-tested. As GM CEO Mary Barra puts it, "Relationships with our stakeholders—governments, dealers, suppliers, unions, and communities—aren't a 'nice to do.' That's part of running the company well." The key is to have

[9] Sanjay Kalavar and Mihir Mysore, "Are you prepared for a corporate crisis?," *McKinsey Quarterly*, April 17, 2017.

built goodwill with these groups over time such that if and when a crisis happens, you're considered innocent until proven guilty instead of the other way around. Such was the case for Richard Davis, former CEO of Minneapolis-based U.S. Bancorp, when he found the bank caught up in the throes of the 2008 financial crisis. Thanks to the trust and credibility built in advance, as *Twin Cities Business* reported, "The eyes of the markets, the industry, and Congress swung towards Minneapolis and Richard Davis as credible exemplars of a competent, trustworthy financial organization."[10] Davis was asked to chair the Financial Services Roundtable and work with US leaders on solutions to restore the industry—including what became the Dodd-Frank Wall Street Reform and Consumer Protection Act.[11] Such was his industry-shaping involvement that Davis was named the 2010 Banker of the Year by *American Banker*.

Future-proofing also means actively building the strength of your company's talent bench by putting real time and energy into coaching, retention, performance management, and succession planning for the most value-creating roles—the most important being your own. "Don't let succession planning sneak up on you," advises Intuit's Smith. "Grooming successors takes time, and your brand will be as much about what happens two or three years after you leave as when you were in." Doing so also makes you a better CEO. "My biggest advice to CEOs is to start early with the attributes of what you believe will make a successful CEO when you're gone," shares former Mastercard CEO Ajay Banga. "Don't be nervous about discussing that with the board. Take their feedback. It's actually a way for you to get an appraisal of how you're doing."

Finally, during your midtenure years, you need to think about future-proofing yourself. Often when CEOs start the job, they go all out, doing whatever is necessary and working as hard and as long as possible to succeed. Typically, there's a feeling of "I'll let my workload be unsustainable for a while to start strong." Then despite good intentions, unsustainable habits can form. These often then go unchecked into one's midtenure until they lead to a personal crisis, be it related to health (mental and physical) or relationships. "To be honest, the job was exhausting . . . . I started to see my energy ebb," reveals Merck's Frazier. "Exercise is important. Family is important. All those are ways of recharging."

Even if you don't experience a personal crisis during your middle years, it's all too easy to set yourself up for one after you've left the job when, in the words of U.S. Bancorp's Davis, "people don't laugh at your jokes, and they don't call anymore." Alain Bejjani, former CEO of the Dubai shopping-mall giant Majid Al Futtaim, shares the mindset that keeps him

[10] "Honors: Richard Davis," Twin Cities Business, April 1, 2020.
[11] Bill George, "These 4 CEOs created a new standard of leadership," Harvard Business School Working Knowledge, January 14, 2019.

The best CEOs tend to their outside interests during their middle years in a far more balanced manner relative to peers.

grounded: “The ‘officer’ in your title denotes that you’re an employee who just happens to be sitting in that chair.” This kind of perspective is why the best CEOs tend to their outside interests during their middle years in a far more balanced manner relative to peers.

By the time the hare in Aesop’s fable wakes up, it’s too late. Unlike the hapless hare, the best midtenure CEOs don’t become complacent when they’re winning. They remain as bold and focused as they were at the starting line, and they dig even deeper to succeed on the road ahead. They enhance their learning agendas, take an outsider’s perspective of their businesses, collaboratively define new S-curves, and future-proof their organizations in such a way that they not only maintain their lead but extend it. In keeping with the universal truths of Aesop’s fables, these lessons also apply in many other leadership situations. As such, we hope these insights from CEOs will help leaders at all levels achieve sustained success throughout their tenures.

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Sending it forward: Successfully transitioning out of the CEO role

Great CEOs know that the transition to their successor will define their legacy and cement the strength of what they've built. Here's how they do it right.

by Carolyn Dewar, Scott Keller, Vik Malhotra, and Kurt Strovink

Illustrations by Edu Fuentes

The greatness of our lives is not in what we leave behind, but in what we send forward.

—Ray Noah

One of the most exciting athletic events in the Summer Olympics is the 4x100-meter relay race. The event, which was inspired by ancient Greek couriers handing off a "message stick" to one another, was introduced at the Stockholm Olympics in 1912. For the entirety of the 20th century, the US teams dominated the sport. Not once in the 21st century, however, have both the US men's and women's teams brought home a gold medal, despite many of their members having done so in their individual events.

What's the problem? Simple: bad handoffs. Consider *New York Magazine's* description of one such handoff at the 2020 Tokyo Olympics: "As the pair attempted to pass the baton, they looked more like Keystone Cops than two of the five fastest men in the world."[1] As a result, the men's team failed to even advance to the final. On the other hand, when well-synchronized handoffs happen, relay times are typically two to three seconds faster than the sum of the best times of individual runners.

When you're a celebrated CEO who has successfully led a company through multiple cycles of performance improvement, it's hard to imagine looking like a Keystone Cop at the end of your career as you pass the baton. Yet, as the transition gets closer, the reality that you've never actually done a CEO handover before can feel daunting. Unlike Olympic athletes who practice the timing, pacing, technique, and communication over and over with the grandstands empty—you'll only have one very public shot at it, and you'll be doing so while under emotional strain. As Caterpillar's former CEO Jim Owens puts it: "In the end, the hardest part of the CEO role is leaving."

The best CEOs are less worried about how their own reputation might fare in the transition, and more focused on how the change will impact the institution moving forward. Like track and field, the goal of the handover is to ensure the next person gets off to a great start and is well positioned to perform even better after the baton is handed off. Dropped batons, on the other hand, come at a huge cost. Poorly managed CEO and C-suite transitions wipe out close to $1 trillion in market value every year in S&P 1500 companies.[2]

Microsoft CEO Satya Nadella stresses the importance of taking an institutional view of transitions: "My dad, a civil servant in India, always used to talk about institution builders as those people whose successors do better than they did themselves. I love that definition. I feel that if the next CEO of Microsoft can be even more successful than I am, then maybe I've done my job right. If the next CEO of Microsoft crashes and burns, that may result in a different verdict."

While the specifics of every transition differ depending on the circumstances, any CEO who's excelled in the role but now senses it's time to start thinking about the endgame will benefit from four best practices:

— Firmly decide when to go.

— Finish the job of preparing successors.

[1] David Gendelman, "Why can't the U.S. relay team figure out how to pass a baton?," *New York*, August 5, 2021.
[2] Claudio Fernández-Aráoz, Carrie Green, and Gregory Nagel, "The high cost of poor succession planning," *Harvard Business Review*, May–June 2021.

— Hand over gracefully.

— Embrace what's next.

Firmly decide when to go

Some CEOs enter the job with a clear idea of how long they want to stay, as was the case with former Cincinnati Children's Hospital Medical Center (CCHMC) CEO Michael Fisher. "When I started the role, I told the board that if I'm healthy and stakeholders think I'm doing a good job, I'll do this for, give or take, ten years." In Fisher's case, he ended up staying almost 12, which is just over the 11.2 years the highest-performing CEOs on average spend in the role. For all large-company CEOs, tenures are far shorter: just 7.3 years.[3]

Getting the timing right for your departure is vital. Like fine wine, you'll have become better at your role with time and experience—but at some point, there will be an inevitable decline. There are many warning signs that this has happened to a CEO. On one end of the spectrum, it's when the desire to protect their reputation of making quarterly numbers causes them to shy away from making bold moves and investments in the future. On the other end, it's when late-tenured CEOs whose strategies have played out become desperate to avoid a growth slowdown and opt to make large, complex acquisitions that are unlikely to be accretive for the institution. Beneath such moves often lurks a selfish desire to sooth increasing anxiety, unrest, and potentially even boredom in the role.

The best chief executives know that there's no place for ego in determining when to go; what matters is what's best for the institution. Often there's a natural need for the company to pivot in a new direction, but the sitting CEO isn't the best one equipped to lead the transition. Gail Kelly chose to leave the Australian bank Westpac when she felt her customer-centric strategy was well in place and she had a successor ready who would be better suited to lead the company into a more digital future. Sony's Kazuo Hirai felt that while he was the right person for the transformation phase of the company, he was less suited for the more stable phase to follow.

While the experience of others is instructive, knowing when to step down is a very personal and difficult decision. "It's hard to know when the right time to leave is," shares former Goldman Sachs CEO Lloyd Blankfein. "When times are tougher, you can't leave. And when times are better, you don't want to leave."[4] Former Medtronic CEO and now Harvard Business School executive fellow Bill George taught classes that focused on the arc of a CEO's tenure. He suggests CEOs regularly ask themselves the following litmus test questions to know when the time is right[5]:

— Do you still find fulfillment and joy?

— Are you continuing to learn and feel challenged?

— Are there new personal circumstances that you should be taking into account (for example, family or personal-health issues)?

— Are there unique opportunities outside that won't come around again?

— How is succession shaping up? (Is more time needed to prepare someone? Are you blocking someone who can lead the next era?)

— Are there company-specific milestones that make transitioning out more or less natural (such as the integration of a major acquisition, the launch of an important new product, or the completion of a long-running project)?

— Is the industry changing so dramatically that the company would benefit from a new perspective?

— Are you staying primarily because you can't imagine what comes next?

[3] Based on a comparison of the 200 highest-performing CEOs to all CEOs in the Forbes 1000 over the past 15 years who have completed tenures (n = 109 and n = 2,238, respectively); top 200 defined using McKinsey's CEO Excellence methodology as outlined in *CEO Excellence: The Six Mindsets That Distinguish the Best Leaders from the Rest,* New York, NY: Scribner, 2022.
[4] Lloyd Blankfein, "Lloyd Blankfein memo to Goldman Sachs staff on departure," Bloomberg, July 17, 2018.
[5] Bill George, "The CEO's guide to retirement: Know when to leave—and plan for what's next," *Harvard Business Review*, November–December 2019.

With these considerations in mind, the best CEOs clarify their time frames with their board well in advance of their planned departure date and commit. “Without a clear timetable,” says Harvard’s George, “grooming internal successors and following an orderly succession process become challenging.”[6] Typically, the lead time given is at least two years.

Ultimately, the adage, “It’s always better to drink wine a year early rather than a day too late,” also applies to CEO succession. As former Intuit CEO Brad Smith explains, “I had friends who stayed a couple of years too long in the job. I thought to myself, ‘My gosh, how could they not have seen this coming?’ Then I thought about all the athletes that stay one or two years past their prime. And you think, ‘Man, I don’t want to be that.’ The only question you have to ask yourself is if you want to be the one choosing the date, or you want someone else to choose it for you.”

Finish the job of preparing successors

In a successful relay, the person receiving the baton starts running well before the baton reaches them. The same can be said for succession planning. Although the job of hiring and firing the CEO ultimately rests with the board, the best chief executives work with their directors on succession planning throughout their tenure to ensure there are runners who have the momentum to receive the handoff. Intuit’s Smith describes this philosophy: “Bill Campbell [Intuit’s chair and coach to many Silicon Valley CEOs] helped me,” he says. “The first day I was in the job as CEO he said, ‘I want you not to think of succession planning as replacing yourself. I want you to think about it as leadership development of your team. And we’re OK if we groom CEOs, and you’re not ready to leave or we don’t want you to leave, and they go someplace else. Because then Intuit will simply be known as a leadership factory.’”

Heeding this advice, Smith gave a verbal update on his succession plan to his board every quarter during his tenure, and once a year there would be an official succession planning session facilitated by an outside consulting firm. In this session, the criteria for the next CEO were updated as the company’s needs changed or as the markets shifted. The board also formally reviewed the pipeline of both internal and external candidates. Smith concludes, “Ultimately, we talked about succession 44 times in my 11 years before the board had to make the decision, and that ensured there were no surprises such as: ‘You think you groomed a successor; we don’t agree.’”

It also pays to get your head of human resources intimately involved in this process. At Singaporean multinational banking and financial services corporation DBS Bank, for example, CEO Piyush Gupta says, “For every job, mine included, we [my head of HR and I] work through what is the slate, who could do the job soon, who could do the job in three or five years. We then case manage 100-odd people. Who needs to move, where should we move them, how do we get them the exposure and growth they need to get from point A to point B. It’s very well structured.”

When it comes time for a transition, if you’ve engaged your board and head of human resources the way Smith and Gupta did, the board will have clarity on both what attributes are needed and who the best internal candidates are. Caterpillar’s Owens puts it starkly: “At any large company, shame on the them if they don’t have at least three strong candidates to take over the top job.” Westpac’s Kelly adds nuance: “My style was to try to develop all of my executives. I always knew that two or three of them would pop out as the most natural successors.”

If the process isn’t well managed, succession planning can lead to unpleasant cultural dynamics. “You might not intend to set up a horse race, but it inevitably becomes one,” Kelly observes. There are ways to mitigate office politics, however. Kelly’s approach was straightforward: “I had an explicit conversation with the candidates who were in the running to let them know their behavior would be watched,” she says. “I was clear with them: ‘You can’t allow your teams to play politics in any shape or form, and neither can you. You must support every member of the team to be the best they can be.’

[6] Ibid.

That worked superbly well." Kelly adds, "I also had to treat them equally, not playing any favorites, and they trusted I would." It's also important not to make any promises to candidates during the process. Ultimately, the decision belongs to the board.

So what does the endgame of succession planning look like? Caterpillar's Owens shares his approach: "The board should be able to evaluate the candidate, so I gave these individuals more autonomy toward the end and let them give more strategy presentations to the board. I also had each candidate present to the investor community on the strategy for their units." In some cases, it also makes sense to move potential successors into new roles to further elevate their profile in the lead up to a passing of the baton. It's important to keep in mind that doing so too late in the race can do more harm than good, because in all likelihood there's not enough time for a leader to establish themselves and excel in a new role. In the last year or two of a CEO's tenure, it's better to develop candidates by involving them in enterprise-level projects, committees, and coaching programs.

The CEO's role in succession planning ends once they've helped the board determine the right criteria and develop a list of internal candidates. It's then up to the board to interview candidates and involve outside parties in the decision (for instance, headhunting firms, interview panels that include sitting executives). Former Ecolab CEO Doug Baker describes how he dealt with his board having the last word: "I didn't want to taint the process. I could live with whatever the final decision was, and I'd fully back it because ultimately it has to be the board's choice. It was how I felt intellectually, and it would have been how I behaved no matter what. Emotionally, of course, I wanted it to be my choice. I mean, we're human."

The "finish the job" notion, of course, doesn't just apply to succession planning. We've seen some CEOs take their foot off the gas once they've decided that it's time to go. Given that the time between notifying the board of your intention to leave and when they'll name your successor is a matter of years, the institution can lose some of its competitive edge if the sitting CEO doesn't stay focused to the very end. It may sound obvious, but as former Cadence Design Systems CEO Lip-Bu Tan shares, "A lot of temptations can derail you; you have to stay focused on the things that really matter."

Hand over gracefully

Once a successor is chosen by the board, it's time to make the actual handoff happen. In track and field, success means passing the baton to the next runner in such a way that they can easily grasp it and take it forward rapidly without letting it drop. Successful CEO handovers have similar attributes.

Let's start with how you can make the baton easy to grasp. The first thing you'll need to do is explain to the new CEO that they don't need to be you—that the board chose them because of their own special skills and attributes and because they are the best fit for the institutional road ahead. Before Intuit's Smith stepped down as CEO, he and his successor, Sasan Goodarzi, talked to Steve Young, the American football player who replaced iconic quarterback Joe Montana. "He talked to us about how for part of his first year he tried to be Joe Montana," Smith recounts. "He grew his hair out like Joe and began to dress like Joe. He even tried to change his throwing mechanics like Joe. And he had the worst half year ever. Eventually, Steve stopped trying to be like Joe and had a great career. Steve looked right at Sasan and said, 'You need to be the best Sasan Goodarzi in the world.' He looked at me and said, 'And you have to let him be the best Sasan Goodarzi in the world.'"

Another way you can make things easier for your successor is to give them the gift of resolving any unpleasant yet institutionally important decisions before the handoff. "You'll have some unassailable capital as a successful outgoing CEO," explains CCHMC's Fisher. "Use it to address some of the lingering tough issues, be they people issues or otherwise, so that your successor doesn't have any messes to clean up." At the same time, Fisher advises not to go too far. "If there are important strategic hires and/or strategic decisions to be made, if at all possible, let your successor get their fingerprints on those decisions; they'll be the ones living with them."

Too fast a handoff could create instability and too slow could mean you, the CEO, are getting in the way.

You want your successor to move forward rapidly, but too fast a handoff could create instability and too slow could mean you're getting in the way. In track and field, handoffs happen in the 20-meter "exchange zone," inside which the next runner must receive the baton from the current runner. The exchange zone for a CEO transition is typically six to nine months and sequenced in three stages:

— *Stage one:* Once your successor is announced, you will still largely run the company for two to three months to give them time to do their listening tour and sharpen their thoughts on how they want to run the company. During this time, you'll also give them full exposure to what the role entails, share the rationale behind past decisions, discuss strengths and weaknesses of the top team and the organization at large, and warmly hand off important stakeholder relationships (for example, large customers, investors, regulators, suppliers, and community leaders). This is also when you can offer them some "live, with a safety net" learning opportunities (roles in senior staff meetings, town halls, board meetings, etcetera) so they can get a good feel for what it means to sit in the driver's seat.

— *Stage two:* In the two to three months leading up to their formal start date, you become copilots. During this time, as Intuit's Smith describes, "Any decision that impacts the next few months, the sitting CEO will take. If it's got longer-term implications that the successor will have to live with—such as a restructure or major engineering effort—they'll take it." In this stage, it's important that you shift from a teaching and enabling stance to a supporting one. More than anything, you are encouraging your followers to accept and embrace their new leader.

— *Stage three:* After the formal start date, all decision making is transferred to your successor, and your job is simply to be available for counsel or practical support as directed by them. This typically involves moving your office to a new location away from headquarters. This is also a time when you should let yourself and your career be celebrated—not out of vanity, but because of how important such closure is for others both individually and institutionally. "Over my last 60 days in the role, I went to virtually every significant area of the medical center," recounts CCHMC's Fisher. "It was a chance for me to thank them and for them to reminisce with me, and it was such important closure for all of us."

Before you start the handoff, it's important to have an explicit up-front conversation with your successor to jointly shape the approach and how decision making will shift over time, as well as to create a concrete plan for how the handoff process will work. It's also important to be explicit about what happens after stage three.

In many companies, the outgoing CEO is asked to take on an executive chairman role. The idea is well intentioned: keep the experience of the former CEO and combine it with the fresh ideas and vigor of the new CEO. In practice, staying around is generally not a good idea. After all, the advice to new CEOs is to reframe what winning looks like, make bold moves early and often, and dynamically reallocate resources, all of which run counter to the inertia created by having the old guard still in a leadership role. Research backs this notion: a new CEO's early dismissal is 2.4 times more likely when the outgoing CEO remains the board chair. The *Wall Street Journal* memorably drove home the point in saying, "Imagine if the former president moved out of the Oval Office but still lived in the White House."[7]

"You really need to get out of the way," suggests Caterpillar's Owens, "and let your successor critique what you did and talk about what needs to go way better." Intuit's Smith concurs: "The last step is to celebrate your successor's success. . . . There's nothing worse than the Ghost of Christmas Past commenting on whether a leader is doing everything the way they should." Smith holds this view despite having successfully played the executive chairman role at Intuit. "Honestly, in hindsight, I should have just stepped away," he says. "That's not because we had any dynamic tension. I simply think it's better to exit, and let the CEO do their thing."

This isn't to say that there aren't some situations that warrant exceptions to this line of thinking, such as when where the board has skipped over a leadership generation to advance a talented but "green" up-and-comer for the role or when the incumbent CEO has been deeply involved in a not-yet-completed acquisition or integration.

Embrace what's next

Stepping down from a powerful job can be very difficult. As former US President Harry Truman said, shortly after leaving office, "Two hours ago I could have said five words and been quoted in every capital of the world. Now I could talk for two hours, and nobody would give a damn."[8] Westpac's Kelly highlights the emotional impact of having to move on. "For a lot of people, it's 'I am what I do, and I do my job,' and that's where their relevance and purpose come from," she observes. "That's really hard to leave." Former Xerox CEO Anne Mulcahy shares an additional challenge she faced: "By the time you are at retirement age," she exclaims, "your kids have left home too. It's double retirement."[9]

We advise CEOs to acknowledge, directly confront, and overcome the basic human fears and needs that arise when stepping down. These include losing the relevance, power, attention, and admiration that come with the job, as well as the prospect of spending time at home with a partner who has established their own rhythms and independent priorities. Add into the mix the term "retirement," which to some implies that the ravages of age and physical decline are accelerating—all of which can be mentally and emotionally difficult to embrace.

While transitions can be traumatic, that stress is more than counterbalanced by the feeling of liberation that stepping down brings. "As CEO, you were a prisoner of the quarterly earnings because you had to deliver," former PepsiCo CEO Indra Nooyi observes. "Now that I am retired, I can put whatever pressure I want on myself, but I'm not a prisoner [anymore]. I can pick and choose what I want to do."[10]

As Nooyi suggests, any sense of loss is typically short lived, as it becomes clear that life can be even more vibrant, interesting, and fulfilling when you are freed of the constraints of the corporate calendar. You can invest more in personal relationships and use your experience to make a difference in many spheres. "A good time to step down," shares former ICICI Bank CEO K. V. Kamath, "is when you see you can do a lot more exciting things outside than you sense you can do within the organization."

The best CEOs don't just confront their emotions, they also plan how to avoid what Ken Chenault, former CEO of American Express, describes as "falling into the abyss." "Don't ignore it. It is very

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[7] Ben Cohen, "Bob Iger is back at Disney to fix his one big failure: Succession," *Wall Street Journal*, December 1, 2022.
[8] H. F. Graff, "When the term's up, it's better to go gracefully," *International Herald Tribune*, January 26, 1988.
[9] Marc A. Feigen and Ron Williams, "The CEO's guide to retirement," *Harvard Business Review*, September 14, 2018.
[10] Shannon Tellis, "No post-retirement blues: Indra Nooyi says she is free from quarterly earnings, learning how to say 'no,'" *Economic Times*, February 3, 2020.

important to be thoughtful [about life after being the CEO]," he recommends. Practically speaking, that means that before leaving the role, you should identify what's important to you. In Chenault's case, even though he didn't know precisely what he'd be doing, he says, "When opportunities came my way, I was ready, because I had thought about them."[11]

Following Chenault's advice to identify what's important to you, Intuit's Smith reflected on what he was going to miss about his role as CEO. "I was going to miss the jersey that made me part of a team, the opportunities to develop the next generation of leaders, and I was going to miss having a scoreboard to measure success by," he reveals. "Then I put my energy not in what I was leaving behind, but in what the next thing could be that would have those characteristics. I was running toward something rather than walking away from something."

Whatever your interests, as a successful former CEO you will be able to find ample opportunities in your new life. For those of a certain age, being CEO of another company may be in the cards. Others may want to simply retire to a quieter life focused on family, friends, and leisure. Between those bookends, however, are numerous options: adviser, investor, board member, entrepreneur, politician, public servant, philanthropist, teacher, and so on. In Smith's case, he became the president of Marshall University in his home state of West Virginia. "Now I wake up every morning wearing a jersey, helping the next generation, and knowing from the scoreboard if we're moving the ball forward," he beams. "I'm 100 percent in."

For most, the path to the next act will start with some experimentation, the seeds for which can be planted before stepping out of the CEO role. "I wanted to start with a portfolio of activities," CCHMC's Fisher explains, "so I started putting some pieces in place—a little bit of business, a little bit of civic and philanthropic work, and some plans with family—so that when I finished, I'd have some ways to contribute, even if it wasn't a full slate."

Fisher's last statement is vital—it's important to keep in mind the first opportunities that come your way may not be the best ones, and it's easy for your life to feel fragmented by too many smaller commitments made for fear of not keeping busy. As PepsiCo's Nooyi admitted shortly after she stepped down from the top job, "I'm overcommitted because I just didn't know how to say no."[12] It typically takes up to a year of experimenting with a targeted portfolio before it becomes clear where you should formalize bigger, longer-term commitments to new opportunities.

If you have a significant other, the exploration of what's important to you and the shaping of your post-CEO portfolio is something best done together. Doing so creates a deeper connection in the near term and helps mitigate frustrations down the road. If they've been waiting patiently for you to retire so you can travel the world together and that's not something on your radar, it's important to have those conversations

[11] "The CEO's guide to retirement," September 2018.
[12] No post-retirement blues," February 3, 2020.

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up front. A third party can sometimes be helpful in facilitating such conversations. Medtronic's George reports, "My wife, Penny, and I met with a counselor six months before I left Medtronic to discuss those issues, and we were able to address the different stages we were at in our careers."[13]

Ultimately, being CEO is just one chapter in the story of your life. As you embark on the next chapter, the adage that "failing to plan is planning to fail" applies. At the same time, it's wise not to hold too tightly to such plans, as though they were a corporate transformation project. Be open to serendipity, knowing that the most exciting opportunities will sometimes come from the most unexpected sources. Also remember that the traits of continuous learning, boldness, authenticity, and service leadership that have underpinned success in the previous chapters of your life will continue to serve you well.

Great CEOs ultimately see themselves as part of an ongoing institutional relay race where each generation of leadership hands to the next generation something better than they were themselves handed. By leaving at the right time, for the right reasons; ensuring a clean handoff to your successor; and knowing where you'll run to next, you'll achieve a gold-medal-worthy finish to your CEO tenure.

[13] "The CEO's guide to retirement," September 2018.

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