The McKinsey Quarterly

# The **elusive** goal of corporate outperformance

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*Few large global companies outperform their competitors on both revenue growth and profitability over a decade. Do those that do have anything else in common?*

**Many executives** focused on growth assume that companies can sustain strong top- and bottom-line performance over long periods of time. McKinsey research, however, confirms that this kind of success is exceedingly rare and suggests that its pursuit can lead executives to set unrealistic expectations. Indeed, a study of large global companies finds that less than 1 percent of them outperformed their competitors on both revenue growth and profitability over a decade.

To identify these top performers, we used McKinsey's proprietary database of more than 20,000 companies around the world, focusing on the 1,077 with revenues exceeding $5 billion in 2004.[1] The study examined their performance on two fundamental indicators of sustained competitive advantage—revenue growth and profitability—over the 11-year period from 1994 to 2004.[2] It differed from similar analyses in that we did not use parametric methods, such as averages, medians, or regressions. These methodologies force analysts to start with the assumption that the performance of companies is normally distributed (in a bell-shaped curve), when it often isn't. Moreover, parametric methods can be misleading because averages obscure the performance of outliers (in this case, high-performing companies) and can prompt researchers to misidentify or overlook superior performance.

Instead, we undertook a nonparametric analysis, essentially allowing the data to determine where the performance of each company would fall.[3] Our analysis tested one metric at a time, comparing each company to every other company in its sector, not to a sector average or an index. We examined rolling five-year windows to avoid weighting the analysis toward any one year. The result was a ranking of companies by performance for each of the 17 industries we studied. We applied a test of statistical significance to the results (80 percent for revenue growth and 90 percent for profitability) to identify our highest performers. Such stringent criteria greatly diminished the chance that a company's superior performance was the result of a random event.

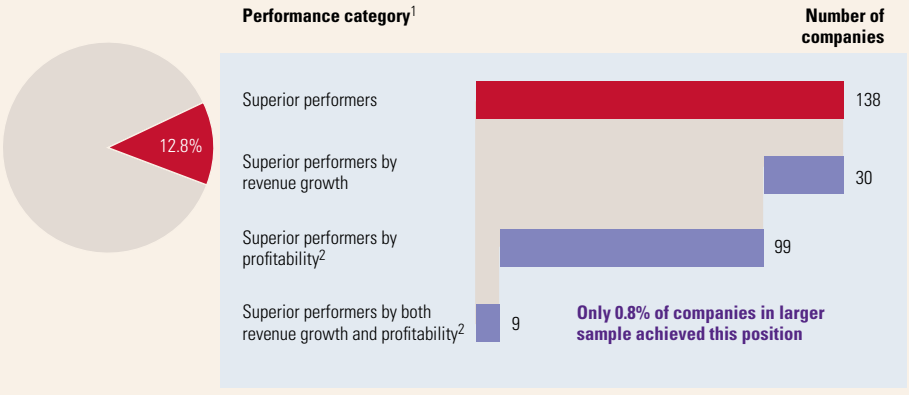
Next, we grouped the highest performers (138 companies) into three categories: companies that placed in the top tier as measured by revenue growth, profitability, or both (Exhibit 1). Only 9 companies met the hurdle for both revenue growth and profitability.

Not that factors largely outside the control of managers didn't help the winners. Indeed, for the 138 companies that achieved superior performance on at least one metric, we found that both their home countries and their industries were statistically significant factors of success.[4]

EXHIBIT 1

## The best of the best

100% = 1,077 companies

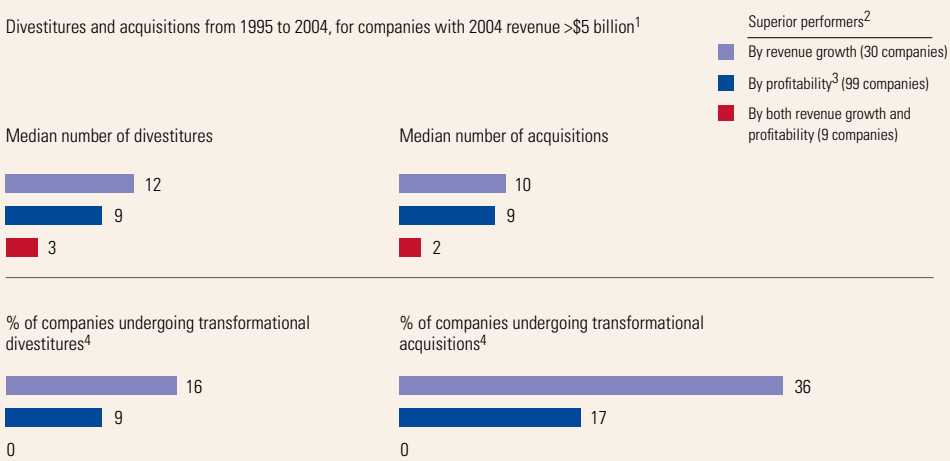



[1]Performance from 1994 to 2004 (rolling 5-year windows) for companies with 2004 revenues >$5 billion; required statistical significance for categorization data: 80% for revenue growth; 90% for profitability.
[2]Profitability was measured by most appropriate profitability metric for each industry (eg, EBIT margin for consumer goods companies, ROCE for retailers, ROE for financial institutions); EBIT = earnings before interest and taxes; ROCE = return on capital employed; ROE = return on equity.

EXHIBIT 2

## Modest dealings

Divestitures and acquisitions from 1995 to 2004, for companies with 2004 revenue >$5 billion[1]

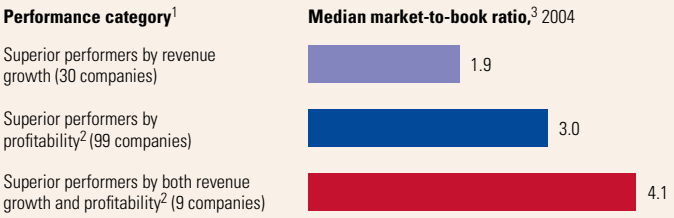



[1]1994 data unavailable.
[2]Performance from 1994 to 2004 (rolling 5-year windows) for companies with 2004 revenues >$5 billion; required statistical significance for categorization data: 80% for revenue growth; 90% for profitability.
[3]Profitability was measured by most appropriate profitability metric for each industry (eg, EBIT margin for consumer goods companies, ROCE for retailers, ROE for financial institutions); EBIT = earnings before interest and taxes; ROCE = return on capital employed; ROE = return on equity.
[4]Transformational deals are those for which deal value equals or exceeds 30% of company's market capitalization in year prior to deal.

Source: Dealogic; Standard & Poor's; McKinsey analysis

EXHIBIT 3

**A higher ratio**




[1]Performance from 1994 to 2004 (rolling 5-year windows) for companies with 2004 revenues >$5 billion; required statistical significance for categorization data: 80% for revenue growth; 90% for profitability.
[2]Profitability was measured by most appropriate profitability metric for each industry (eg, EBIT margin for consumer goods companies, ROCE for retailers, ROE for financial institutions); EBIT = earnings before interest and taxes; ROCE = return on capital employed; ROE = return on equity.
[3]Measure of shareholder performance that compares company's market capitalization with its book value; market-to-book ratio tested statistically significant for profitability but not for growth.

Source: Standard & Poor's; McKinsey analysis

But we also wanted to know if other factors, more easily replicated by executives, could explain the differences. While we identified two interesting correlations among the top 9 companies, our analysis could not determine whether these factors are causes or attributes of performance.[5]

First, the top nine performers strongly preferred organic growth: they made few acquisitions and divestitures when compared with other companies in their industries. Further, none of the deals these companies made were transformational; that is, no divestiture or acquisition had a value exceeding 30 percent of their market capitalization in the year before the deal (Exhibit 2). By contrast, 37 percent of the companies enjoying either strong revenue growth or profitability—but not both—attempted some type of transformational deal.

Second, we found that all nine companies had higher market-to-book ratios than their competitors did. (The M/B ratio is a measure of corporate performance that compares a company's market cap with its book value.) In fact, these top performers logged M/B ratios more than two times higher than those of poor and average performers, as well as 25 percent or more higher than those of companies that excelled at either revenue growth or profitability, but not both (Exhibit 3). These findings indicate that the nine companies rely on intangible assets more than the rest do. In our view, their ability to generate value from knowledge-intensive intangibles (such as copyrights, trade secrets, or strong brands) represents a good starting point for further exploration of their superior performance.

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[1] The database contains a mix of publicly available financial data and proprietary metrics (relating, for example, to globalization and diversification) for companies in some 17 industries, across 32 countries.
[2] At the time of the study, which began in 2006, 2004 data were the latest available. We used the most appropriate profitability metric for each industry—for example, return on equity (ROE) for insurance companies and return on capital employed (ROCE) for retailers.
[3] We used the Iterative Kolmogorov-Smirnov (IK-S) technique developed by Timothy W. Ruefli and Robert R. Wiggins. See Timothy W. Ruefli and Robert R. Wiggins, "Longitudinal performance stratification: An Iterative Kolmogorov-Smirnov approach," *Management Science*, May 2000, Volume 46, Number 5, pp. 685–92.
[4] Sven Smit, Caroline M. Thompson, and S. Patrick Viguerie, "The do-or-die struggle for growth," *The McKinsey Quarterly*, 2005 Number 3, pp. 34–45.
[5] Phil Rosenzweig, "The halo effect, and other managerial delusions," *The McKinsey Quarterly*, 2007 Number 1, pp. 76–85.