Strategy & Corporate Finance Practice

Tying short-term decisions to long-term strategy

A new survey confirms the well-founded principles behind the allocation of resources for long-term value creation.

May 2024

For years, we've pointed to best—and worst—practices in resource allocation.[1] To maximize cash flow over the long term, organizations need to shake free from an incremental approach and shift resources *now* to invest where the growth will be. Studies show that companies that actively reallocate resources outperform those that don't.[2] Yet making bold moves is a lot harder than it sounds. Inertia inevitably takes hold in most organizations. Leaders default to allocating resources in the same old ways, failing to champion growth; teams get lost in the details rather than highlighting the few most important sources of value creation; and even the most brilliant executives fall prey to common decision biases—which become magnified in an organizational setting.

Our latest survey strongly confirms these long-held observations about resource allocation and identifies some practices that can help leaders address them: too many companies do not effectively follow through on their strategies, thereby hindering their chances of outperforming competitors in the long run.

In our new McKinsey Global Survey on resource allocation, we find that only about half of the 617 executives and managers surveyed say their companies effectively align their budgets with their corporate strategies.[3] What's more, just 53 percent say their organizations are in the habit of fully funding the priorities they've identified. Respondents report that their organizations are not taking enough risk with their investments, suggesting that leaders may not be sufficiently planning for the long term. Yet those who indicate that their organizations succeed at linking their budgets to their corporate strategies—and at taking appropriate levels of risk—are much more likely than others to report that their organizations outperform on both revenue growth and return on capital.

In particular, the survey results suggest that better approaches in four areas—governance, processes, analytics, and decision making—can position companies for better long-term performance.

Governance: The importance of influential and involved leadership

In our experience, effective governance can make or break a company's ability to achieve its strategic goals. The impact is most significant when the CEO is supported by a strong financial-planning and -analysis (FP&A) or corporate strategy team.[4]

However, a previous survey of strategy leaders found that only about one-quarter reported having a clear mandate aligned with the rest of the company, and many struggled to enhance their companies' performance.[5] Our latest research reinforces the significance of having an influential FP&A or corporate strategy leader, as well as senior managers who actively participate in carrying out corporate strategies.

Respondents who say that the leader of the team responsible for developing the organization's three- to seven-year financial plan holds influence—meaning they have significant influence on C-suite leaders and throughout the organization—are much more likely than their peers to say their organizations outperform their competitors. Those who say that this leader, who is typically from the FP&A or corporate strategy team, has significant influence on the CEO's and CFO's thinking on strategy and resource allocation are 1.8 times more likely than those who deny such influence to report

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[1] Aaron De Smet and Tim Koller, "Capital allocation starts with governance—and should be led by the CEO," McKinsey, June 22, 2023.
[2] Marc de Jong, Nathan Marston, and Erik Roth, "The eight essentials of innovation," *McKinsey Quarterly*, April 1, 2015; see also Stephen Hall, Dan Lovallo, and Reinier Musters, "How to put your money where your strategy is," *McKinsey Quarterly*, March 1, 2012.
[3] The online survey was in the field from October 3 to October 13, 2023, and garnered responses from 617 participants representing the full range of regions, industries, and functional specialties. The survey included only respondents working in midlevel-manager, senior-manager, and C-level positions at companies with reported revenues of $500 million or more. To adjust for differences in response rates, the data are weighted based on each respondent's nation, taking into consideration its contribution to the region's share of the global GDP. Just over half of the respondents say that their companies often or consistently transform strategic goals into three- to seven-year strategic financial plans. A similar share say their organizations' annual budgets are aligned with their strategic financial plans, and we know from experience that, at many companies, the previous year's budget drives decisions for the following year.
[4] "Capital allocation starts with governance," June 22, 2023.
[5] The 2022 McKinsey survey on the role of the strategy leader surveyed more than 300 strategy leaders. Forty-two percent of respondents said they were not fully successful at improving company performance.

that their organizations outperform on revenue growth, and they are 1.9 times more likely to report that their organizations outperform on return on capital (Exhibit 1). Similarly, respondents who agree that the leader is highly influential throughout the organization are 1.4 times more likely than those who disagree to say their organizations outperform on revenue growth and 1.7 times more likely to say their organizations outperform on return on capital. Overall, 51 percent of respondents report that this leader is highly influential across their organization.

The leadership's level of involvement within an organization also matters. Respondents who say that their corporate senior management often or almost always gives clear strategic direction to business units and product lines are more likely than others to report financial outperformance.

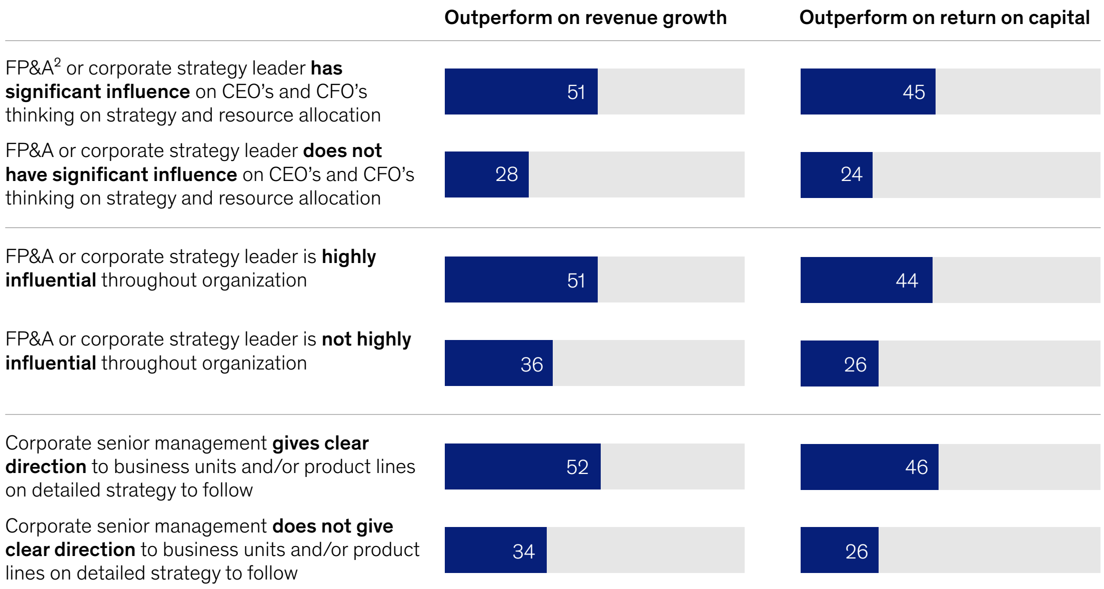
Processes: The nimbler, the better

Companies often move slowly to create plans and reallocate resources, with prolonged timelines for financial planning that can diminish the process's value. Nearly half of respondents say it usually takes their organizations at least four months to develop and approve their three- to seven-year strategic financial plans, and one-third say it takes at least four months to finalize their organizations' annual budgets. The survey results suggest that the shorter the process, the better. Respondents who say their organizations develop and approve their three- to seven-year strategic financial plans in three months or less are more likely than others to say their organizations outperform on revenue growth and return on capital, and the same is true of respondents who say their organizations create and approve their annual budgets in two months or less (Exhibit 2).

Exhibit 1

Respondents reporting influential, involved FP&A or strategy leaders are much more likely than others to say their organizations outperform.

Respondents who agree that their organizations outperform competitors, by each of the following statements,[1] %



[1]Respondents who answered "disagree," "neutral," or "don't know/not applicable" are not shown.
[2]Financial planning and analysis.
Source: McKinsey Global Survey on resource allocation; 617 midlevel managers through C-level executives at organizations with $500 million or more in reported annual revenues; Oct 3–13, 2023

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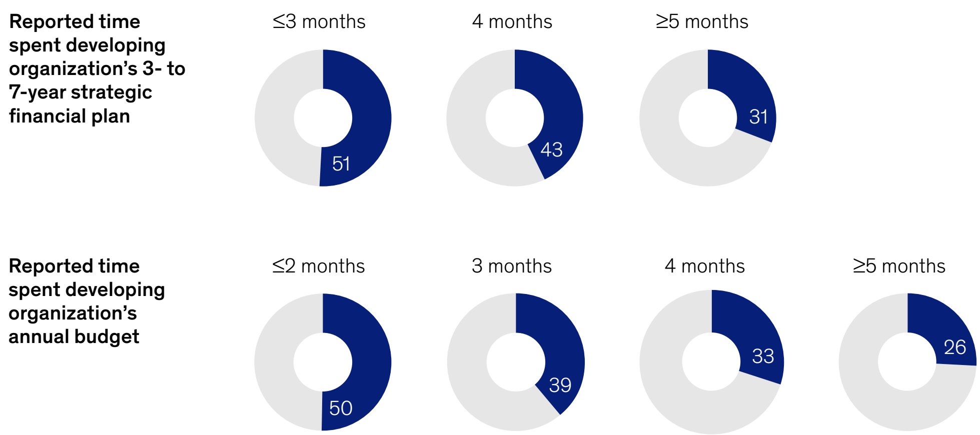
Exhibit 2

Respondents reporting faster development of strategic financial plans and annual budgets are likelier than others to say their organizations outperform.

Respondents who agree that their organizations outperform competitors on return on capital,[1] %



[1]Respondents who answered "disagree," "neutral," or "don't know/not applicable" about their organizations' return-on-capital performance are not shown.
Source: McKinsey Global Survey on resource allocation; 617 midlevel managers through C-level executives at organizations with $500 million or more in reported annual revenues; Oct 3–13, 2023

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What's more, survey responses link nimble reallocation of resources with self-reported financial outperformance.[6] Respondents who report that their organizations reallocate resources across business units within the year are much more likely than respondents who report no in-year reallocation to say their organizations outperform on both revenue growth and return on capital. Additionally, when respondents say that their organizations incentivize executives to free up resources for higher-value-creating opportunities elsewhere in the enterprise, they are 1.8 times more likely than others to report outperformance on revenue growth and 1.7 times more likely to report outperformance on return on capital.

Analytics: Rigorous financial analysis of projects is mandatory

Organizations that use rigorous, standardized analytics to assess initiatives' performance and their potential to create value can ensure consistent evaluation across different parts of the business, which can help them effectively prioritize strategic initiatives. Respondents who say most or all of their organizations' projects are evaluated using financial metrics (such as net present value or internal rate of return) are much more likely than those who say half or fewer projects use those metrics to report that their organizations outperform on revenue growth and return on capital. The survey results also suggest that the acknowledgment of uncertainty in forecasts matters. Respondents who say their organizations' financial forecasts for all projects include a range of outcomes are 1.7 times more likely than those who don't to say their organizations outperform on both revenue growth and return on capital.

The findings also suggest that ranking strategic programs based on financial outcomes can help guide effective resourcing decisions—but

[6] For more about in-year flexibility with allocation and other processes for effectively allocating capital, see "Keep calm and allocate capital: Six process improvements," forthcoming on McKinsey.com.

only if companies do so consistently (Exhibit 3). Just 28 percent of all respondents say that their organizations almost always rank their top ten to 30 most important strategic programs based on financial metrics, but those who report that frequency are much more likely than those who say they do so “sometimes” or even less frequently to report that their organizations outperform on revenue growth and return on capital.

Decision making: Debias to pursue bold investments

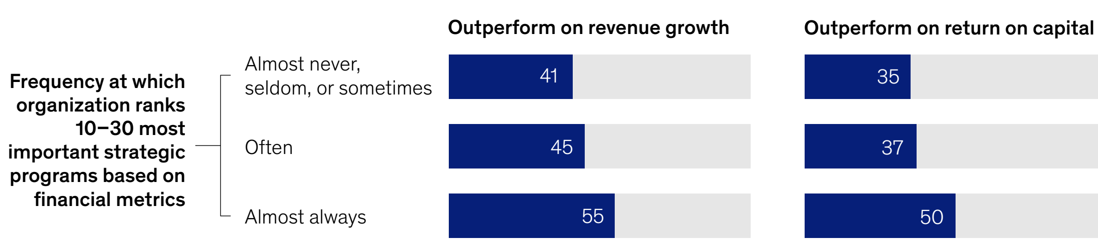
Human nature is remarkable. It makes innovation possible—along with a multitude of invaluable advancements (not least in healthcare, agriculture, and standard of living) that benefit billions of people. But human nature is prone to biases, which can impede innovation itself, particularly in a corporate, organizational setting. One such bias is striving to achieve consensus across a large number of executives, which can stifle debate and hinder strategic-planning decisions. If not addressed, groupthink and loss aversion—the tendency to experience losses more acutely than gains—can easily prevent companies from making bold investments in initiatives that have the potential to create more value than lower-risk investments. Breaking out of this groupthink starts at the top, and several management practices that help companies do so are ones that survey responses commonly link with outperformance.

Our survey results support previous research that suggests the importance of rigorous debate, particularly as a predictor of success in making “big bet” decisions.[7] In the latest survey, respondents who say their organizations’ critical resource allocation decisions are often or almost always preceded by the management team engaging in active debate are 1.3 times more likely than others to say their organizations outperform on revenue growth and 1.4 times more likely to report outperformance on return on capital (Exhibit 4). Furthermore, when respondents say C-suite and division leaders at their organizations often or almost always discuss multiple outcomes, including unfavorable ones, they are 1.7 times more likely than others to say their organizations outperform on revenue growth and 1.8 times more likely to report outperformance on return on capital.

Exhibit 3

Ranking strategic programs based on financial outcomes can help guide effective resourcing decisions—if companies do it consistently.

Respondents who agree that their organizations outperform competitors,[1] by extent to which organization ranks strategic programs, %



[1]Respondents who answered “disagree,” “neutral,” or “don’t know/not applicable” are not shown.
Source: McKinsey Global Survey on resource allocation; 617 midlevel managers through C-level executives at organizations with $500 million or more in reported annual revenues; Oct 3–13, 2023

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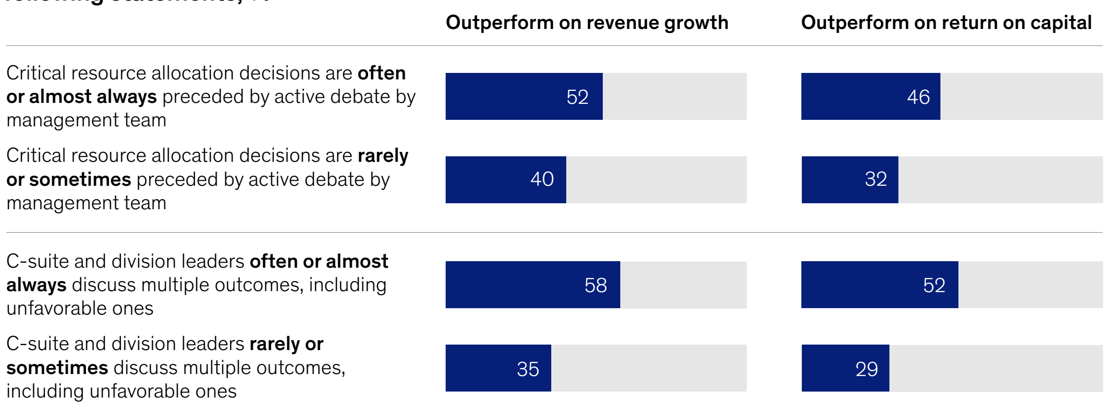
[7] “Decision making in the age of urgency,” McKinsey, April 30, 2019.

Exhibit 4

Respondents reporting rigorous debate and consideration of multiple outcomes as norms are more likely to say their organizations outperform.

Respondents who agree that their organizations outperform competitors,[1] by each of the following statements, %



[1]Respondents who answered "disagree," "neutral," or "don't know/not applicable" are not shown.
Source: McKinsey Global Survey on resource allocation; 617 midlevel managers through C-level executives at organizations with $500 million or more in reported annual revenues; Oct 3–13, 2023

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Employees at any level of an organization sometimes hesitate to speak up in meetings, particularly if they disagree with a senior leader. But there is a body of research that suggests that decision making is more effective when more voices are included. Respondents who say executives at all levels are often or almost always comfortable disagreeing with their leaders are 1.8 times more likely than others to report outperformance on revenue growth and 1.6 times more likely to report outperformance on return on capital. The importance of this comfort seems to extend beyond just executives: respondents who say their organizations' employees are comfortable expressing contrarian points of view to senior colleagues are nearly twice as likely as others to report outperformance on revenue growth and return on capital.

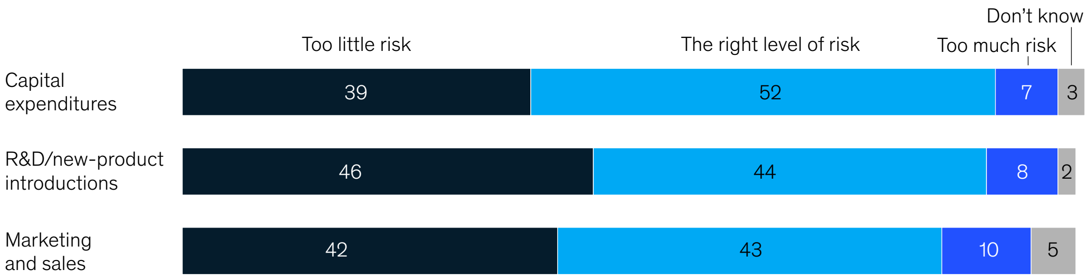
The results also suggest that overcoming loss aversion, a common decision-making bias, serves companies well. To overcome loss aversion, some companies reward noble failures—that is, courageous, responsible, and well-executed initiatives that don't ultimately achieve their goals but can provide valuable lessons. Taking on what respondents deem "the right level of risk" with a company's portfolio and investing for the long term are correlated with self-reported outperformance. Strikingly, though, the share of respondents who say their organizations take too little risk in certain areas is nearly as large or larger than the share saying their organizations pursue the right level of risk (Exhibit 5).

Respondents who indicate that their organizations take on appropriate risk with capital expenditures are 1.6 times more likely than those reporting too little risk to say their organizations outperform on revenue growth and 1.6 times more likely than others to say their organizations outperform on return on capital. What's more, the more often respondents say their organizations invest in low-probability, high-payoff projects within R&D and marketing and sales, the more likely they are to say their organizations outperform on revenue growth and return on capital.

Exhibit 5

Respondents often say that their organizations are taking too little risk with their investments.

Level of reported risk that respondents' organizations take in given category,[1]
% of respondents



[1]Figures may not sum to 100%, because of rounding.
Source: McKinsey Global Survey on resource allocation; 617 midlevel managers through C-level executives at organizations with $500 million or more in reported annual revenues; Oct 3–13, 2023

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While there are also well-established benefits to encouraging individuals to take risks, just 28 percent of respondents say top management at their organizations encourages high-potential, risky projects. Respondents who say that their management does support employees in taking on these efforts are also more likely than others to report outperformance, both on revenue growth and return on capital.

Lessons for today—and the long term

The findings suggest that organizations that take a long-term approach are turning strategy into value more effectively. Organizations that respondents say prioritize long-term value creation over short-term profits are much more likely than their peers to effectively translate strategic goals into a strategic plan and budget. They are also almost two times more likely to outperform competitors on growth and return on capital than organizations that respondents say do not prioritize the long term. We see a similar connection between innovation and effectively executing strategy: for example, respondents who agree that their organizations are more innovative than competitors are twice as likely as those who disagree to say their organizations effectively translate strategic goals into their three- to seven-year strategic financial plans.

Companies can't stand still; innovation and creative destruction are always on the march. The most spectacular growth stories are those made possible by unshakable commitments to bold resource allocations over long time horizons. As technology races forward and the future seems even more unpredictable, today's leaders are reaffirming what's been fundamental for years—and strikingly so, as our survey finds.

The survey content and analysis were developed by **Andy West,** a senior partner in McKinsey's Boston office; **Tim Koller,** a partner in the Denver office; and **Rishabh Bhargava,** a consultant in the New York office.

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