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Transformation with a capital *T*

Companies must be prepared to tear themselves away from routine thinking and behavior.

by Michael Bucy, Stephen Hall, and Doug Yakola

Imagine. You lead a large basic-resources business. For the past decade, the global commodities supercycle has fueled volume growth and higher prices, shaping your company's processes and culture and defining its outlook. Most of the top team cannot remember a time when the business priorities were different. Then one day it dawns on you that the party is over.

Or imagine again. You run a retail bank with a solid strategy, a strong brand, a well-positioned branch network, and a loyal customer base. But a growing and fast-moving ecosystem of fintech players—microloan sites, peer-to-peer lenders, algorithm-based financial advisers—is starting to nibble at your franchise. The board feels anxious about what no longer seems to be a marginal threat. It worries that management has grown complacent.

In industry after industry, scenarios that once appeared improbable are becoming all too real, prompting boards and CEOs of flagging (or perhaps merely drifting) businesses to embrace the T-word: *transformation*.

Transformation is perhaps the most overused term in business. Often, companies apply it loosely—too loosely—to any form of change, however minor or routine. There are organizational transformations (otherwise known as

org redesigns), when businesses redraw organizational roles and accountabilities. Strategic transformations imply a change in the business model. The term transformation is also increasingly used for a digital reinvention: companies fundamentally reworking the way they're wired and, in particular, how they go to market.

What we're focused on here—and what businesses like the previously mentioned bank and basic-resource companies need—is something different: a transformation with a capital *T*, which we define as an intense, organization-wide program to enhance performance (an earnings improvement of 25 percent or more, for example) *and* to boost organizational health. When such transformations succeed, they radically improve the important business drivers, such as topline growth, capital productivity, cost efficiency, operational effectiveness, customer satisfaction, and sales excellence. Because such transformations instill the importance of internal alignment around a common vision and strategy, increase the capacity for renewal, and develop superior execution skills, they enable companies to go on improving their results in sustainable ways year after year. These sorts of transformations may well involve exploiting new digital opportunities or accompany a strategic rethink. But in essence, they are largely about delivering the full potential of what's already there.

The reported failure rate of large-scale change programs has hovered around 70 percent over many years. In 2010, conscious of the special challenges and disappointed expectations of many businesses embarking on transformations, McKinsey set up a group to focus exclusively on this sort of effort. In six years, our Recovery & Transformation Services (RTS) unit has worked with more than 100 companies, covering almost every geography and industry around the world. These cases—both the successes and the efforts that fell short—helped us distill a set of empirical insights about improving the odds of success. Combined with the right strategic choices, a transformation can turn a mediocre (or good) business into a world-class one.

WHY TRANSFORMATIONS FAIL

Transformations as we define them take up a surprisingly large share of a leadership's and an organization's time and attention. They require enormous energy to realize the necessary degree of change. Herein lie the seeds of disappointment. Our most fundamental lesson from the past half-dozen years is that average companies rarely have the combination of skills, mindsets, and ongoing commitment needed to pull off a large-scale transformation.

It's true that across the economy as a whole, "creative destruction" has been a constant, since at least 1942, when Joseph Schumpeter coined the term. But for individual organizations and their leaders, disruption is episodic and sufficiently infrequent that most CEOs and top-management teams are more accomplished at running businesses in stable environments than in changing ones. Odds are that their training and practical experience predominantly take place in times when extensive, deep-rooted, and rapid changes aren't necessary. For many organizations, this relatively placid experience leads to a "steady state" of stable structures, regular budgeting, incremental targets, quarterly reviews, and modest reward systems. All that makes leaders poorly prepared for the much faster-paced, more bruising work of a transformation. Intensive exposure to such efforts has taught us that many executives struggle to change gears and can be reluctant to lead rather than delegate when they face external disruption, successive quarters of flagging performance, or just an opportunity to up a company's game.

Executives embarking on a transformation can resemble career commercial air pilots thrust into the cockpit of a fighter jet. They are still flying a plane, but they have been trained to prioritize safety, stability, and efficiency and therefore lack the tools and pattern-recognition experience to respond appropriately to the demands of combat. Yet because they are still behind the controls, they do not recognize the different threats and requirements the new situation presents. One manufacturing executive whose company learned that lesson the hard way told us, "I just put my head down and worked harder. But while this had got us out of tight spots in the past, extra effort, on its own, was not enough this time."

TILTING THE ODDS TOWARD SUCCESS

The most important starting point of a transformation, and the best predictor of success, is a CEO who recognizes that only a new approach will dramatically improve the company's performance. No matter how powerful the aspirations, conviction, and sheer determination of the CEO, though, our experience suggests that companies must also get five other important dimensions right if they are to overcome organizational inertia, shed deeply ingrained steady-state habits, and create a new long-term upward momentum. They must identify the company's full potential; set a new pace through a transformation office (TO) that is empowered to make decisions; reinforce the executive team with a chief transformation officer (CTO); change employee and managerial mind-sets that are holding the organization back; and embed a new culture of execution throughout the business to sustain the transformation. The last is in some ways the most difficult task of all.

Stretch for the full potential

Targets in most corporations emerge from negotiations. Leaders and line managers go back and forth: the former invariably push for more, while the latter point out all the reasons why the proposed targets are unachievable. Inevitably, the same dynamic applies during transformation efforts, and this leads to compromises and incremental changes rather than radical improvements. When managers at one company in a highly competitive, asset-intense industry were shown strong external evidence that they could add £250 million in revenue above what they themselves had identified, for example, they immediately talked down the proposed targets. For them, targets meant accountability—and, when missed, adverse consequences for their own compensation. Their default reaction was “let’s underpromise and overdeliver.”

To counter this natural tendency, CEOs should demand a clear analysis of the company’s full value-creation potential: specific revenue and cost goals backed up by well-grounded facts. We have found it helpful for the CEO and top team to assume the mind-set, independence, and tool kit of an activist investor or private-equity acquirer. To do so, they must step outside the self-imposed constraints and define what’s truly achievable. The message: it’s time to take a single self-confident leap rather than a series of incremental steps that don’t lead very far. In our experience, targets that are two to three times a company’s initial estimates of its potential are routinely achievable—not the exception.

Change the cadence

Experience has taught us that it’s essential to create a hub to oversee the transformation and to drive a cadence markedly different from the normal day-to-day one. We call this hub the transformation office.

What makes a TO work? One company with a program to boost EBITDA[1] by more than $1 billion set up an unusual but highly effective TO. For a start, it was located in a circular room that had no chairs—only standing room. Around the wall was what came to be known, throughout the business, as “the snake”: a weekly tracker that marked progress toward the goal. By the end of the process, the snake had eaten its own tail as the company materially exceeded its financial target.

Each Tuesday, at the weekly TO meeting, work-stream leaders and their teams reviewed progress on the tasks they had committed themselves (the

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[1] Earnings before interest, taxes, depreciation, and amortization.

previous week) to complete and made measurable commitments for the next week in front of their peers. They used only handwritten whiteboard notes—no PowerPoint presentations—and had just 15 minutes apiece to make their points. Owners of individual initiatives within each work stream reviewed their specific initiatives on a rotating basis, so third- or fourth-level managers met the top leaders, further increasing ownership and accountability. Even the divisional CEO made a point of attending these TO meetings each time he visited the business, an experience that in hindsight convinced him that the TO process was more crucial than anything else to shifting the company's culture.

For senior leaders, distraction is the constant enemy. Most prefer talking about new customers, M&A opportunities, or fresh strategic choices—hence the temptation at the top to delegate responsibility to a steering committee or an old-style program-management office charged with providing periodic updates. When top management's attention is diverted elsewhere, line managers will emulate that behavior when they choose their own priorities.

Given these distractions, many initiatives move too slowly. Parkinson's law states that work expands to fill the time available, and business managers aren't immune: given a month to complete a project requiring a week's worth of effort, they will generally start working on it a week before the deadline. In successful transformations, a week means a week, and the transformation office constantly asks, "how can you move more swiftly?" and "what do you need to make things happen?" This faster clock speed is one of the most defining characteristics of successful transformations.

Collaborating with senior leaders across the entire business, the TO must have the grit, discipline, energy, and focus to drive forward perhaps five to eight major work streams. All of them are further divided into perhaps hundreds (even the low thousands) of separate initiatives, each with a specific owner and a detailed, fully costed bottom-up plan. Above all, the TO must constantly push for decisions so that the organization is conscious of any foot dragging when progress stalls.

Bring on the CTO

Managing a complex enterprise-wide transformation is a full-time executive-level job. It should be filled by someone with the clear authority to push the organization to its full potential, as well as the skills, experience, and even personality of a seasoned fighter pilot, to use our earlier analogy.

The chief transformation officer's job is to question, push, praise, prod, cajole, and otherwise irritate an organization that needs to think and act differently. One CEO introduced a new CTO to his top team by saying, "Bill's job is to make you and me feel uncomfortable. If we aren't feeling uncomfortable, then he's not doing his job." Of course, the CTO shouldn't take the place of the CEO, who (on the contrary) must be front and center, continually reinforcing the idea that this is *my* transformation.

Many leaders of traditional program-management offices are strong on processes but unable or unwilling to push the CEO and top team. The right CTO can sometimes come from within the organization. But one of the biggest mistakes we see companies making in the early stages is to choose the CTO only from an internal slate of candidates. The CTO must be dynamic, respected, unafraid of confrontation, and willing to challenge corporate orthodoxies. These qualities are harder to find among people concerned about protecting their legacy, pursuing their next role, or tiptoeing around long-simmering internal political tensions.

What does a CTO actually do? Consider what happened at one company mounting a billion-dollar productivity program. The new CTO became exasperated as executives focused on individual technical problems rather than the worsening cost and schedule slippage. Although he lacked any background in the program's technical aspects, he called out the facts, warning the members of the operations team that they would lose their jobs—and the whole project would close—unless things got back on track within the next 30 days. The conversation then shifted, resources were reallocated, and the operations team planned and executed a new approach. Within two weeks, the project was indeed back on track. Without the CTO's independent perspective and candor, none of that would have happened.

Remove barriers, create incentives

Many companies perform under their full potential not because of structural disadvantages but rather through a combination of poor leadership, a deficient culture and capabilities, and misaligned incentives. In good or even average times, when businesses can get away with trundling along, these barriers may be manageable. But the transformation will reach full potential only if they are addressed early and explicitly. Common problematic mind-sets we encounter include prioritizing the "tribe" (local unit) over the "nation" (the business as a whole), being too proud to ask for help, and blaming the external world "because it is not under our control."

One public utility we know was paralyzed because its employees were passively "waiting to be told" rather than taking the initiative. Given its history, they had unconsciously decided that there was no advantage in taking action, because if they did and made a mistake, the results would make the front pages of newspapers. A bureaucratic culture had hidden the underlying cause of paralysis. To make progress, the company had to counter this very real and well-founded fear.

McKinsey's influence model, one proven tool for helping to change such mind-sets, emphasizes telling a compelling change story, role modeling by the senior team, building reinforcement mechanisms, and providing employees with the skills to change.[2] While all four of these interventions are important in a transformation, companies must address the change story and reinforcement mechanisms (particularly incentives) at the outset.

An engaging change story. Most companies underestimate the importance of communicating the "why" of a transformation; too often, they assume that a letter from the CEO and a corporate slide pack will secure organizational engagement. But it's not enough to say "we aren't making our budget plan" or "we must be more competitive." Engagement with employees and managers needs to have a context, a vision, and a call to action that will resonate with each person individually. This kind of personalization is what motivates a workforce.

At one agribusiness, for example, someone not known for speaking out stood up at the launch of its transformation program and talked about growing up on a family farm, suffering the consequences of worsening market conditions, and observing his father's struggle as he had to postpone retirement. The son's vision was to transform the company's performance out of a sense of obligation to those who had come before him and a desire to be a strong partner to farmers. The other workers rallied round his story much more than the financially based argument from the CEO.

Incentives. Incentives are especially important in changing behavior. In our experience, traditional incentive plans, with multiple variables and weightings—say, six to ten objectives with average weights of 10 to 15 percent each—are too complicated. In a transformation, the incentive plan should have no more than three objectives, with an outsized payout for outsized

[2] See Tessa Basford and Bill Schaninger, "The four building blocks of change," *McKinsey Quarterly*, April 2016, McKinsey.com.

performance; the period of transformation, after all, is likely to be one of the most difficult and demanding of any professional career. The usual excuses (such as "our incentive program is already set" or "our people don't need special incentives to give their best") should not deter leaders from revisiting this critical reinforcement tool.

Nonmonetary incentives are also vital.[3] One CEO made a point, each week, of writing a short handwritten note to a different employee involved in the transformation effort. This cost nothing but had an almost magical effect on morale. In another company, an employee went far beyond normal expectations to deliver a particularly challenging initiative. The CEO heard about this and gathered a group, including the employee's wife and two children, for a surprise party. Within 24 hours, the story of this celebration had spread throughout the company.

No going back

Transformations typically degrade rather than visibly fail. Leaders and their employees summon up a huge initial effort; corporate results improve, sometimes dramatically; and those involved pat themselves on the back and declare victory. Then, slowly but surely, the company slips back into its old ways. How many times have frontline managers told us things like "we have undergone three transformations in the last eight years, and each time we were back where we started 18 months later"?

The true test of a transformation, therefore, is what happens when the TO is disbanded and life reverts to a more normal rhythm. What's critical is that leaders try to bottle the lessons of the transformation as it moves along and to ingrain, within the organization, a repeatable process to deliver better and better results long after it formally ends. This often means, for example, applying the TO meetings' cadence and robust style to financial reviews, annual budget cycles, even daily performance meetings—the basic routines of the business. It's no good starting this effort near the end of the program. Embedding the processes and working approaches of the transformation into everyday activities should start much earlier to ensure that the momentum of performance continues to accelerate after the transformation is over.

Companies that create this sort of momentum stand out—so much that we've come to view the interlocking processes, skills, and attitudes needed to achieve it as a distinct source of power, one we call an "execution engine."

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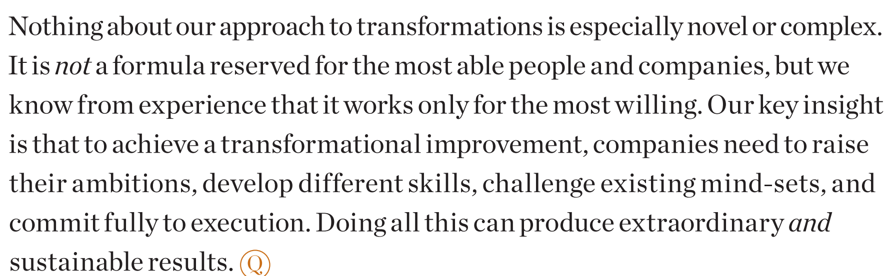
[3] See Susie Cranston and Scott Keller, "Increasing the 'meaning quotient' of work," *McKinsey Quarterly*, January 2013, McKinsey.com.

Organizations with an effective execution engine conspicuously continue to challenge everything, using an independent perspective. They act like investors—all employees treat company money as if it were their own. They ensure that accountability remains in the line, not in a central team or external advisers. Their focus on execution remains relentless even as results improve, and they are always seeking new ways to motivate their employees to keep striving for more. By contrast, companies doomed to fail tend to revert to high-level targets assigned to the line, with a minimal focus on execution or on tapping the energy and ideas of employees. They often lose the talented people responsible for the initial achievements to headhunters or other internal jobs before the processes are ingrained. To avoid this, leaders must take care to retain the enthusiasm, commitment, and focus of these key employees until the execution engine is fully embedded.

Consider the experience of one company that had realized a $4 billion (40 percent) bottom-line improvement over several years. The impetus to "go back to the well" for a new round of improvements, far from being a top-leadership initiative, came out of a series of conversations at performance-review meetings where line leaders had become energized about new opportunities previously considered out of reach. The result was an additional billion dollars of savings over the next year.



Nothing about our approach to transformations is especially novel or complex. It is *not* a formula reserved for the most able people and companies, but we know from experience that it works only for the most willing. Our key insight is that to achieve a transformational improvement, companies need to raise their ambitions, develop different skills, challenge existing mind-sets, and commit fully to execution. Doing all this can produce extraordinary *and* sustainable results.

Michael Bucy is a partner in McKinsey's Charlotte office; **Stephen Hall** is a senior partner in the London office; **Doug Yakola** is a senior partner of McKinsey's Recovery & Transformation Services group and is based in the Boston office.

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