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Organization

A better way to lead large-scale change

By methodically putting equal emphasis on the hard and soft elements of leading change, organizations can more than double their odds of success.

by Scott Keller and Bill Schaninger

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In *Beyond Performance 2.0* (John Wiley & Sons, 2019), McKinsey senior partners Scott Keller and Bill Schaninger draw on their 40-plus years of combined experience, and on the most comprehensive research effort of its kind, to provide a practical and proven "how to" guide for leading successful large-scale change. This article, drawn from the book's opening chapter, provides an overview of this approach and explains why it works. Future articles will deal with specific topics, such as uncovering and shifting limiting mind-sets during change efforts, as well as how to create the energy and ownership needed to succeed.

Neville Isdell took the helm as CEO of Coca-Cola during troubled times. In his words, "These were dark days. Coke was losing market share. Nothing, it seemed—even thousands of layoffs—had been enough to get the company back on track."[1] Its total shareholder returns stood at minus 26 percent, while its great rival, PepsiCo, delivered a handsome 46 percent. Isdell was clear eyed about the challenge ahead; as he put it, "There were so many problems at Coke, a turnaround was risky at best."[2]

Isdell had a clear sense of what the company needed: to capture the full potential of the trademark Coca-Cola brand, develop other core brands in noncarbonated soft drinks, build wellness platforms, and create adjacent businesses. These weren't new ideas, and Isdell's predecessors had failed to make change happen at scale. No matter which direction he set, the company couldn't make progress until it improved its declining morale, deficient capabilities, strained partnerships with bottlers, divisive politics, and flagging performance culture.

Just a hundred days into the new role, Isdell announced that the company would fall short of its meager earnings-growth target: 3 percent. Later that year, Coca-Cola announced that its third-quarter earnings had tanked by 24 percent. However, Isdell plowed onward, launching what he called "Coca-Cola's Manifesto for Growth." The goal was to outline a path that showed not just where the company aimed to go—its strategy—but also what it would do to get there and how people would work together differently along the way.

Working teams tackled performance-related issues, such as the company's new targets and objectives, as well as the capabilities they would require. Other teams addressed organizational effectiveness: how people could work together as a global team; how to improve planning, metrics, rewards, and people development; and how once again to "live our values." The manifesto was created using a collaborative process to ensure that the organization's leaders would feel deep ownership and authorship of the program. As Isdell explained, "The magic of the manifesto is that it was written in detail by the top 150 managers and had input from the top 400. Therefore, it was their program for implementation."[3]

Soon, the benefits of Isdell's approach became apparent. Within three years, shareholder value jumped from negative territory to a 20 percent positive return. Volume growth in units sold increased by almost 10 percent, to 21.4 billion. Coca-Cola had amassed 13 billion-dollar brands—30 percent more than Pepsi. Of the 16 market analysts who followed the company, 13 rated it as outperforming.

Quantifiable improvements in people-related measures matched these impressive performance gains. Staff turnover at US operations fell by almost 25 percent. Employee-engagement scores jumped so high that researchers at the external company that conducted the survey hailed what it called an "unprecedented improvement." Employees' views of the company's leadership improved by 19 percent. Communication and awareness of goals rose to 76 percent, from 17 percent. According to Isdell, however,

[1] David Beasley and Neville Isdell, *Inside Coca-Cola: A CEO's Life Story of Building the World's Most Popular Brand*, New York, NY: St. Martin's Press, 2011.
[2] Ibid.
[3] Adrienne Fox, "Refreshing a beverage company's culture," *HR Magazine*, November 1, 2007, shrm.org.

the biggest change was qualitative. Three years into the role, Isdell noted that "when I first arrived, about 80 percent of the people would cast their eyes to the ground. Now, I would say it's about 10 percent. Employees are engaged."[4] When he retired as CEO, he handed over a healthy, well-performing company.

Isdell explained the turnaround's success by pointing out that he had "taken the 'how' as seriously as the 'what.'"[5] Another way to explain it is that he put equal emphasis on the hard and the soft stuff: performance and health. *Performance* is what an enterprise does to deliver improved financial and operational results for its stakeholders. Companies evaluate their performance through financial and operational metrics such as net operating profit, returns on capital employed, total shareholder returns, net operating costs, and stock turn (and the relevant equivalents in not-for-profit and service industries). By contrast, *health* describes how effectively people work together to pursue a common goal. It is evaluated by an organization's levels of internal alignment, quality of execution, and capacity to renew itself to sustain high performance in an ever-changing external environment. To deliver successful change at scale, leaders should emphasize performance- and health-related efforts equally.

How do we know? In 2010, we wrote *Beyond Performance*,[6] which laid out a methodology we called the "five frames of performance and health," a change-leadership approach that emphasized performance and health equally. The book included the finding (from our 2010 survey of 2,314 global business executives) that only a third of those who had experienced a large-scale change program during the previous five years reported that it had been "mostly" or "completely" successful. This was consistent with findings from previous research that we had conducted and others in the field had reported.[7] By 2015, we felt enough time had passed to test how well the five-frames approach worked. A global survey of 1,713 executives who had taken part in at least one large-scale change program during the previous five years showed that 79 percent of those organizations fully implementing the five-frames methodology reported success.

The value of health

Quotes about the importance of organizational health could fill a whole article, if not a whole book. Yet many leaders think that however well this wisdom works elsewhere, it won't for their companies. Still others argue that they must improve performance first or that the people-oriented aspects of change don't have a proven return on investment. Our research, over many years, has therefore focused on determining—through hard facts—how much value organizational health creates. When we wrote *Beyond Performance*, we had accumulated 600,000 data points across 500 organizations from our Organizational Health Index survey tool since its development in 2002, which meant that we had the data required to answer the question once and for all.

When we tested for correlations between performance and health on a broad range of business metrics, we found a strong positive one in every case. Companies in the top quartile of organizational health were 2.2 times more likely than lower-quartile companies to have above-median EBITDA[8] margins, twice as likely to have above-

4 Ibid.
5 Personal interview.
6 Scott Keller and Colin Price, *Beyond Performance: How Great Organizations Build Ultimate Competitive Advantage*, Hoboken, NY: John Wiley & Sons, 2011.
7 A sample of the reporting on the 30 percent odds includes James Champy and Michael Hammer, *Reengineering the Corporation: A Manifesto for Business Transformation*, New York, NY: Harper Business, 1993: "50 percent to 70 percent of the organizations … do not achieve the dramatic results they intended"; John P. Kotter, *Leading Change*, Boston, MA: Harvard Business Review Press, 1996: "More than 70 percent of needed change either fails to be launched … [or] to be completed"; Martin E. Smith, "Success rates for different types of organizational change," *Performance Improvement*, January 2002, Volume 41, Issue 1, pp. 26–33, onlinelibrary.wiley.com: in a review of 49 studies that encompassed a sample size of more than 40,000 respondents, 33 percent of change programs succeed; a 2006 *McKinsey Quarterly* survey of 1,536 global business executives: "30 percent were 'mostly' or 'completely' successful" in improving and sustaining performance; John P. Kotter, *A Sense of Urgency*, Boston, MA: Harvard Business Press, 2008: "the same appalling 70 percent figure" for change failure; and a 2008 *McKinsey Quarterly* survey of 3,199 global business executives: "Only a third say their organizations succeeded."
8 Earnings before interest, taxes, depreciation, and amortization.

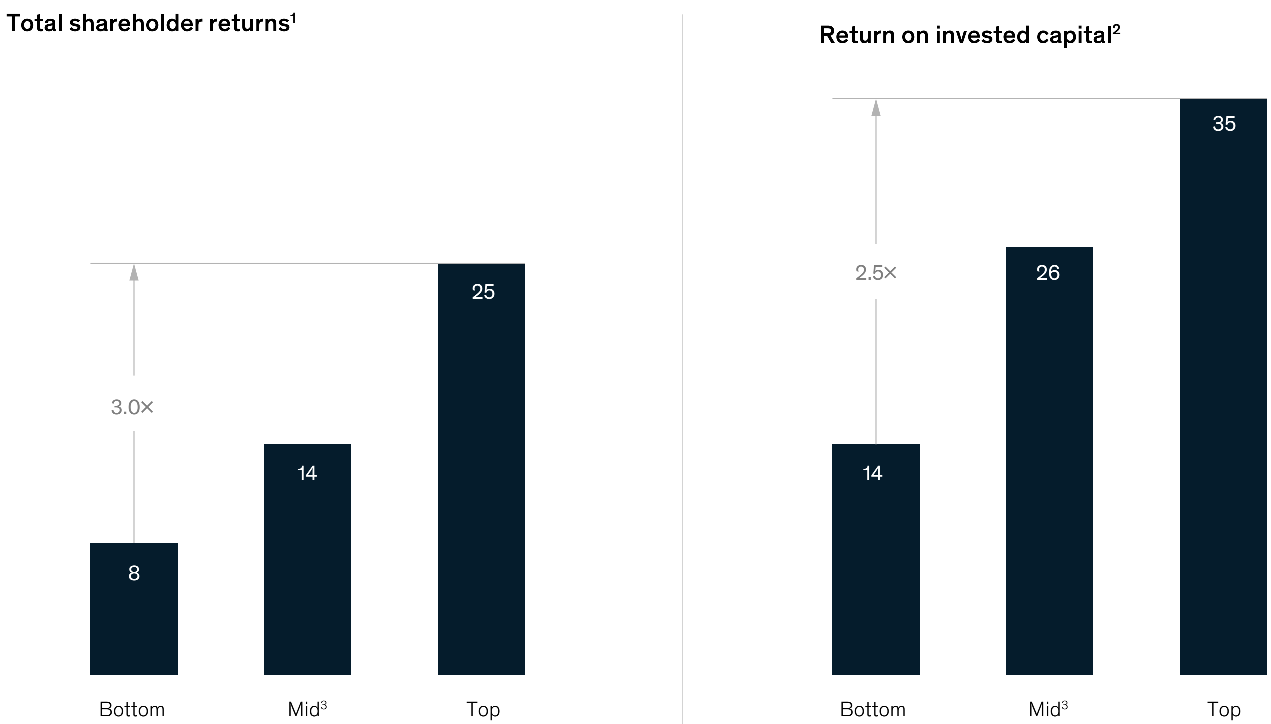
median growth in enterprise value to book value, and 1.5 times more likely to have above-median growth in net income to sales.

Now, almost ten years later, with more than five million data points across 2,000 organizations, the analytics tell the same story. Companies in the top quartile of organizational health had total shareholder returns three times greater than bottom-quartile companies, and their returns on invested capital were two times higher (Exhibit 1). Companies in the bottom quartile for health didn't experience any growth in sales; top-quartile ones averaged 24 percent sales growth.[9]

The correlation between health and performance doesn't necessarily mean that the relationship is causal. Education and income are highly correlated, for example, but it is just as logical to argue that a higher income creates opportunities for a higher education as that a higher education creates opportunities for a higher income. This is why we haven't rested our case on correlations alone. We've also tested the relationship over time. First, we looked at regression coefficients between comparable units within organizations—for example, the performance and health of branches in bank networks, hospitals in healthcare networks, stores in retail networks, and oil refineries in oil companies

Exhibit 1

Top-quartile companies for organizational health have far better shareholder returns and returns on invested capital than bottom-quartile companies.



[1] 8-year average used to exclude volatility from 2007–08 global financial crisis.
[2] Average 3-year financial indicators of companies in respective quartiles.
[3] 2nd and 3rd quartiles.

[9] McKinsey Organizational Health Index Survey, December 2016.

(Exhibit 2). We've found, in every case, that health explains more than 50 percent of the variation in performance across locations.

We've also tested causality by conducting extensive research comparing experimental and control groups over multiyear time frames. One group embarked on change in a traditional, relatively performance-oriented way, the other used our five-frames approach. After running five longitudinal tests in industries as diverse as telecommunications, mining, financial services, and retailing, we found that the experimental groups applying the balanced performance-and-health approach delivered results that, on average, were 1.8 times higher than those of groups using the traditional one (Exhibit 3).

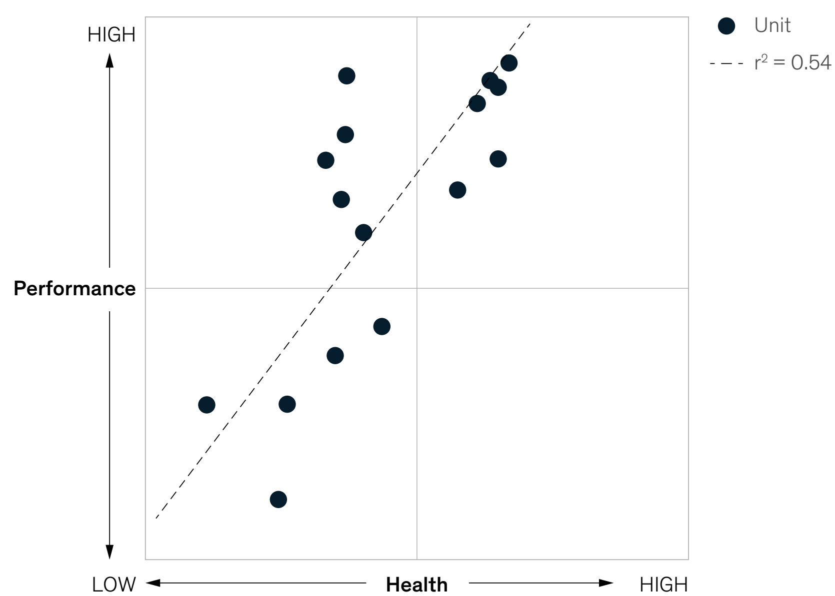
For example, at a large financial-services institution, we studied two experimental groups and a control group, which were comparable and representative of the wider organization across a range of criteria, including net profit before taxes, branch-staff characteristics, and customer economics (average income per customer in retail banking and industry composition in business banking). Over an 18-month period, each experimental group pursued a sales-stimulation program, one using a more traditional, performance-heavy approach, the other emphasizing performance and health equally. During the trial, we took care to minimize distortions (corporate initiatives such as operational restructuring, leadership changes, and significant staff turnover) that might disproportionately affect any one group.

The results of the study were compelling. In business banking, the traditional approach generated 8 percent more value than the control group did, but the performance-and-health approach generated 19 percent more value than the control group. In retail banking, the respective figures were 7 and 12 percent. With findings like these across multiple

Exhibit 2

Organizational health explains more than 50 percent of the performance variations across locations in networks.

Example: Refineries at an oil company,
$ per unit produced



Note: r^2 is the proportion or percentage of variance explained by a regression.

industries, we felt that the case for causation was well and truly closed. This proof that health is a significant causal driver of performance is great news for leaders. Unlike many factors that affect performance—changes in customer behavior, competitors' moves, government actions—your organization's health is something *you* can control.

The perils of performance

Emphasizing performance and health equally isn't simple. When your company requires large-scale change, for example, spending time on health may seem counterintuitive. In fact, companies can and often do make short-term gains without improving their health, but these are unlikely to last.

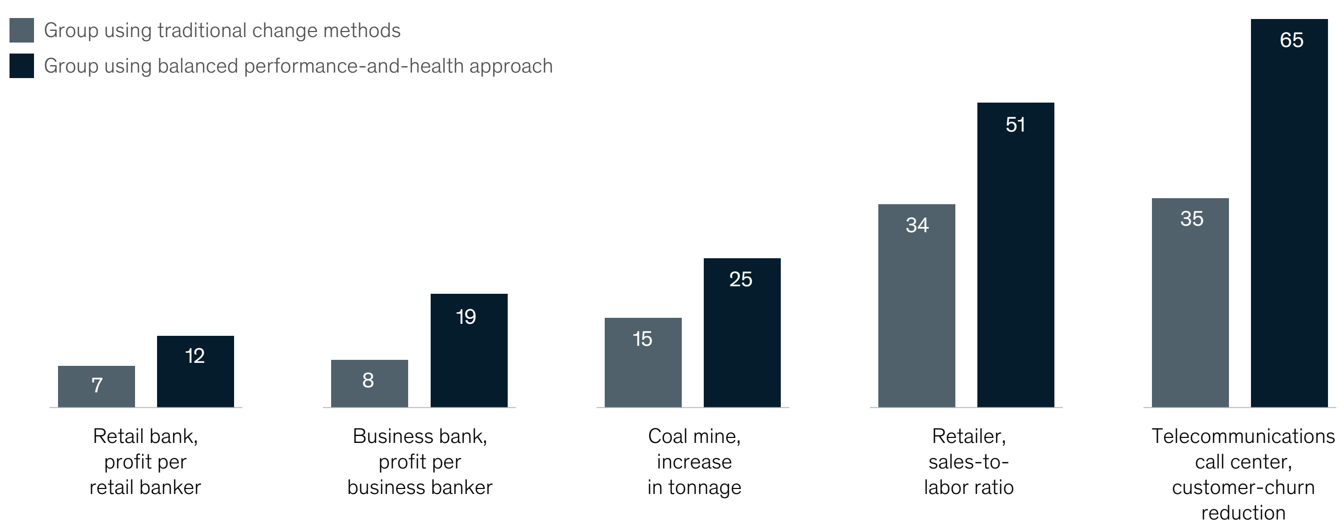
Perhaps the starkest example of the perils of pursuing performance at the expense of health is the story of Albert J. Dunlap—"Chainsaw Al"—famous for taking over struggling companies, ruthlessly downsizing them, and selling them at a profit. When he took over the US appliance-maker Sunbeam, he sold two-thirds of its plants and fired half of its 12,000 employees. Ironically, the stock price of Sunbeam then rose so high that he couldn't sell it quickly. Having compromised its health, Dunlap now needed to sustain its performance for the foreseeable future. But the damage was too great. Two years later, the company faced quarterly losses as high as $60 million, and Dunlap was fired.

By contrast, when Louis Gerstner became CEO of IBM, he decided—in the face of pressure from Wall Street—not to focus exclusively on improving its performance but instead to devote considerable effort and resources to lifting its health as well. Under Gerstner, the company strived to act as "one IBM" across its businesses: it became more externally oriented and less arrogant, trimmed its bureaucracy, and adopted a continuous-learning mind-set. By the time Gerstner retired, nine years later, IBM's stock had increased in value by 800 percent, and the company had regained its leadership in parts of the computer, technology, and IT-consulting sectors.

Exhibit 3

Groups applying the balanced performance-and-health approach had results far higher than those of groups using the traditional one.

Comparison of traditional and experimental change efforts over an 18- to 24-month period,
% improvement



Gerstner was courageous to work on IBM's culture despite the threat that the company would fail. Yet, perversely, the greatest obstacle to emphasizing health in an appropriate way isn't an urgent performance imperative but rather its absence. When organizations are thriving financially, a certain complacency may set in, so that their health declines. That in turn leads, in the least-bad case, to a slow decline in performance and, in the worst, to an existential crisis.

Consider the cautionary tale of Atari. Founded in 1972 to develop electronic games, which were then just a figment of a designer's imagination, the company sold $40 million worth of them and earned profits of $3 million in 1973. Not long afterward, deep-pocketed owners who invested heavily in R&D bought Atari. By 1980, it had posted revenues of $415 million and was hailed as the fastest-growing business in US history.

Yet Atari soon began to crumble from inside: teamwork declined, communication broke down, a risk-avoidance culture set in, investment in R&D fell, and the quality of products was sacrificed to push them into the market more quickly. The result was some of the biggest duds in video-gaming history. Alienated engineers departed, many to found or join rival companies. By 1983, Atari had lost $536 million and resorted to massive layoffs. It never recovered. The shell of the company—little more than a brand name—was sold in 1998 for only $5 million. Atari was so focused on performance that it was unaware of its deteriorating health.

By way of contrast, consider the case of Pixar, the computer-generated-animation studio. Pixar has 15 offerings that rank among the 50 highest-grossing animated films, and it has earned 19 Academy Awards, eight Golden Globes, and 11 Grammys. Its president, Ed Catmull, who had no business experience before cofounding the company, says that its development process is unusual: "Our development team doesn't look for stories. Their job is to create teams of people that work well together."[10]

That isn't the company's only distinctive feature. An average Hollywood studio produces six to 12 films a year. Pixar produces just one—a risky bet, since an animated film costs about $180 million to make. "We have realized that having lower standards for something is bad for your soul," Catmull explained. Taking the right risks and accepting the reality that bold, innovative ideas demand a tolerance for uncertainty are central to the culture. As Catmull says, "Talent is rare. Management's job is not to prevent risk but to build the capability to recover when failures occur."[11]

Pixar focused on health to build a strong organization from the start. Other companies have learned over time the importance of pursuing performance and health in equal measure. In 2009, for instance, General Motors (GM)—once the world's dominant carmaker—filed for bankruptcy and accepted a $50 billion US government bailout. The company then underwent an 18-month turnaround that enabled it to pay back a significant portion of that money and to reenter the stock market in 2010. Many observers suggested that GM was on track, but though performance was on the upswing, underlying health issues remained.

Soon enough, in 2014, the devastating ignition-switch problems of GM cars left at least 124 people dead and 275 injured. An internal investigation attributed this disaster to organizational-health-related factors.[12] Mary Barra, who took over as CEO in 2014, vowed to improve not only the company's performance but also its health by focusing on accountability, teamwork, results, candor, transparency, and customers.[13] Her efforts seem to be paying off, with three profitable years and a strong balance sheet. As GM's experience shows,

[10] Mel Cowan, "Pixar co-founder mulls meaning of success," USC News, December 10, 2009, news.usc.edu.
[11] Ed Catmull, "How Pixar fosters collective creativity," *Harvard Business Review*, September 2008, hbr.com.
[12] Rick Tetzeli, "Mary Barra is remaking GM's culture—and the company itself," *Fast Company*, October 17, 2016, fastcompany.com.
[13] Ibid.

when organizations tend to their health, it really does improve—and so does performance.

The five frames of performance and health

How can change leaders emphasize performance and health equally in practice? There are no simple guiding principles or rules of thumb—if there were, success rates would no doubt be much higher than 30 percent. However, we can offer a structured, careful, and proven methodology that has now been battle tested and further refined for almost ten years: the five frames of performance and health.

This approach divides the overall change journey into smaller, more manageable stages. Each stage has a basic question companies must answer through their work at that point in the journey. It's easy to know when to advance from one stage to the next—if you have the answer, move forward. These five stages are collectively called the "5As":

— *Aspire*. Where do we want to go?

— *Assess*. How ready are we to go there?

— *Architect*. What must we do to get there?

— *Act*. How do we manage the journey?

— *Advance*. How do we continue to improve?

For each of these five stages, we offer explicit, practical guidance for addressing performance and health. It takes the form of five frameworks for performance (one for each stage) and five for health (ditto). These are the frameworks for performance:

— *Strategic objectives (aspire).* Create a compelling long-term change vision, set midterm aspirations along the path, and guard against biases in the process.

— *Skill-set requirements (assess).* Forecast demand for skills and understand their supply dynamics; then decide how to close gaps.

— *Bankable plan (architect).* Define the portfolio of initiatives that will realize your strategic objectives and meet your skill requirements; then sequence your actions and reallocate resources accordingly.

— *Ownership model (act).* Establish strong governance, decide how to scale your change initiatives, monitor their progress, and dynamically adjust them throughout implementation.

— *Learning infrastructure (advance).* Institutionalize processes and expertise so that the organization shares knowledge, constantly improves, and continually learns how to do new things.

Here are the five frameworks for health:

— *Health goals (aspire).* Objectively check your organization's health, choose where to be exceptional, and target areas that need immediate improvement.

— *Mind-set shifts (assess).* Pinpoint helping and hindering behaviors for priority health areas, explore the underlying mind-set drivers, and prioritize a critical few "from–to" mind-set shifts.

— *Influence levers (architect).* Use four levers to reshape the work environment: role modeling, understanding and conviction, reinforcement mechanisms, and confidence-building efforts. Then ensure that performance initiatives are engineered to promote the necessary mind-set and behavioral shifts.

— *Generation of energy (act).* Mobilize influence leaders, make the change personal for employees, and maintain high-impact, two-way communication.

— *Leadership placement (advance).* Prioritize ongoing roles by their potential to create value, match the most important ones to the best talent, and make the talent-match process business as usual.

Exhibit 4

The performance-and-health methodology is a proven approach to leading large-scale change.

	Performance		Health
1. Aspire Where do we want to go?	– Create a compelling long-term vision – Roll back to midterm aspirations – Guard against biases	Strategic objectives / Health goals Masterstroke: Involve a broad coalition	– Check health – Choose where to be exceptional – Target broken practices
2. Assess How ready are we to go there?	– Forecast skill demand – Understand skill-supply dynamics – Determine how to close gaps	Skill-set require-ments / Mind-set shifts Masterstroke: Balance your inquiry	– Identify helping and hindering behaviors – Uncover underlying mind-set drivers – Reframe root-cause mind-sets
3. Architect What must we do to get there?	– Define portfolio of initiatives – Programmatically sequence activity – Reallocate resources	Bankable plan / Influence levers Masterstroke: Appeal to multiple sources of meaning	– Determine how to reshape work environment – Hardwire health into performance – Interactively cascade change story
4. Act How do we manage the journey?	– Establish strong governance – Choose scale-up methods – Monitor progress and dynamically adjust	Ownership and energy Masterstroke: Motivate through social contracts	– Mobilize influence leaders – Make things personal for a critical mass – Maintain high-impact, 2-way communication
5. Advance How do we continue to improve?	– Embed knowledge sharing – Institutionalize improvement processes – Facilitate continuous learning	Learning and leader-ship Masterstroke: Ensure fair process	– Prioritize roles by value – Match talent to priority roles – Operationalize process

The *advance* stage prepares the way for another five-frames cycle, starting once again with *aspire*. This approach helps organizations to drive multiple S-curves of change: an intensive period of activity and radical improvement, followed by a period of consolidation and incremental improvement, eventually followed by another ramp-up in intensity, and so on. If both performance and health improve during each cycle, the organization over time "learns to learn" and changes continually.

To apply this approach, it's important to understand how the elements work together horizontally and vertically. Let's start with the horizontal elements.

In practice, the performance and health elements of each stage are far more integrated than the previous discussion implies. Early on (for example, in the *aspire* stage), the work related to each element of performance and health is relatively self-contained. Later, as the work moves from planning to action, efforts to boost performance increasingly reinforce health, and vice versa. By the *act* stage, employees experience a single, integrated change program—the distinction between performance and health is semantics. Unfortunately, however, some leaders grasp the concepts of performance and health but not the need for integrated activity to promote them. They therefore tell their business heads to "do the performance stuff" and HR to "do the health stuff." That approach is doomed to fail.

Now let's consider the vertical relationship between the elements of performance and health. Although we lay out the 5A change process in a linear way, from *aspire* to *advance*, in practice it must be applied far more dynamically. In the *assess* stage, for example, an organization may discover that its readiness to change is so doubtful that the aspiration it set earlier isn't realistic. If so, the next step is to move backward. That must also happen if new discoveries or unexpected events in the *act* stage invalidate assumptions in the *architect* stage.

Mastering irrationality

The Nobel Prize–winning physicist and Santa Fe Institute cofounder Murray Gell-Mann once asked people to consider "how hard physics would be if particles could think."[14] The "particles" in the physics of change—employees—can not only think but often do so in seemingly irrational ways. As the change journey unfolds, smart leaders must therefore understand the social science of "predictable irrationality."[15] When people are in a hurry to park, for example, how many circle around a parking lot to find the most convenient space when it would be much quicker to take the first one they see? Why take home pencils from the office without guilt if the idea of raiding the petty cash to buy pencils would shock you? As these examples show, we are all susceptible to irrationality in decision making.

The social, cognitive, and emotional biases that promote seemingly irrational decisions are well understood by the field of behavioral economics. That isn't true for change management and organizational leadership, but it should be. In each stage of the 5A process, leaders ought to consider important lessons about human irrationality and how to work with it constructively. We call this part of the effort the change leader's "masterstrokes": building buy-in by involving the people who will execute a solution in its development; paying as much attention to what's going well (and trying to get more of that) as to finding and fixing problems; thoughtfully describing the "why?" of change to tap into five sources of motivation; signaling a long-term, reciprocal relationship with employees rather than a transactional one; and putting equal effort into ensuring a fair process and a fair outcome.

Exhibit 4 shows the specific steps within each of the five frames of performance and health, as well as the relevant masterstrokes.

Many workplaces are characterized by competing agendas and conflict (no alignment on direction), by

[14] George Johnson, *Strange Beauty: Murray Gell-Mann and the Revolution in Twentieth-Century Physics*, New York, NY: Vintage Books, 1999.
[15] Dan Ariely, *Predictably Irrational: The Hidden Forces That Shape Our Decisions*, New York, NY: HarperCollins Publishers, 2008.

politics and bureaucracy (low quality of execution), and by the corrosive idea that work is “just a job” (a low sense of renewal). These aren’t just unhealthy for companies that want to deliver sustainable bottom-line results—they are unhealthy for the human soul. As the Japanese proverb goes, “Vision without action is a daydream. Action without vision is a nightmare.”

Healthy organizations, by contrast, unleash our potential and uplift our spirit. They inspire (aligning on a big, important goal), create a sense of belonging (executing as one team), and foster creativity and innovation (through a sense of renewal). To paraphrase motivational speaker Joel Barker’s riff on the aforementioned Japanese proverb, healthy organizations connect vision with action to change the world.

In this way, putting equal emphasis on the performance and health elements of leading organizational change doesn’t just improve the odds of success; it improves the lives of employees, builds an organization’s resilience, and creates a pro-change mind-set.

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