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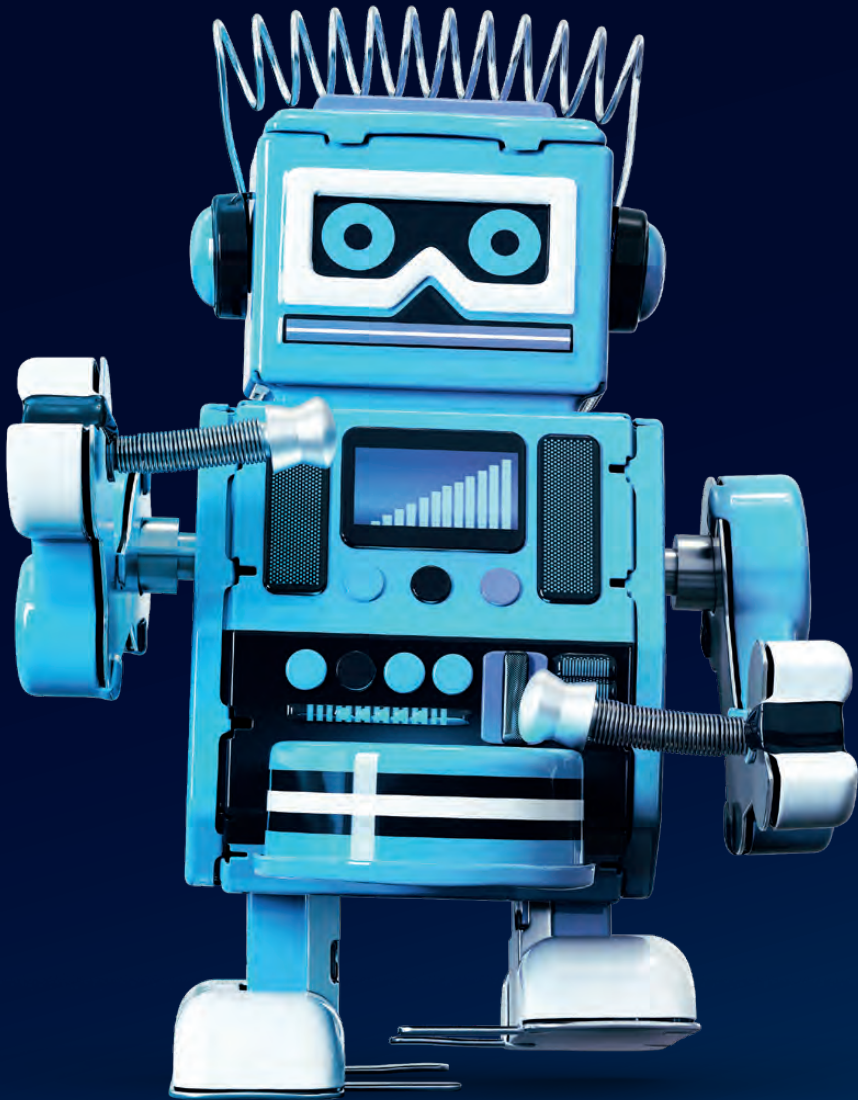

The drumbeat of digital

How winning teams play

Number 3
2019

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This Quarter

In 1819, the SS *Savannah* became the first steam-powered ship to cross the Atlantic Ocean. That voyage did not, however, mark the end, or even the beginning of the end, of the sailing age. The *Savannah* itself was a hybrid vessel, outfitted with sails as well as a steam engine, and the makers of sailing ships sought to fend off the challenge of steam for many years thereafter. Part of the response: adding more sails, culminating with the 1902 launch of the *Thomas W. Lawson*, which was the largest pure-sailing vessel ever built, boasting 25 sails on a larger number of masts—seven—than any sailing ship in modern times. The *Lawson* sank in 1907, smashed to bits in a ferocious storm after the ship had become grounded on underwater rocks. The age of commercial sailing ended along with the massive ship, according to Richard Foster, a director emeritus of McKinsey, and his coauthor, Sarah Kaplan, in their book, *Creative Destruction: Why Companies That Are Built to Last Underperform the Market—and How to Successfully Transform Them* (Currency, 2001).

It's easy for companies whose industries are experiencing digital disruption to lapse into a "more sails" approach that leads them, despite dogged efforts, to get better at doing what they have always done. This issue's cover story, "The drumbeat of digital: How winning teams play," suggests a different path forward. If, like many leaders, you need to make fundamental changes in your business—to embrace steam instead of adding more sails—then research by my colleagues Jacques Bughin, Tanguy Catlin, and Laura LaBerge suggests you will need to speed things up. In a nutshell, the accelerated repetition of management practices associated with learning, engaging with data, sharing results, and reallocating people and capital helps organizations to become more adaptive, to identify digital opportunities more effectively, and to execute digital change efforts successfully.

Many of the other articles in this issue reinforce these themes. New work by Massimo Garbuio, Tim Koller, and Zane Williams pinpoints critical tactics—such as removing budget anchors, rapidly prototyping new ideas, and limiting

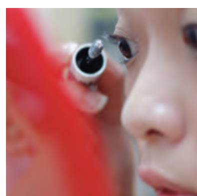
the number of decision makers who review project proposals—that boost the rigor and flexibility of resource reallocation.

M&A looms large in many organizations' efforts to reinvent themselves, and a package on deal making shows how to do it right: on average, companies that pursue a steady stream of small- to medium-size deals outperform peers that pursue less frequent, "big bang" transactions. If you do go after a big deal, you had better have your own house in order first. New research finds a strong correlation between the preclose organizational health of companies making large acquisitions and the postclose financial performance of the newly created entity. In a related interview, MilliporeSigma CEO Udit Batra describes in detail the integration approach he and his team at EMD Millipore took when they acquired Sigma-Aldrich.

The mind-sets of leaders, their top teams, and employees up and down the line can be powerful enablers of transformative business moves—or immovable barriers to them. In an article adapted from the new book *Beyond Performance 2.0: A Proven Approach to Leading Large-Scale Change*, Scott Keller and Bill Schaninger lay out an approach for identifying the root causes of behaviors that inhibit change, reframing them to expand the degrees of operating freedom that organization members perceive, and personalizing the case for change so that it becomes emotional, not just intellectual. For an inside view of dramatic organizational change, look no further than "All in: From recovery to agility at Spark New Zealand," in which key members of the telco's top team describe how they adopted new ways of working as they sought to shift their business focus and become a true digital-services provider. It's the antithesis of a "more sails" story, and I hope, like this *Quarterly* issue as a whole, it provides useful inspiration as you seek to boost the speed and power of your organization's drumbeat.

Kevin Sneader
Global managing partner,
Hong Kong office
McKinsey & Company

For Starters



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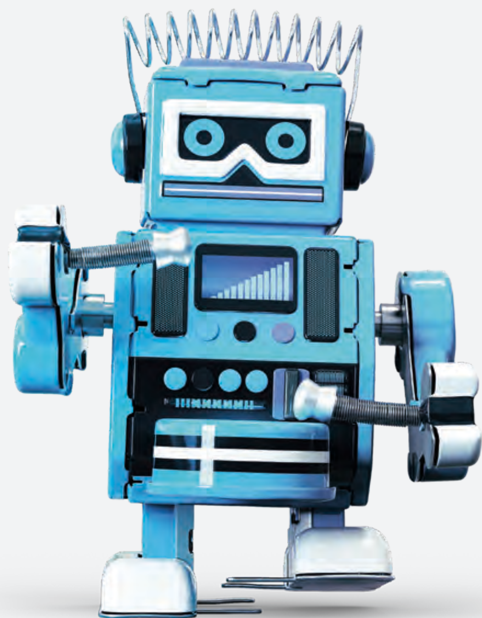
Customer experience is becoming more important everywhere. Tapping a range of recent McKinsey research, as well as insights from government leaders, we look at how governments are faring in a challenging environment.



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The need to shift mind-sets is the biggest block to successful transformations. The key lies in making the shift both individual and institutional—at the same time. Adapted from the authors' new book, *Beyond Performance 2.0: A Proven Approach to Leading Large-Scale Change*.

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Two longtime experts in mergers and acquisitions describe what works—and what doesn't—in corporate deal making, including how to approach the role of activist investors.

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Key members of the telco's top team describe the challenges and rewards of going agile rapidly—and the power of a "no plan B" approach to change.

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Best practices are well understood. But are companies following them as closely as their leaders claim?

Tera Allas, Louis Chambers, and Tom Welchman

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Jacques Bughin and Eric Hazan

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The Chinese luxury consumer

If you're in luxury goods and services, China is the story.

A 3-part guide to the new luxury landscape

Chinese consumers are now the engine of worldwide growth in luxury spending. The fast-expanding bulge of affluent citizens combined with a small but very wealthy coterie means there's much more income to spend on luxury goods and services—from fashion, jewelry, and prestige cosmetics to artwork and high-end travel.

1 China leads the world in luxury

It's a burgeoning market and maybe the deepest pool of spending on high-end products the world has ever witnessed. Understanding the new dynamics is important for luxury brands, of course, but all companies will benefit from insights into the purchasing power and aspirations of these new, mostly younger consumers.

The explosion

China's luxury spending will nearly double between now and 2025. Propelling this growth (nearly three-quarters of all new spending globally) is an explosion in upper-middle-class households, which continue to purchase in luxury categories even as growth in China's economy has eased. The majority of these consumers—about 70 percent, in fact—will be doing their luxury spending overseas, a result of an increasing affinity for outbound travel. Over time, that ratio may shift in favor of domestic spending as a result of moves to cut luxury import taxes.

Chinese consumers' spending on luxury goods will continue to grow.

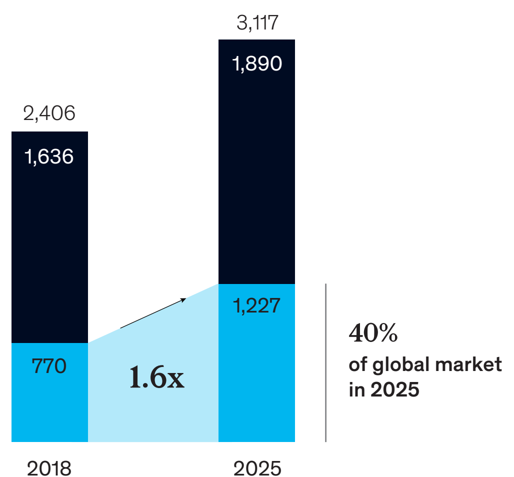


Photo courtesy of Shiseido

Beauty is booming

"Our sales in China are really growing, up more than 30 percent this year, and China is our number-two market now, bigger even than the US. Also, Chinese consumers are traveling. More than 130 million people went out of China [in 2017], and ten million of them came to Japan. Chinese consumers love to buy cosmetics and visit travel retail businesses, as well as duty-free shops at airports; they do a lot of shopping."

—Masahiko Uotani, CEO of Shiseido

For the full interview with Masahiko Uotani, see "How a cosmetics giant reaches Chinese consumers: An interview with Shiseido CEO Masahiko Uotani," on McKinsey.com.

2 Generational differences

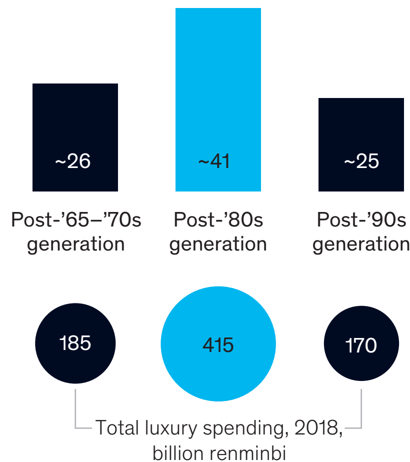
On this bustling terrain, companies will find youthful spenders with a keen desire to be different, the newly affluent with deep pockets, and the truly wealthy.

A luxury vanguard

China's affluent post-1980s generation is fueling luxury buying right now. They grew up as China emerged as an economic power and are now at the peak of their career and earnings, travel frequently, and spend to demonstrate their individualism and success. The post-1990s millennials are the emerging powerhouse. The vanguard of China's urban middle-class spenders, they're a dynamic and digitally engrossed cohort.

China's post-1980s generation currently leads in luxury spending.

Average annual per capita spending, thousand renminbi



Affluent travelers

"Ctrip serves the most affluent segment in China. The most expensive tour we've sold costs about $200,000 per person per trip, and it only took us about 17 seconds to sell these packages. That gives you an idea of how exclusive consumers can go when it comes to choosing their package. We see an uptick in demand for tailor-made tours."

—Jane Sun, CEO of Ctrip

For the full interview with Jane Sun, see "How China's largest online travel agency connects the world: An interview with Ctrip CEO Jane Sun," on McKinsey.com.

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Newcomers and status seekers

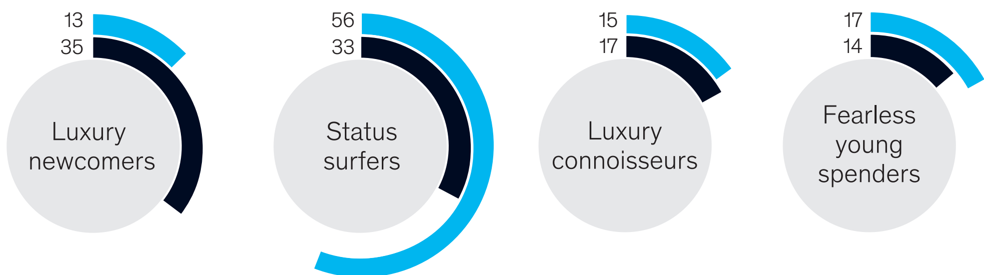
Across China's post-1980s and post-1990s generations, there are four distinct clusters of buyers. Luxury newcomers care most about brands, while status surfers are the least brand loyal. Together they account for 70 percent of the young luxury market. Luxury connoisseurs, with more sophistication and higher aspirations, often are business owners with higher incomes or substantial family money. Fearless young spenders shop for what's trendy rather than branded products.

Across two generations, four distinct clusters of consumers emerge.

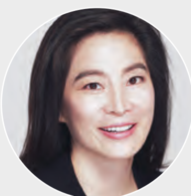
Post-'80s and post-'90s luxury shoppers in China

% of luxury spending

% of luxury-buying population



The connoisseur



"It's interesting: even with [an internet-entrepreneur] background, people still come into Christie's looking to buy a vase, perhaps from the Qing Dynasty. They could be buying a Chinese painting by Zhang Daqian or a painting by a contemporary artist like Zao Wou-Ki. But I would say the majority, if they're trying an auction house for the first time, tend to look for art from their own country, with which they can associate emotionally, feel they understand, and can enjoy day to day."

—Rebecca Wei, chairman of Christie's Asia

For the full interview with Rebecca Wei, see "Navigating Asia's booming art market: An interview with Rebecca Wei, chairman of Christie's Asia," on McKinsey.com.

© South China Morning Post/Getty Images

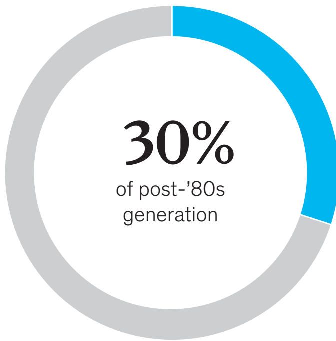
3 Action plan

Knowing how China's luxury consumers think and how they connect with products is useful for any business competing in China. We offer some priorities for action.

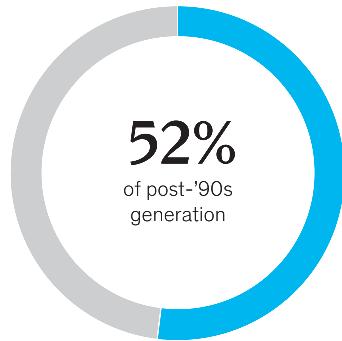
Invest beyond the brand

First off, companies need to think outside the brand box. Brands matter in informing tastes across generations. Young consumers, while still brand conscious, aren't loyal to brands in the same way that older cohorts were. They're more willing to venture beyond them for new luxury experiences and tend to churn through them more quickly than older, more loyal consumers do.

Younger Chinese consumers are less loyal.



Share of respondents who occasionally buy luxury goods outside of preferred brands



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Social influencers create greater luxury discernment among younger buyers. They are more likely to appreciate product nuances, and they're drawn to brand–product combinations, such as bags from one designer and dresses from another. Luxury companies need the right mix of incentives to get young consumers to try a new brand. And there's a premium on renewed and refreshed product lines and marketing that creates an aura of novelty.

Younger Chinese luxury consumers are learning to appreciate more nuanced elements, not just brand itself.

Share of respondents who consider **fabric, design, or production** among their top reasons to purchase

25%

Post-'80s and post-'90s generations

vs

5%

Post-'65–'70s generations

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Target the influencers

Second, luxury companies should earn the digital attention they need by influencing the influencers. After all, media is everything and social media is everywhere. Digitally savvy younger consumers are better able to navigate across channels to get a better deal and use digital media for intensive research before buying. They are heavily influenced by opinion leaders, often global or Chinese celebrities, who talk about and display their purchases on social media. They want personalized digital experiences—from their interactions online to apps that use games to heighten engagement.

How do luxury buyers in China get information about new luxury brands?

100%

consult both online and offline sources occasionally

Each consumer regularly consults

~16

information sources on luxury products

~3–5

hours spent on luxury and fashion information each week

Close the sale

Finally, as much as digital matters, companies should look to close the sale in brick-and-mortar stores. Despite their affinity for digital, nine out of ten young Chinese consumers favor in-person experiences with sales staff in brand stores when it comes to making a purchase decision. Brands need to reimagine in-store experiences; catering to young consumers' desire to feel different and valued is important. They should think of the store as its own media channel. That means better execution across a range of brand stores, premium malls, duty-free shops, and other outlets.

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Luxury consumers in China look to salespeople for suggestions.

Offline brand channels with greatest impact on purchasing decisions, top 3 choices, % of respondents

For more, see "How young Chinese consumers are reshaping global luxury," on McKinsey.com.

Aimee Kim is a senior partner in McKinsey's Seoul office, **Lan Luan** is an alumna of the Shanghai office, and **Daniel Zipser** is a senior partner in the Shenzhen office.

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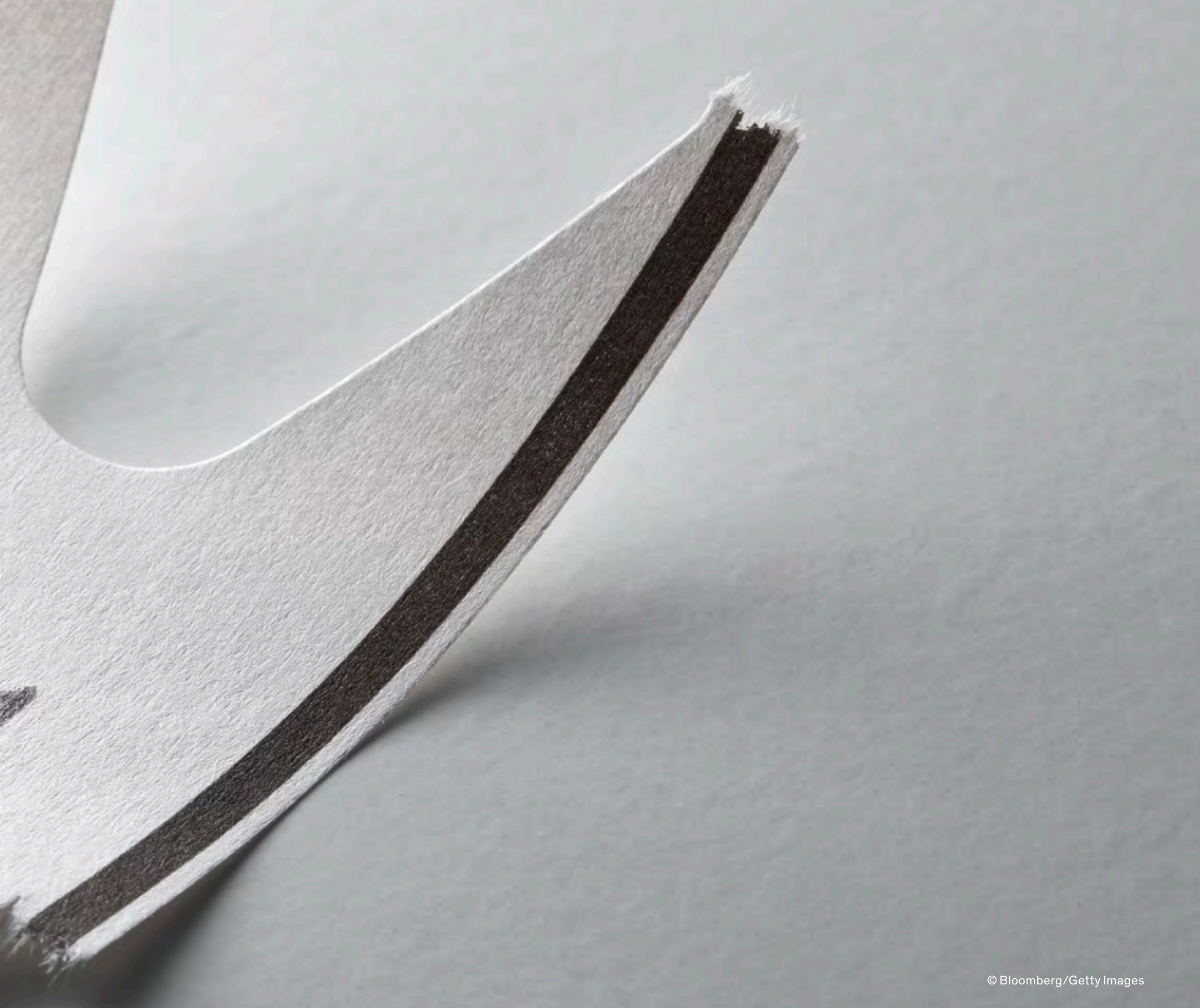
The public sector gets serious about customer experience

8 things you should know about customer experience in the public sector


© Bloomberg/Getty Images

Customer experience (CX) is getting more important everywhere—including in government. Citizens are accustomed to the experiences offered by companies from Amazon to Zillow and now want the same from governments. In this survey, we look at how the public sector is faring in a challenging environment. There are plenty of lessons here for private-sector leaders, too.

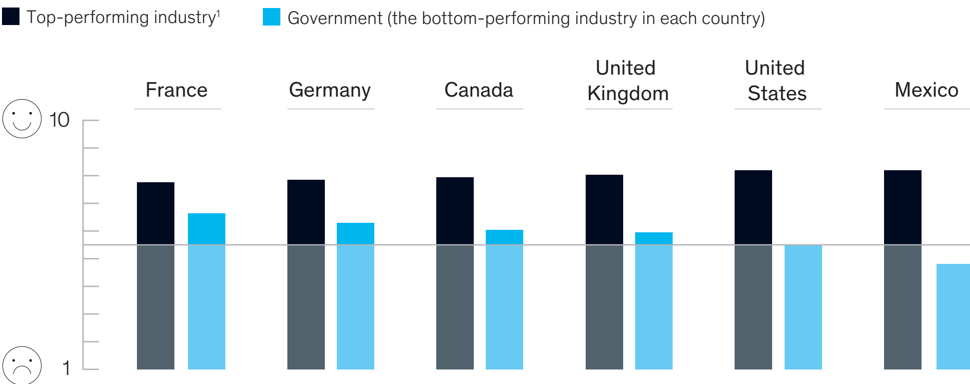
1 A poor report card

It turns out that government customers aren't so easy to please. While many governments are moving forward with CX initiatives, across the globe, we find that in general private-sector organizations are a lot better than those in the public sector at providing services.

The grades

Most governments underperform in customer satisfaction.

Customer-satisfaction score on a scale from 1 (very dissatisfied) to 10 (very satisfied)



[1] Top-performing industry in Canada, Mexico, and the United Kingdom = supermarkets; in France and Germany = e-commerce sites; and in the United States = credit-card providers.

Source: 2018 Public Sector Journey Benchmark Survey

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2 The hurdles are often higher

Government agencies need to build a holistic view of the customer experience so they can put themselves in their clients' shoes, understand their journeys as they access services, and figure out what really delights or displeases their customers. The challenges can be daunting.

Stumbling blocks

1. A monopolistic mind-set is a pervasive obstacle. When customers don't have a choice, it dramatically removes a major incentive for governments to innovate and improve service. It also hampers agencies' ability to set priorities.

2. Unlike private-sector organizations, government agencies must aim to serve everyone within their mandated mission; they can't just ignore certain customer segments. This bar for fairness often solidifies over time into a principle of providing one-size-fits-all service.

3. Governments often lack the capabilities needed to assess and address gaps in customer experiences. Those with deep analytics skills, as well as human-centered design skills, are often in short supply.

4. The data that agencies rely upon are typically incomplete or sequestered in silos. Thus, agencies often lack a full, timely picture of the customer's overall experience.

For the full article, see "Understanding the customer experience with government," on McKinsey.com.

© Alex Wong/Getty Images

'Our customers don't have a choice'

"The way I see it, our customers don't have a choice when it comes to obtaining our services. They can't go to a competitor if we are not performing well, so we have an even greater responsibility than does the private sector to provide a great experience for our customers. We also need to ensure that all agencies provide a consistently excellent experience, because the citizens do not separate, for example, the SSA [Social Security Administration], the US Postal Service, and the Department of Homeland Security in their minds. To them, we are all the same, so if one of us performs poorly for them, it affects their perception and confidence in the whole system.

"I accept calls from our constituents at home, and people think I'm crazy for it, but I want to show our entire organization how important it is to resolve the needs of the customer. [. . .] If I don't send the message that this is important, then I would be naive to expect the staff to follow suit."

—**Carolyn Colvin,** former acting commissioner of the US Social Security Administration

For the full interview with Carolyn Colvin, see "Building a long-term customer-experience vision at the Social Security Administration," on McKinsey.com.

3 Good experiences can boost outcomes

Good outcomes matter to all government leaders, who are typically measured on achieving a mission, staying within budget, mitigating risk, improving employee morale, and earning and keeping customers' trust. Increasingly, agencies are adding customer experience to this list. But they often view customer experience as a trade-off, and when the budget season rolls around, customer-experience initiatives starve. Agencies instead invest in outcomes where they see a clear link to value, such as cost reduction. We see this pattern across countries. Yet good customer experience reinforces the other outcomes, and it is often the key to accelerating and enhancing critical agency outcomes across the board. The lesson: governments need to put the customer at the core of every improvement initiative.

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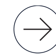
When mission matters

In 2014, a recognized crisis in patient access affected trust in the US Department of Veterans Affairs. Among the initiatives adopted by the agency's new leadership, one sought to rekindle employees' sense of mission. Efforts to improve patient outcomes and to revitalize employees' passion for their work have produced noteworthy results. Veterans' trust in the agency rose to 70 percent in October 2018, from 47 percent in December 2015.



For the full article, see "Two views on how customer experience can better serve US military veterans," on McKinsey.com.

The multiplier

Mission
A German health insurer mobilized >6,500 employees to focus on customer experience, yielding a
70%
reduction in call-center wait time

Employee engagement
Two years into a transformation, one US agency had experienced a
50%
increase in organizational health

Budget
Dissatisfied customers are
≥2×
more likely to contact agency hotlines three or more times for help, straining resources and budgets

Trust
Public customers are
9×
more likely to trust a government agency if they are satisfied with its service

Risk
Dissatisfied customers are
2×
more likely to admit to publicly expressing their unhappiness through social media or calls to their public representatives

4 Every government service can delight (even tax authorities)

It's a common belief that some services simply create better experiences—that a benefit program will always provide more positive experiences than a tax program, for example. Except for a small number of services—including national parks, which are at the top of our survey across countries for customer service—this maxim isn't true. In fact, any service can meet or exceed expectations and create a great experience for its customers.

"With their digital IDs, Estonians can use their smartphones to get just about anything done online—from their children's grades to their health records. I should have called the Estonians when we were setting up our healthcare website."

—**Barack Obama,** former president of the United States

Estonia gets it

Estonia is often touted for having created a superior customer experience when it revolutionized its system for filing taxes. The government created e-Tax, an electronic portal allowing Estonians to pay taxes with a single click—taking just three to five minutes. This service, which has made filing taxes seamless and intuitive, led about 98 percent of those filing taxes to use the digital option.

For more on this transformation, see the New Yorker *article "Estonia, the digital republic," on newyorker.com.*

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5 Customer journeys that really make a difference

Customer experiences are shaped by their journeys—a series of actions and interactions with government service that have a discrete beginning and end. Though every service is different, journey types are consistent. They can have many touch points and cross digital and physical channels. The underlying processes, people, and systems that support agency journeys are key. As a result, customer journeys are the most powerful lever agencies have to reshape experiences.

© Tim Boyle/Getty Images

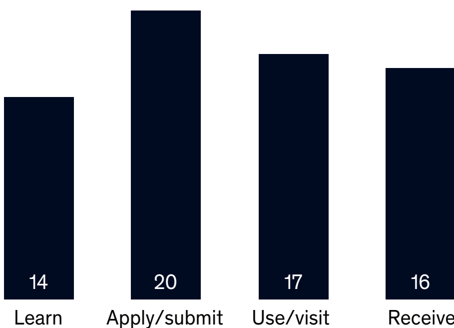
The ranking

We'll start by noting that not all journeys are viewed equally. Of the ten most common government journeys, our research finds that four account for 67 percent of overall customer experience.

- **learn:** research about and understanding of the service options before usage
- **apply and submit:** the end-to-end steps involved in an application process
- **use and visit:** what happens the moment someone actually uses a service (for example, an online postal service or a post office)
- **receive:** anything the citizen might get from the public sector—how a Social Security benefit is deposited, for example

Certain journeys matter more to customers.

Top 4 of the 10 most common government-service journeys globally, derived importance,[1] %



[1]The derived importance shown here is a simple average across countries and does not total to 100%.

Source: 2018 Public Sector Journey Benchmark Survey

One-stop shopping in Australia

What it is:
"A start-up in government, brought together by the then premier, to bring to life a one-stop shop for government services. The idea had actually been tried twice before and failed."

What changed:
"We wanted to create that feeling of unhappiness with the status quo so that everyone felt energized to want to change. And then we wanted to put the power to change it into the hands of everyone who was working at Service New South Wales."

—**Rachna Gandhi,** former CEO of Service New South Wales

What got better:
There was a radical turnaround in customer-satisfaction rates—from a baseline of under 60 percent to a sustained average of over 97 percent in the five years since its 2013 launch.

For the full interview with Rachna Gandhi, see "Building a one-stop shop for government services in Australia," on McKinsey.com.

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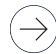
In Dubai, just ask Rashid

© visualspace/Getty Images

DubaiNow offers information and access to more than 50 government services from 24 entities. Government customers can manage utilities bills and traffic fines, track visa status, renew trade licensing, and register a car. Smart Dubai debuted Rashid, an adviser powered by artificial intelligence that offers answers to customers' questions about necessary procedures, documents, and requirements to conduct various transactions across government entities. Information is updated by agencies seamlessly and autonomously.



For more, visit the DubaiNow website at dubainow.dubai.ae/en.

Negative defining moments

A growing body of behavioral-psychology research shows that bad events have more power than good ones to shape experiences, and our research across 27 US government agencies aligns with those findings. Negative defining moments on average affect overall government customer-satisfaction scores four times more than positive defining moments. One bad incident—a rude customs agent, an unexpected notification for renewing a green card, an especially long airport-security line—can deeply color a customer's overall impression of an agency. Identifying these negative defining moments can lead to targeted interventions that have a big impact on outcomes. Agencies that succeed in making bad incidents as rare as possible have more satisfied customers than those that don't.

For the full article, see "Understanding the customer experience with government," on McKinsey.com.

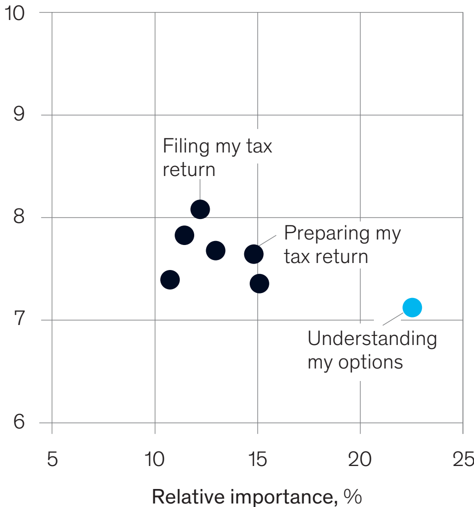
6 A winning journey design starts with the data

Measuring satisfaction during journeys is the biggest gap most government agencies face in understanding what matters to their customers. Across industries, journey satisfaction is a far better predictor of overall customer satisfaction and outcomes than satisfaction around a single touch point. Agencies are pushing hard to get better information to help them design better journeys.

For one government agency, the most important customer journey generated the most dissatisfaction.

Example: US Internal Revenue Service subjourney

Customer satisfaction
(from 1 to 10, where 10 is highest)



Source: 2018 Public Sector Journey Benchmark Survey

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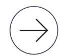
Data dive

The US Internal Revenue Service identified a handful of separate customer journeys. One, however, was particularly important to customer satisfaction: accessing details on preparing and filing returns and a better understanding of process options. Delving more deeply into that journey's data, the agency found that understanding options ranked most important and generated the most dissatisfaction.



For the full article, see "Understanding the customer experience with government," on McKinsey.com.

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A data strategy

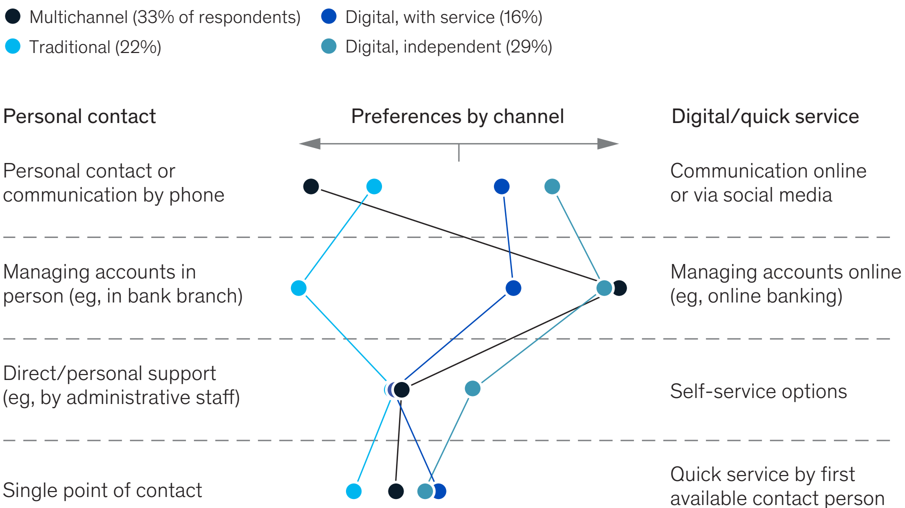
"We are learning that we don't currently have a great process to capture valuable insight from customers, so we are trying to start up a function to conduct interviews, have focus groups with customers, and even follow up on things like Yelp reviews for passport agencies to help with that prioritization process.

Reality check

Digital delivery of government services beckons, yet there are plenty of “analog” customers with unique preferences. Millennials may skew heavily toward digital-only interactions, older citizens may prefer traditional delivery with a human contact, and many customers are in the middle, preferring multichannel options or a mix of digital and personal services. All segments value reliability. Tech-savvy segments value transparency more, and less tech-savvy segments prefer simplicity. No one seems to enjoy visiting a government location or calling a government help line. Here’s a deeper dive into the interactions that German customers preferred.

When using government services, people display a range of preferences between personal contact and digital engagement.

Example of user segments in Germany



Source: 2018 Public Sector Journey Benchmark Survey

“We’ve also started making a concerted effort to gather feedback directly from employees and contractors so we can start to build a view of what preferences our customers have in their experience. We found the number-one reason applications were suspended was due to photo issues. Around 15 percent, or 2.5 million, applications each fiscal year are suspended during the adjudication process, causing delays and more effort on the part of the customer.”

—**Aileen Smith,** former head of operations for the US Department of State’s Passport Services Directorate

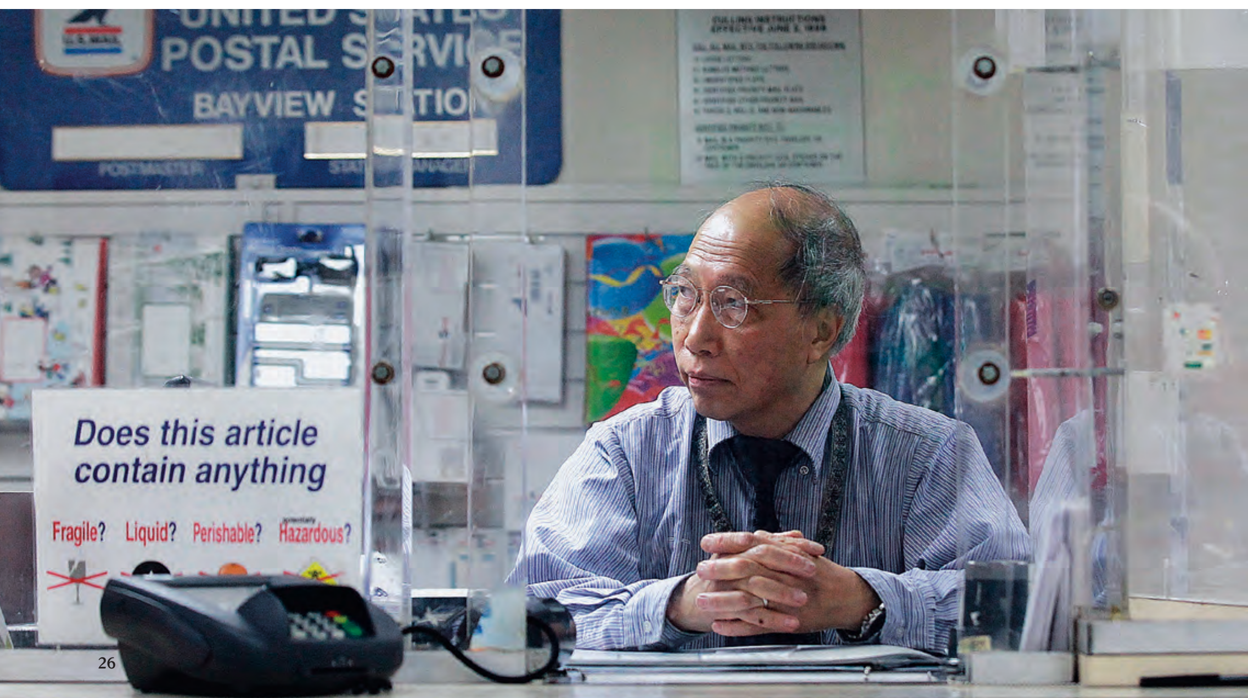
For the full interview with Aileen Smith, see “Using data to improve customer experience in passport services,” on McKinsey.com.

7 Speed is important, but simplicity and reliability more so

Government agencies looking to improve customer experience prioritize delivering those services faster—whether it's delivering a benefit, returning a refund, or shepherding individuals through security. There are obvious reasons for this: slow service is a common complaint in feedback surveys, and decreasing processing time is straightforward to measure. Yet for most services in most countries, speed is only third or fourth on the list of citizens' priorities.

We've found that across the majority of countries and services, simplicity and reliability are the most critical drivers of service satisfaction. In their interactions with government agencies, customers want experiences to be easy and to occur in line with their expectations. In fact, the criticism of slow service tends to be more about expectations than actual speed. For example, a survey of those applying for a new passport or renewing an old one revealed that speed of return was not the most important driver. Instead, reliability most affected service satisfaction—when people know when their passport is going to arrive (and trust that it will), they can plan travel based on the passport date. Even if it took a few months, transparency is critical in this journey, demonstrating the need to identify the right driver to prioritize for each journey.

Customers want experiences to be easy and to occur in line with their expectations.



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8 Add to the list: Leadership and innovation models

Transforming a public-sector organization requires a clear statement of purpose and shared values. The leader's role should be that of an integrating force, and communication is paramount. A good leader needs to look outside for inspiration. While benchmarking progress against other government agencies is critical, it might not be enough to achieve breakthrough innovation.

Leaders as listeners

"I went around the organization and stood in front of the entire staff, albeit in groups of 30, 40, and 50 at a time. I introduced a weekly blog. Bear in mind, most had never met the chief land registrar before. Suddenly, they get a weekly blog from me with the opportunity to post comments under their own names—no anonymity. Their colleagues can like or disagree with their comments, as well as my blog.

"In the first few months, there were loads of negative comments—most of them along the lines of, 'Graham, we've been saying the same thing for the past five or more years. Why hasn't anyone been listening to us?' But that has evened out as people have had more opportunity to articulate their thoughts and share them directly with me. Now they know someone is listening. Staff understand what we're doing, and they can see that I and the board believe in the registry and registration."

—**Graham Farrant,** CEO of HM Land Registry

For the full interview with Graham Farrant, see "Transforming a 150-year-old government agency: A CEO story," on McKinsey.com.

The 'Valley' view

Last year, McKinsey and the Aspen Institute convened a group of senior government leaders and tech-industry executives for two days of immersion in and discussion about innovation. At the San Francisco conference, tech executives urged the use of four tech-sector practices to transform how the public sector functions:

1. Be bold in vision but iterative in delivery—think big but start small.

2. Become obsessed with end users: citizens, yes, but also companies, organizations, and foreign visitors and investors.

3. Cultivate talent and practices with an eye to the future rather than anchoring them in the present.

4. Harness the insights of others: around the world, governments are tackling the same challenges, some with great success. Q

For the full article, see "Advice from Silicon Valley: How tech-sector practices can promote innovation in government," on McKinsey.com.

For more on improving public-sector customer experience, see our special-collection page "Customer Experience in the Public Sector," on McKinsey.com.

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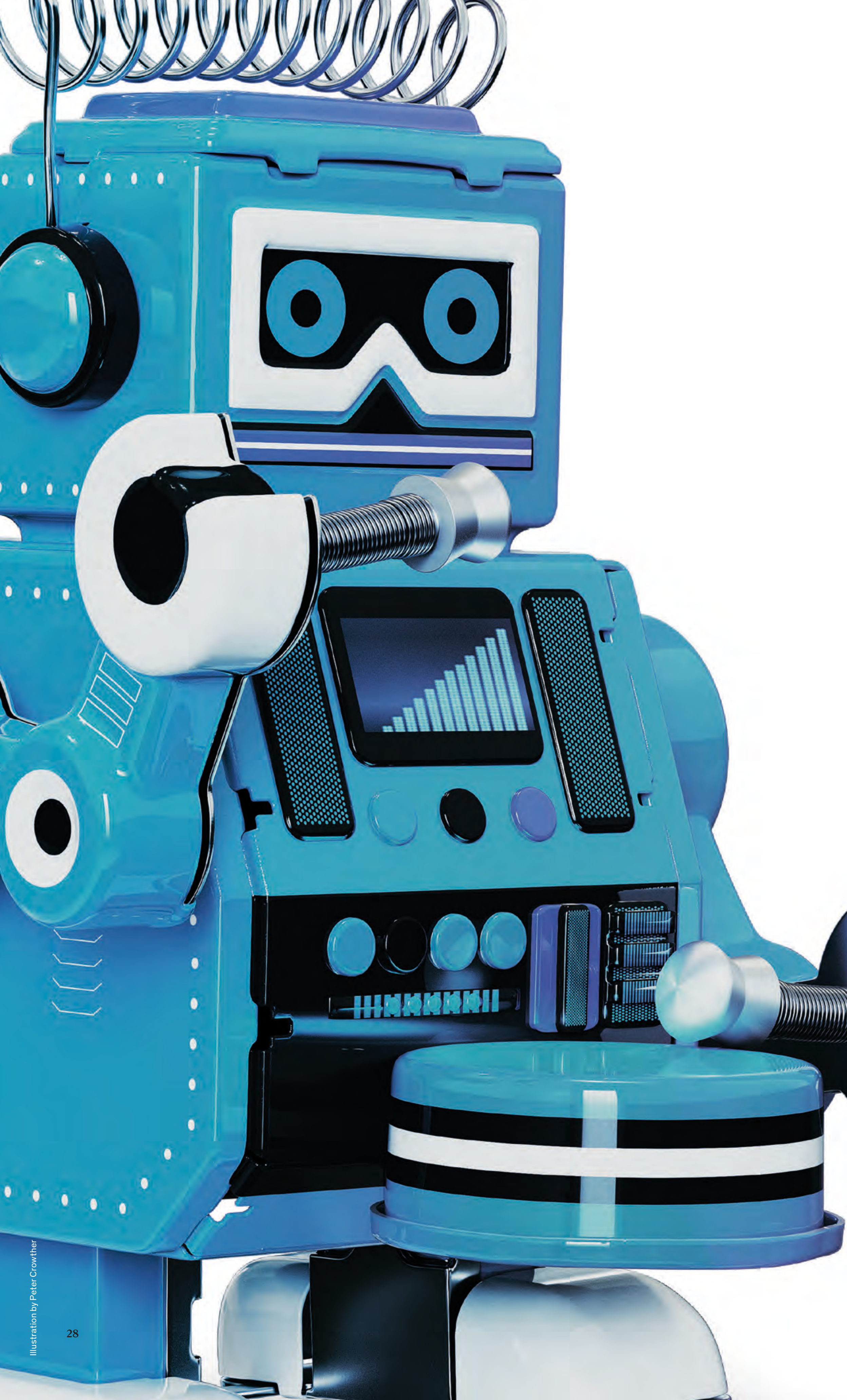


Illustration by Peter Crowther

The drumbeat of digital: How winning teams play

Pace and power go hand in hand for digital leaders, which typically run four times faster and pull critical strategic levers two times harder than other companies do.

by Jacques Bughin, Tanguy Catlin, and Laura LaBerge

Most executives we know have a powerful, intuitive feel for the rhythm of their businesses. They know how hard and fast to pull strategic levers, move their organization, and drive execution to achieve their objectives. Or at least they did. Digitization has intensified the rhythm of competition in many industries, leaving executives adrift, with information-gathering systems that are too slow or disconnected, direction-setting approaches that are too timid, and talent-management norms that are misaligned and incremental.

These leaders know their companies must adjust and accelerate. Digital is putting pressure on profit pools as it transfers an increasing share of value to consumers. Furthermore, those profit pools are bleeding across traditional industry lines as advanced technologies enable companies to forge ahead into adjacent markets, changing who in the value chain is making money, what share of the pie they capture, and how. The slow and inefficient are left behind, competing for scraps.

What is *unclear* to these executives, however, is how much and how fast to adapt their business rhythms. The exhortation to "change at the speed of digital" generates more anxiety than answers. We have recently completed some research that provides clear guidance: digital leaders appear to keep up a drumbeat in their businesses that can be four times faster, and twice as powerful, as those of their peers.

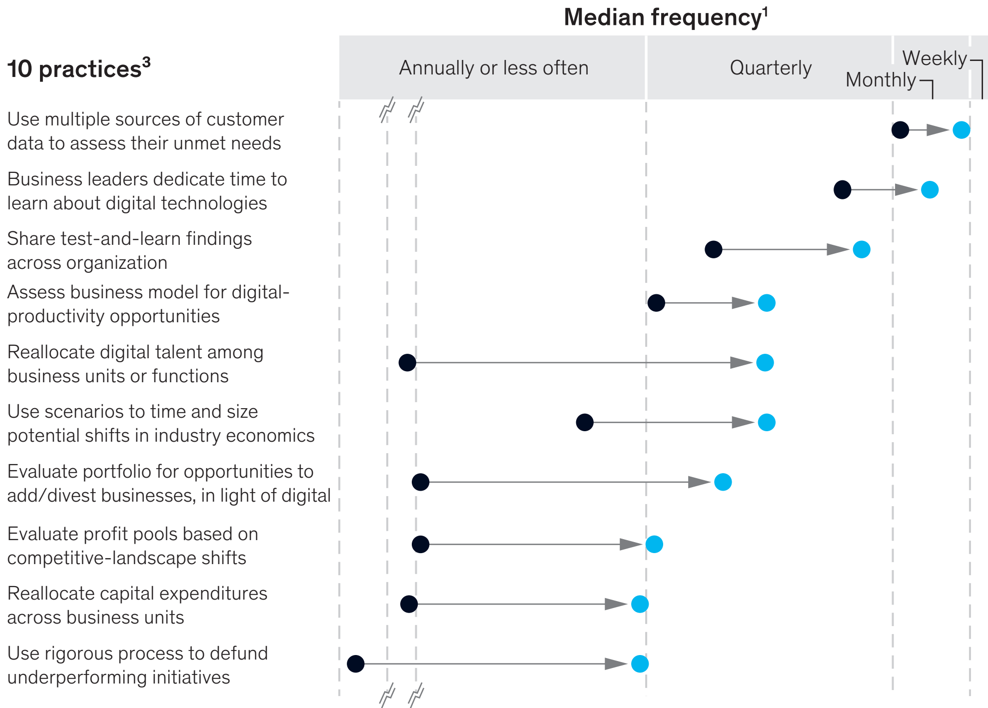
In earlier studies, we identified 11 strategic and operational practices that are tightly correlated with the successful execution of digital efforts. More recently, we asked more than 1,500 executives how frequently their companies carry out these 11 practices.[1]

[1] See "A winning operating model for digital strategy," January 2019, McKinsey.com.

Exhibit 1

The top economic performers follow a faster rhythm in their repetition of certain critical practices.

● Respondents at top-performing companies[2] (n = 138)
● All other respondents (n = 1,304)



[1] Median-frequency values were drawn from a histogram that was constructed by assigning “weekly” responses a value of 1; “monthly,” 2; “quarterly,” 3; “annually,” 4; “every few years,” 5; and “never,” 6.
[2] Respondents who say their organizations have a top-decile rate of organic revenue growth (ie, ≥25% in past 3 years), relative to other respondents.
[3] The 11th practice—ie, the frequency of evaluating M&A opportunities as part of strategy-setting discussions—is not included, because M&A typically requires a longer time frame than the other 10 operational practices tested, often because of regulatory reasons.

The responses of the best-performing companies—those in the top decile for organic revenue growth—suggest that the accelerated repetition of certain critical practices is closely associated with adaptive cultures that are comfortable with change, learning all the time, and swiftly responsive (Exhibit 1).

These practices fall into two different categories. One is a set of actions that a company must take continuously (monthly, or even weekly) to increase the pulse of the organization. The other is a set of activities done intermittently (often quarterly) and involves taking a step back to review all that the company has learned, as well as making powerful adjustments or realignments accordingly (see sidebar, “Faster and harder: Behind the numbers”).

Moving four times faster: The beat of the company

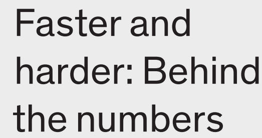
You can’t quicken the pace of an organization by fiat. You have to build it by accelerating the frequency of manageable practices that are integral to achieving key goals, such as serving the customer or driving internal efficiency. These “light-touch” actions are low risk and low investment, but they can provide high-yield returns. We have grouped

them into two buckets that can help mold incumbents into digital players.

1. Learn, engage, and share
How often does your organization analyze customer data to look proactively for new ways of delighting your customers? How frequently do your senior business leaders take time to investigate and understand new digital technologies so that they recognize which ones are truly relevant to their areas of the business? How quickly and consistently does your company share lessons acquired from test-and-learn experiments performed by those on the front lines? If you are like most organizations, you aren't performing the following tasks fast enough:

- *Learning: From quarterly to monthly.* Top-performing companies are voracious opportunists, and it starts at the top. Senior leaders take time to tune up their understanding of the digital tools and practices their businesses need to stay ahead. That happens monthly (often, more frequently) at the best performers, compared with quarterly at the lower performers. Much faster than average companies, top companies scan for digitally enabled productivity opportunities and for external-environment shifts that are changing the economics and boundaries of their businesses.

- *Engaging with data: From monthly to weekly.* Nearly half (44 percent) of digital leaders collect and analyze customer data weekly (or more frequently) to identify new ways of winning over buyers, compared with just 16 percent of laggards, which, on average, dig into customer data only monthly. And the drive for urgency is omnipresent. A company



Faster and harder: Behind the numbers

We isolated 11 different practices that we had observed and identified in prior research[1] as differentiators between digital winners and all others. First we confirmed that these practices were statistically significant drivers of profitable growth compared with other factors. Then we looked not just at whether companies were taking these actions but also at how frequently they were executing them. To test whether these practices, taken together, were those that mattered most to performance, we examined the effects of their cumulative adoption.

We found that companies scoring highest (using an agility index based on adoption levels) had three-year revenue-growth rates that were more than 60 percent higher than those of com-panies with the lowest scores. Performance increased steadily as adoption increased.

[1] See Chris Bradley, Martin Hirt, and Sven Smit, "Eight shifts that will take your strategy into high gear," *McKinsey Quarterly*, April 2018, McKinsey.com; Jacques Bughin, Laura LaBerge, and Anette Mellbye, "The case for digital reinvention," *McKinsey Quarterly*, February 2017, McKinsey.com; and "How digital reinventors are pulling away from the pack," October 2017, McKinsey.com.

Exhibit 2

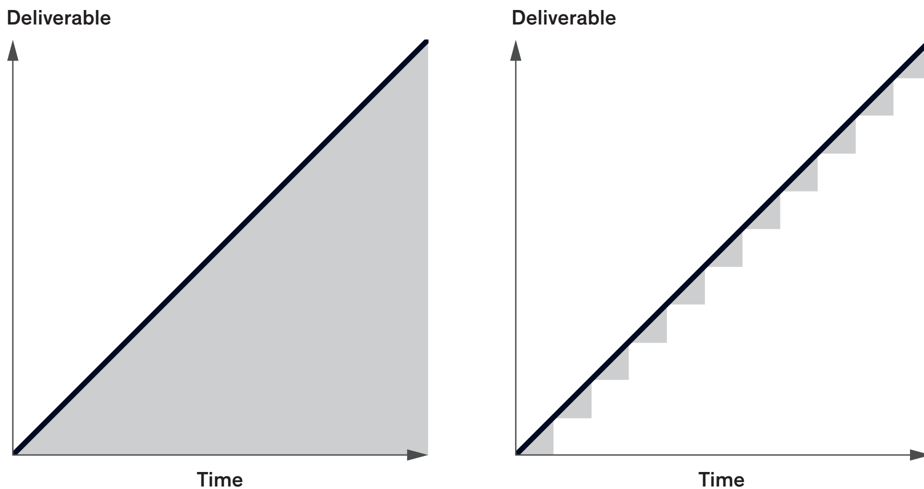
At agile companies, incrementalism doesn't get in the way of breakthroughs—it enables them by lowering the risk at each step.

Waterfall vs agile development

Degree of risk

The **waterfall model's** linear, sequential process for digital implementation does not allow for quick revision of requirements; serious problems may not be visible until the end.

The **agile model's** iterative, team-based process surfaces and resolves digital-implementation issues incrementally, resulting in less risk at each step.



with a database of 2,000 customers, for example, decided to generate online sales by offering a discount code. Instead of simply sending a single email to its customers, it tested two different promotional offers, one demanding faster action from customers than the other. The more time-sensitive offer generated a 60 percent higher response rate, which became the standard for the company's future promotional emails.

- *Sharing results: From quarterly to monthly—or even weekly.* To ensure that results such as those in the previous example permeate the organization, top-performing companies encourage employees to share their lessons from lower-performing tests and successes from better-performing ones. As basic as this practice might seem, top-decile performers are five times more likely than others to do this weekly. And top performers are committed to sharing with the broader organization what has been gleaned from any test-and-learn activities. They do this about three to four times faster than their peers do—at least monthly, rather than the quarterly frequency seen in other companies—with the very highest performers sharing knowledge weekly.

Why do these particular actions matter so much? As Gandhi said, "Your actions become your habits; your habits become your values; your values become your destiny." It goes back to the elements of organizational culture—risk taking, customer focus, silo

busting—that our past research has highlighted as core to digital effectiveness. Focusing on frequent inputs about what your customers are wanting, and how new technologies can help you deliver that, drives both a more customer-centric view and a greater confidence about what direction to take new offers. Sharing insights about what is working and what is not beyond the team that launched a particular initiative helps break down siloed views of both the business and the customers, and it can spur calculated risk taking in other parts of the organization. As Gandhi knew well, small but frequent actions can lead to big and meaningful changes.

Adapt and deploy

The top-performing companies in our survey are just as opportunistic when it comes to redistributing talent. This often comes through the formation, dissolution, reformulation, and work of agile teams, whose many small, low-risk steps enable swift progress, rapid talent reallocation, and massive change (Exhibit 2). At agile companies, incrementalism enables breakthroughs by lowering the risks at each step:

- Talent reallocation: From yearly to quarterly. On average, leading companies reallocate digital talent more than five times faster than their peers do, doing so on a quarterly or faster basis. Most companies wait a year or more to reallocate talent. This large spread is likely to grow as more companies expand their use of agile methodology beyond IT. Agile ensures that organizations bring together small multidisciplinary teams aligned on common goals. These groups make iterative progress on—and continuously manage their backlogs of—those activities that matter most in achieving critical outcomes. Their work enables rapid, large-scale reprioritization of digital initiatives and has the added merit of lowering the risk on bold moves.

- Agility in action: From every two months to every two weeks. At the Dutch banking group ING, for example, an agile workplace has allowed the company to reinvent the way it serves customers. People increasingly use a variety of channels for financial services: branches, smartphone apps, laptops. They want every one of those experiences to be seamless.

  Agility accelerates everything. Cross-functional “squads” of nine people or fewer focus on delivering solutions for specific needs of their customers in ways that were impossible in the old organization. Squads with a shared overarching mission (such as mortgages, payments, or consumer credit) are united in “tribes” of 150 employees or fewer. Reallocation of talent is executed swiftly, with focus on value. Each tribe has a leader who can deliver key resources, including IT engineers, as needed. These tribe leaders convene once a quarter in a quarterly business review. Before the review, tribe leaders share a brief memo with all of their peers, documenting what the tribe achieved in the past three months, as well as what it was unable to accomplish and why. They also share, in writing, their commitments for the coming quarter and document the resources and support they require to achieve these ambitious goals. Based on this input and related conversations, the bank’s top management reallocates talent to the tribes with the greatest opportunities. The process has unleashed creativity and productivity. At the beginning of the journey, ING could

deliver only four new software releases a year, a pace that would have left it hopelessly behind its customers. These days, ING delivers new software on an ongoing basis, at an astonishing rate of more than 20,000 small releases per month.

Driving your strategy with twice the power

Our survey findings make clear that digital leaders undertake big strategic initiatives more often—and more successfully—than their peers do. They are more likely to develop entirely new digital offerings or to launch new businesses.[2] Their digital transformations are more likely to be deep, organization-wide efforts than experiments conducted on the fringes.

Big moves that turbocharge digital effectiveness are underpinned by strategic clarity and adaptability. The two go hand in hand because keen insights and a view of the future are more powerful when combined with learning through experimentation. Companies with both have the confidence to make big calls when others are frozen in wait-and-see mode.

Two of the most important such calls are major acquisitions and capital bets. Not only are these two of the five big moves shown by our colleagues in separate research[3] to be the greatest contributors to exceptional corporate-performance improvement, they also loomed large in our findings—powerful differentiators that separated digital leaders from laggards:

- Our survey suggests that digital leaders spend three times more on M&A (27 percent of annual revenue, compared with 9 percent spent by others) and dedicate more than 1.5 times more of their M&A activity to the acquisition of digital capabilities and digital businesses (64 percent, compared with 39 percent for their peers). Taken together, those results suggest that the leaders are pursuing digital M&A about twice as hard, on average, as everyone else.

- Digital winners typically allocate 9 percent of their capital expenditures toward digital-transformation efforts, while others allocate half that much—again, twice the power for digital leaders. The results are transformative as well: expenditures that lead to better analytics tools or greater automation can be key in building competitive advantage over digital competitors.

Strategic power and rapid pace are mutually reinforcing. When digital leaders launch initiatives at a greater rate than peers do, they create opportunities to collect data, analyze them, and learn faster than other companies. That learning about the evolution of markets, consumer attitudes, and behavior, in turn, sets those companies up to make bigger, better, faster acquisition and capital-expenditure decisions—which, in turn, fuel new initiatives and more learning.

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[2] We have found, for example, that incumbents implementing artificial-intelligence initiatives move up the digital-learning curve at an accelerated rate, which helps them close the gap with first movers in their industry. See “Notes from the AI frontier: Modeling the impact of AI on the world economy,” McKinsey Global Institute, September 2018, McKinsey.com.

[3] See Chris Bradley, Martin Hirt, and Sven Smit, “Strategy to beat the odds,” *McKinsey Quarterly*, February 2018, McKinsey.com.

Accelerating the digital drumbeat: A checklist for companies

The speed and power with which digital leaders move are best illustrated through examples. So let's examine a group of financial-services players that dramatically increased the rhythm of their businesses in response to emerging digital challenges. One company, which had performed well by steadily improving productivity, was seeing leaner digital players cherry-pick its clients, forcing consideration of radical digital interventions to its core business model. Another company had seen its portfolio of new, B2C businesses, which delivered the highest profit growth in the company, getting hammered in the press for poor customer experience and unimaginative offerings.

The CEO and heads of the business lines in these organizations agreed *something* had to be done—they just weren't sure what. To accelerate learning, one company empowered a new group to examine the end-to-end journeys of their customers and built out an insights and analytics group to uncover unmet needs. This gave the company the knowledge it needed to do a cleansheet redesign of its current offerings and to create some new ones. Another company launched a tech-enabled productivity transformation of its core business, aimed at embedding artificial intelligence and automating a variety of functions. The direction was starting to crystallize for these organizations. But the companies needed to take five interrelated actions to support their digital goals.

1. Seeking real-time digital learning

The executive teams knew that their business leaders, while familiar with the basics of digital, needed to become both deeply knowledgeable about the advanced technologies their units were starting to deploy and able to think, in real time, about the strategic implications of technologies and tools. Robotics, for example, was no longer about building machines but instead about automating the assembly of digital apps that would be immensely important to ongoing customer interactions. This raised important questions: If you can automate 10 percent of 100 app-creation jobs, do you simply save the full-time equivalent of ten people, or do you redeploy them to other digital thrusts, perhaps in other areas of the organization? And how do you align executive incentives behind such resource shifting?

Rather than inundate business leaders with educational material, one organization launched a cross-functional initiative to discover jointly how AI-supported robotic process automation could boost productivity, drive down cost, and expand strategic options. Cross-functional teams cocreated pilots and shared their models, assumptions, and findings in monthly meetings attended by the business leaders, including those whose head counts were in question. This practical and open approach simultaneously gave key leaders a valuable education in the potential of digital and crafted consensus around resource reallocation.

2. Sharing insights at the pace of digital

The companies had plenty of algorithms to identify inefficiencies but did a poor job of turning the tremendous amount of data they had—about interactions with customers and how customers used (or didn't use) its products—into valuable insights that could lead to new and better products and services. Part of the problem had to do with technology: the companies lacked key algorithms in customer-facing areas.

But another part of it was the result of an organizational weakness. Droves of customer insights were trapped in silos. The operations teams had information on which customer issues pushed up costs. The marketing teams had insights into what drove or lost sales. Channel partners had data on why customers had chosen a competitor's offering. Not only were the insights siloed in disconnected groups, but when data in one silo contradicted data in another, nothing was done to reconcile the findings, meaning that divisions were sometimes working at cross-purposes.

With the backing of the CEO, one executive team instituted a quarterly check-in across the businesses to identify top customer pain points coming in from the company's websites, call centers, and product-usage databases. As people across the company came to see the value of these check-ins, meetings started occurring monthly or even more frequently. For example, small, cross-cutting groups met weekly to share the findings of their tests and pilots and to talk about where they might find resources (including those for a new analytics team) to fix the problems surfaced in those tests. These insights were shared directly with business-unit heads to help drive alignment at the executive level and to ensure that everyone was on the same page about what the problems were and what solutions were working.

3. Deploying digital talent with agility

Talent was a bottleneck holding back the pursuit of digital initiatives in the organizations we spoke with. Matters were made worse by the many different ways individual divisions deployed, prioritized, and ran the operating expenses associated with digital talent. While the marketing function, for example, might have completed its part of a project, the initiative would stall if the operations function didn't prioritize launching the new initiative. Resources in one company were truly agile only within silos, not across the organization, and divisions reviewed talent allocation at wildly different intervals.

To get this right, the senior-leadership team formulated a consistent set of criteria for prioritizing the deployment of digital talent. As a group, it came to grips with resource trade-offs, such as productivity versus customer experience, and core versus new business. These criteria were reconsidered every quarter, and they changed as the company learned more about the efficacy of different elements of the digital strategy. The reallocation, however, was done weekly, in keeping with the urgency of digital initiatives and competitive threats.

4. Reallocating resources flexibly

Since these companies were on steep digital-learning curves, they regularly found that they had overfunded certain projects and underinvested in others. Initiatives that seemed most promising at the start of a quarter might seem less critical three months later. Perhaps a company had learned that scaling the project would cost far more than planned, or perhaps another project had come to show much greater potential. Traditionally, one company had looked at reallocation once a year and given great leeway to each division head. With these kinds of digital discoveries happening often and everywhere, the company's annual process had to be drastically reconfigured.

First the top team shifted priorities for operating and capital expenditures, carving out a portion reserved for the execution of the digital strategy. Then they moved from an annual to a quarterly reallocation one so that resources would always be focused where they would do the most for the enterprise as a whole. Not surprisingly, this was a difficult transition for many of the business-unit leaders, since they were accustomed to having their own budgets and calling the shots. While their input was still critical, they no longer had the final say: if a major cross-cutting initiative needed resources, they had to come from somewhere—and that might well force a business-unit leader to free up funds by placing a certain digital priority on the back burner. This piece was the most contentious, and there have been periods of backsliding, but the organization is moving steadily in this new direction.

5. Shifting the culture
The frequent sharing of insights, successes, and failures buoyed the confidence of key leaders. And on the front lines, the freedom to make many small moves quickly diminished risks and started shifting the culture: managers and employees became less afraid of failure as they pursued digital initiatives. Considerations of M&A and capital expenditure, in the meantime, became more about business impact and well-understood risks (thanks to better data) and less about organizational politics. As leaders became clearer on how, exactly, their digital efforts were contributing to the twin goals of driving down costs and creating new and improved customer journeys, they grew more comfortable making bigger bets and swiftly reallocating human and financial capital.[4] The full transformations are still underway because of the complexity of the organizational change, but the momentum is building with each new company success.

Aspiring to the speed and power of digital leaders may seem daunting. But increasing the rhythm of your business is an achievable goal; it just requires building out a set of clear, collaborative, and consistent practices for digital learning, engaging with data, sharing results, deploying talent, and reallocating resources. One of evolution's lessons is that adaptable species outlive those that are merely more powerful. By accelerating the digital drumbeat, your company can transform itself from a powerful but slow-moving target into a sleek and swift predator—the fastest fish, which feasts on the slower ones that have failed to change. Q

[4] For more on the combined effects of M&A, agility, and digital effectiveness, see Jacques Bughin and Tanguy Catlin, "3 digital strategies for companies that have fallen behind," *Harvard Business Review*, February 12, 2019, hbr.org.

Jacques Bughin is a director of the McKinsey Global Institute and a senior partner in McKinsey's Brussels office, **Tanguy Catlin** is a senior partner in the Boston office, and **Laura LaBerge** is a senior expert in the Stamford office.

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Illustration by Daniel Hertzberg

Admit it, your investments are stuck in neutral

New research shows that companies that know how to shift critical resources where and when they're needed share common traits. Rigor is the first one.

by Massimo Garbuio, Tim Koller, and Zane Williams

Studies show that companies that actively reallocate resources outperform those that don't.[1] In many companies, however, a range of obstacles—cognitive biases and inconsistent decision-making processes, for example—keep planning teams and senior executives from being as "active" as they could be. As a result, when executives are faced with opportunities outside of the traditional budgeting cycle, they can get caught flat-footed.[2]

Pervasive as this problem is, it can be overcome. Our research on how companies make investment decisions (capital expenditures, marketing and sales, R&D, and the like) suggests there are tangible ways to get better at promptly reallocating resources when the need arises.

We surveyed executives in more than 500 distinct companies across a range of industries. We asked them 35 questions about their investment and decision-making practices, as well as managers' appetite for taking risks and the incentives that were present in their companies. We identified common traits in these companies, and we used cluster and regression analyses to quantify the impact of those traits on companies' performance generally and on their growth and innovation more specifically. We supplemented those data with 16 in-depth interviews with a subset of respondents.

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[1] Marc de Jong, Nathan Marston, and Erik Roth, "The eight essentials of innovation," *McKinsey Quarterly*, April 2015, McKinsey.com; see also Stephen Hall, Dan Lovallo, and Reinier Musters, "How to put your money where your strategy is," *McKinsey Quarterly*, March 2012, McKinsey.com.

[2] Ronald Klingebiel and Christian Rammer, "Resource allocation strategy for innovation portfolio management," *Strategic Management Journal*, February 2014, Volume 35, Number 2, pp. 246–68; see also Andy Dong, Massimo Garbuio, and Dan Lovallo, "Generative sensing: A design perspective on the microfoundations of sensing capabilities," *California Management Review*, August 2016, Volume 58, Number 4, pp. 97–117.

As we looked more closely at the outperformers in our data set—or, the companies that actively reallocated resources within their portfolios—three traits kept turning up: agility, a commitment to project discipline, and a higher-than-normal tolerance for taking risks (see sidebar, "The three characteristics of active reallocators").

Follow-up conversations with the most active reallocators revealed that when it comes to organizing operations, they appear to do two things particularly well: they are simultaneously rigorous and flexible, keeping decision-making processes and project cycles in sync; and they recognize the importance of offering incentives that encourage managers to move critical resources to where they're needed, when they're needed.

How to be rigorous and flexible

One of the main themes we heard from survey respondents is that having the right kinds of processes for making investment decisions is important—not just for clarifying who has the power to propose new projects but also to monitor how flexible the allocation of resources is over the course of a year or a project. Here are some of the more common processes these companies follow:

Pushing decisions down in the organization. A telecommunications-equipment manufacturer gave business units in some locations leeway in making investment decisions: they had "universal" targets for revenues and margins, same as everyone, but they also had freedom to invest and make trade-offs as needed to hit targets at the local level. The only rule was that those additional investments needed to be signed off by the business-unit head and the finance head. Some of the local business units used a rolling 18-month performance forecast to ease this process. The forecast allowed them to understand trade-offs and model the implications of potential actions in real time.

Minimizing the number of meetings and decision makers. Several of the executives we interviewed said they held only two or three meetings to review a project proposal and typically designated only two to four people, on average, to formally approve a project.

As we looked more closely at the outperformers in our data set, three traits kept turning up: agility, a commitment to project discipline, and a higher-than-normal tolerance for taking risks.

Sidebar

The three characteristics of active reallocators

Our data and conversations with executives in the field reveal that the companies that actively reallocate resources tend to excel in three main areas.

Agility. Active reallocation of resources requires managers to be systematic about their pursuit of opportunities outside the traditional annual capital-budgeting cycle. This means adding to (or subtracting from) investment budgets during the year so managers can allocate extra cash to fund new projects as they arise—and so managers can accelerate the timeline or expand the scale of projects that are doing better than expected, even if this increases costs.[1]

Project discipline. The idea that a visionary CEO or CFO can decide to bet everything on some disruptive new technology is enticing, but that's not what happens in most organizations. In our experience, most of the companies that are active reallocators have specific metrics in place that everyone understands up front. They consider a range of potential outcomes or scenarios for a given project and welcome input from all organizational functions no matter what the project is about.

Risk tolerance and incentives. Many of the companies that are active reallocators tend to establish cultures and reward systems that make it safe for employees to explore projects that may or may not be that far afield from the current business—identifying new ways of serving existing customers, for instance, or new customers and new geographies. They provide training and well-defined career paths for project managers. And the rewards for substantial successes include both financial incentives and job promotions.

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[1] Another survey of more than 2,000 executives found that a large proportion of strategic decisions takes place outside the annual planning process, either because the decisions are prompted by external factors or because there is no formal annual process. See "How companies make good decisions: McKinsey Global Survey Results," January 2009, McKinsey.com.

Many executives we spoke with said they regard the annual budgeting cycle as too slow; they add spending to the capital budget throughout the year.

These companies did not want to court recklessness, however, so they also implemented clear, consistently applied criteria for how projects should be evaluated. Executives know in advance what to include in their investment proposals, what metrics they should present, and how to defend their proposal to decision makers without a ton of unnecessary back-and-forth. One oil and gas company wanted to minimize politics in its decision making, so it does not allow business-unit heads in the room when allocations are made. Written proposals are submitted, and only the CEO, CFO, and head of technology meet to review requirements and decide on resource allocation.

Encouraging cross-functional collaboration. One consumer-products company made sure that marketing and design executives were primary contributors to resource-related decisions, alongside business-development, finance, and other leaders. The senior team understood that marketing and design leaders' perspectives (at both the early and end stages of product development) were just as critical as any others' for understanding how business strategy could be affected if resources were pulled from, say, a solid but stagnant product line and shifted to newer, emerging initiatives. By positioning marketing and design executives as part owners of the proposal, rather than just reviewers or evaluators, the company was able to identify and handle issues early in the process, eliminating errors or the need for rework.

Setting clear strategic goals. Project teams need to understand the boundaries within which smaller decisions can be made more rapidly. Executives in a hospital company, for instance, maintain demand forecasts for medical services offered in the different locations where it operates. The company uses these forecasts to identify potential areas for expansion. Its finance function also maintains a 15-year cash-flow forecast, so the company can readily determine how many projects it can fund at any given time. These two forecasts have enabled the company to respond quickly when opportunities arise. When it was offered a commercial office building by a distressed seller,

executives knew in less than a day that they had the funding and that the location was a desirable one for the company. This accelerated the subsequent due-diligence process, as the COO and CFO jointly prepared proposals that were quickly reviewed and approved by the board.

Prototyping new ideas. Several respondents mentioned the importance of casting a wide net for ideas and frequently testing new concepts with customers. Some even require project sponsors to submit variations of a project idea (a different size or scope, for instance) alongside original proposals. Executives at one telecommunications-equipment company routinely assign technical and sales staffers to work at customer sites for long periods, so they can better understand customers' needs and share with the home office real-time observations about what's working and what isn't. Using this information, the home office has been able to identify emerging trends sooner than competitors did. Over time, the company has been able to significantly increase the number of new systems it designs and sells.

Removing budget anchors. To avoid rubber-stamping the same allocations year after year, one large luxury-goods company instituted a reanchoring procedure. It defined a fact-based set of performance criteria without noting the prior year's budget. The criteria included market size, potential market-share growth, and sales-force head count relative to competitors. Using those criteria, the company built a predictive model to answer the following question: "If you did not know what your sales targets were this year, and were relying only on the criteria you defined, what would be the targets for next year?" It then positioned that model as a new anchor—using the results not to make decisions but to challenge status quo investments. This new process changed the dynamics of the budgeting discussions: the team was encouraged to ask "why?" about every line item, instead of "why not?"

Considering budgets to be rolling, not fixed. Many of the executives we spoke with said they consider the annual budgeting cycle to be too slow; instead they add spending to the capital budget throughout the year so they can act quickly when markets shift. When executives at one advertising agency were presented with a new market opportunity, they were encouraged to pursue it even though it would lower the company's margin for the current year. Instead of being penalized, the team was simply asked to revise its revenue and margin forecasts as the project progressed. This process allowed the ad agency to adapt to technology changes in the market more rapidly than their peers.

Killing underperforming projects. Several of the managers we interviewed cited the need to set the ground rules for early termination, and they reported the use of contingent road maps and other tools and approaches to achieve this goal. Managers agree up front on specific project milestones and specific metrics for evaluating progress—for instance, did it meet thresholds for growth or profitability? When such targets aren't met, they wind down projects quickly and reallocate resources to more promising ones. In these companies, the burden of proof is on the business units to prove that a project should continue rather than just assume that it should.

Establishing the right incentives

Having the right kinds of processes for investment decision making is important, but our experience suggests they will fail if companies' incentive structures do not reward risk taking. Ideas will suffocate on the front line before they can even be considered.

Many of the executives we interviewed said they use financial and noncompensation incentives to make it safer for employees to support potentially risky investment decisions. Having a good balance of both is critical: one hospital chain was installing a new electronic-medical-records (EMR) system. Senior leaders said employees' bonuses and other longer-term performance-based compensation would be tied to this particular project's success, not the company's success. And the technology partner in the project agreed to send out interim status reports to the hospital CEO and other senior executives, assigning letter grades to various stages of the implementation and calling out specific roadblocks and challenges for the project. The financial incentives and performance-tracking mechanisms were clear. The idea was to make team members feel fully accountable for keeping the project on track—not an insignificant matter for an initiative that was likely to cost $1 billion over ten years.

However, the lack of nonfinancial incentives associated with this initiative eventually proved to be problematic. The roles on the EMR implementation team for IT and medical professionals were designated as temporary, and those who moved to the project team had their old jobs backfilled. It was unclear what career path they would return to after the project. As a result, many of the more experienced and skilled IT staff avoided working on the project, leaving the implementation team shorthanded in certain skill areas.

Some of the managers we spoke with also cited the importance of establishing incentives to take risks and innovate. One software company convenes a committee of midlevel executives each year from different parts of the organization—

Having the right kinds of processes for investment decision making is important, but our experience suggests they will fail if companies' incentive structures do not reward risk taking.

managers charged with gathering ideas for new products and features. The committee members pool, refine, and share the ideas with a group of senior executives who further refine them and develop proposals. The proposals are then sent to the executive committee for debate and approval. Once the process is complete, successful ideas are sent back to the business units for execution—essentially completing the circle.

Executives need to see and fund the most promising investment opportunities at any time, no matter where in the organization they originate. The best practices shared here can help them do just that. With the right processes and incentives in place, managers at all levels will be better positioned to feed senior executives the innovative ideas and proposals needed to fundamentally transform their organizations as technologies and market trends change. Q

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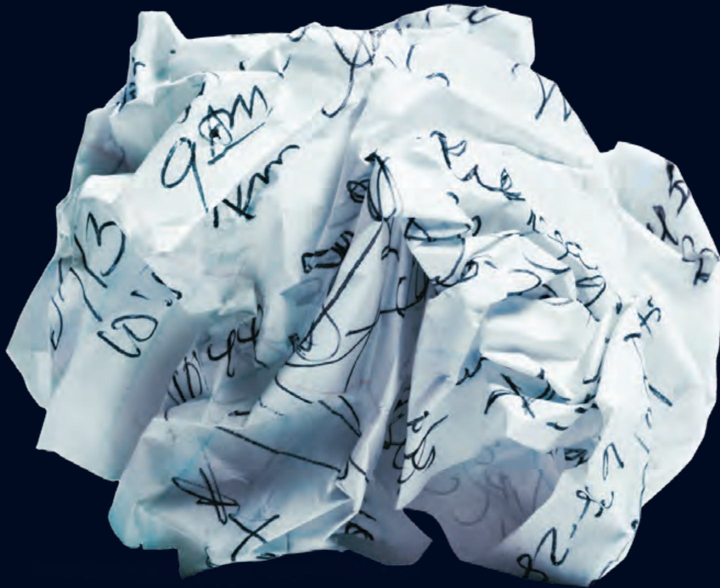

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Bias Busters

Knowing when to kill a project

You're keen on encouraging innovation and letting a thousand flowers bloom, but how do you sort the weeds from the seeds?

by J. André de Barros Teixeira, Tim Koller, and Dan Lovallo

The dilemma

In the past six months, the product-development group in your company has generated a dozen concepts that would breathe new life into existing brands—for instance, "foaming" variations of the company's established line of bar soaps. In fact, the team is coming up with more promising ideas than there is funding to support them. These would be small investments relative to the rest of the company's overall R&D expenditures, but altogether they would account for a significant percentage of the limited resources tabbed for product development. As the head of R&D, you're keen on encouraging this sort of enthusiasm for innovation and letting a thousand flowers bloom, but how do you sort the weeds from the seeds?

The research

Multiple studies have indicated the degree to which business leaders are loath to kill projects. One such study developed by IESE Business School Professor Luis Huete found that companies and individuals that have had a track record of success have a harder time killing projects, because they carry with them an ingrained

belief that they can turn everything into gold, so long as everyone works hard enough.[1] Managers under these circumstances attribute more credit than is warranted to the person making or supporting an investment proposal than to the merits of the proposal itself. Compounding this belief is the sunk-cost fallacy, in which managers who are assessing projects lend more weight to the costs they've already incurred from an initiative rather than the costs to come. Not wanting to see past efforts go to waste, they put their pruning shears away and let projects grow indefinitely.

The remedy

One global producer of baking ingredients, oils and spreads, and other types of food designated a full-time "project killer"—someone with deep knowledge of both food technology and the business aspects of the industry—to rein in project creep.

Researchers at the food company were motivated to find the next "home run" product. But over time, the number of R&D investments became disproportionate to the value being generated from them. The project killer sits within the R&D team at the company but loosely reports to different functions within the business. He maintains a database of all active projects, noting areas of repeated inefficiency or lack of success or lack of opportunity. Using these data, he builds a dispassionate case for why a project should continue (under changed circumstances) or be killed. The project killer's review of the database considers the costs and benefits of *all* projects in play, not just individual initiatives, and this review happens on a rolling basis, not as part of a meeting or event. As such, there are few formal opportunities for project ombudsmen to re-pitch failing initiatives.

In the three years since it designated a project killer, the food company has been able to cull its portfolio—from more than 560 projects to just over 200. And the effect on profitability has been overwhelmingly positive.

The project killer role is a better fit in some scenarios than in others—useful in fast-moving consumer-goods companies, for instance, but not necessarily in the film industry, or in oil and gas companies, where production lead times are very long. Still, the theory behind this approach—mandating objectivity—is worth noting, regardless of company or sector. Companies absolutely need to invest in new ideas. They must be entrepreneurial and imaginative. But they also need to adopt mechanisms that take some of the emotion out of their resource-allocation decisions. Q

[1] Luis Huete, *Construye tu sueño* [*Build your dream*], sixth edition, Madrid: LID Editorial, 2008.

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Dealing with M&A

In this package

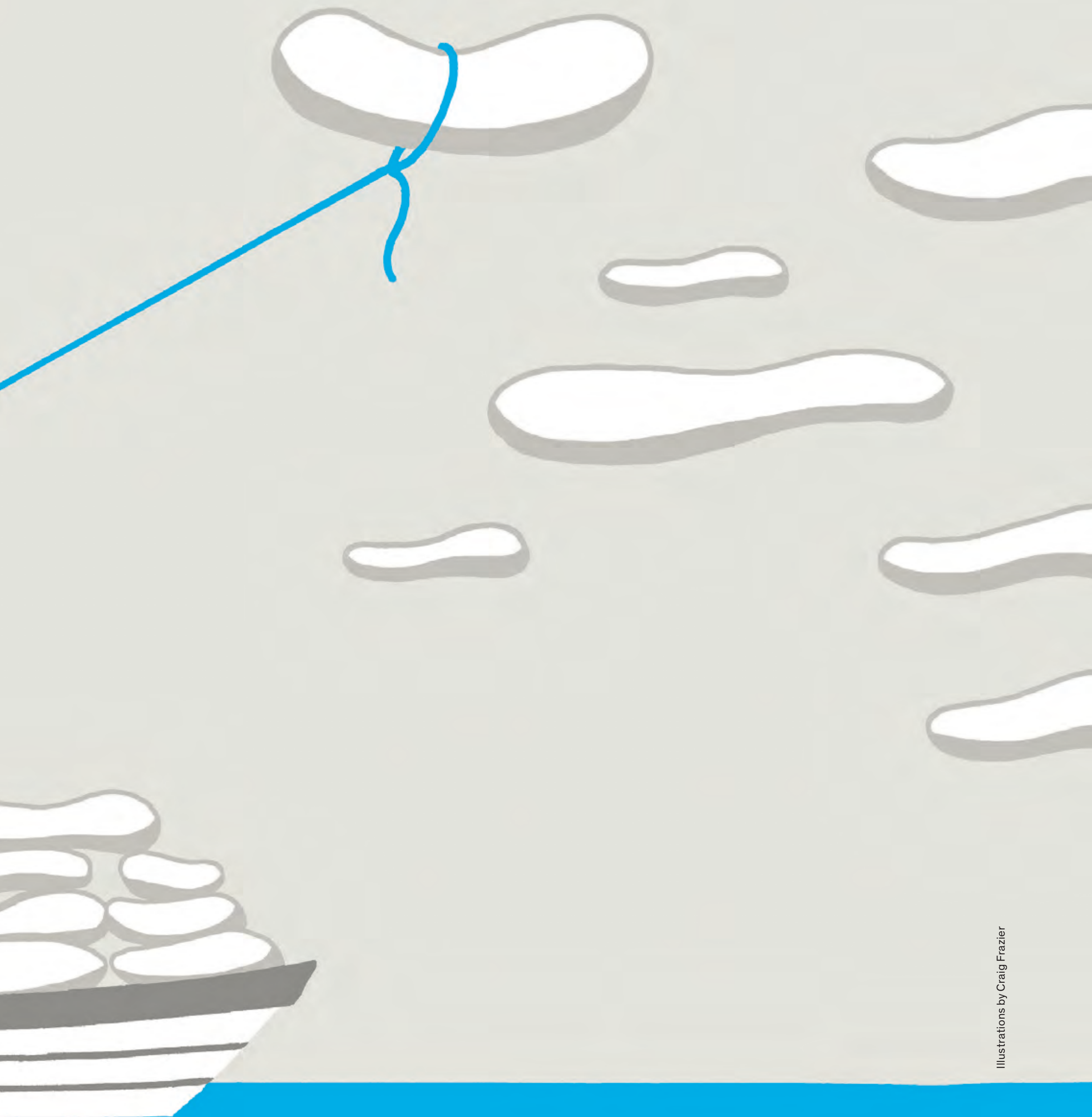
50 How lots of small M&A deals add up to big value

56 Compound growth at MilliporeSigma

65 The secret ingredient of successful big deals: Organizational health

70 Demystifying deal making: Lessons from M&A veterans

Done well, M&A can become an organization's competitive edge; done poorly, a value-destroying catastrophe. This package explores how successful practitioners approach M&A integration, strategy, and investor activism, while new McKinsey research underscores the characteristics, capabilities, and approaches of successful deal makers.



Illustrations by Craig Frazier

How lots of small M&A deals add up to big value

New research confirms that companies that regularly and systematically pursue mergers and acquisitions deliver better returns to shareholders than companies that don't.

by Jeff Rudnicki, Kate Siegel, and Andy West

Nearly a decade ago, we set out to answer a critical management question: What type of M&A strategy creates the most value for large corporations? We crunched the numbers, and the answer was clear: pursue many small deals that accrue to a meaningful amount of market capitalization over multiple years instead of relying on episodic, "big bang" transactions.[1] Between 1999 and 2010, companies following this programmatic approach to M&A generally outperformed peers.[2]

That pattern is even more pronounced in today's fast-moving, increasingly uncertain business environment (see sidebar, "The staying power of programmatic acquisition"). A recent update of our research reflects the growing importance of placing multiple bets and being nimble with capital: between 2007 and 2017, the programmatic acquirers in our data set of 1,000 global companies (or Global 1,000) achieved higher excess total shareholder returns than did industry peers using other M&A strategies (large deals, selective acquisitions, or organic growth).[3] What's more, the alternative approaches seem to have underdelivered. Companies making selective acquisitions or relying on organic growth, on average, showed losses in excess total shareholder returns relative to peers (Exhibit 1).

The data also confirmed just how challenging it is for individual companies to make the transition to programmatic M&A from any of the other models we identified. For instance, none of the companies that followed an organic approach between 2004 and 2014 had shifted to a programmatic model by the time we performed our latest analysis. And by 2017, more than a quarter of those companies had dropped out of the Global 1,000 altogether because of takeovers and other factors. The story was similar among those companies we deemed selective acquirers (Exhibit 2).

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[1] Werner Rehm, Robert Uhlaner, and Andy West, "Taking a longer-term look at M&A value creation," January 2012, McKinsey.com.

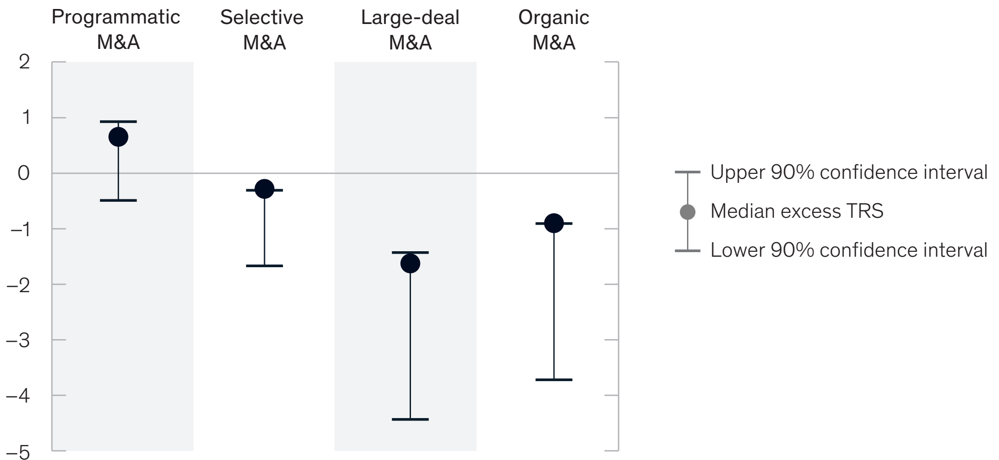
[2] The definition of programmatic M&A is when a company makes more than two small or midsize deals in a year, with a meaningful target market capitalization acquired (median of 15 percent).

[3] In the large-deal approach, a company makes one deal or more per year, and the target market capitalization is equal to or greater than 30 percent of the acquirer's market capitalization. In the selective approach, a company makes two or fewer deals per year, and the cumulative value of the deals is more than 2 percent of the acquirer's market capitalization. In the organic approach, a company makes one deal or fewer every three years, and the cumulative value of the deals is less than 2 percent of the acquirer's market capitalization.

Exhibit 1

Programmatic acquirers achieved excess total returns to shareholders that were higher than the median.

Median excess TRS for companies that remained in the Global 1,000 from Dec 2007 to Dec 2017,[1] %



[1] TRS = total returns to shareholders. Global 1,000 comprises companies that are among top 1,000 by market capitalization; excludes companies headquartered in Africa and Latin America.

Source: Global 1,000 2017; Thomson Reuters; McKinsey analysis

When we looked even closer at the data, we saw some striking differences in what high-volume deal makers do relative to peers. For example, the programmatic acquirers were twice as likely as peers to estimate revenue and cost synergies at various stages of the deal-making process, and they were 1.4 times more likely than peers to have designated clear owners for each stage.[4]

These findings are consistent with our experience in the field, in which we see that programmatic acquirers have built up organizational infrastructures and established best practices across *all* stages of the M&A process—from strategy and sourcing to due diligence and integration planning to establishing the operating model. In this article, we will consider how programmatic acquirers typically manage each of these stages.

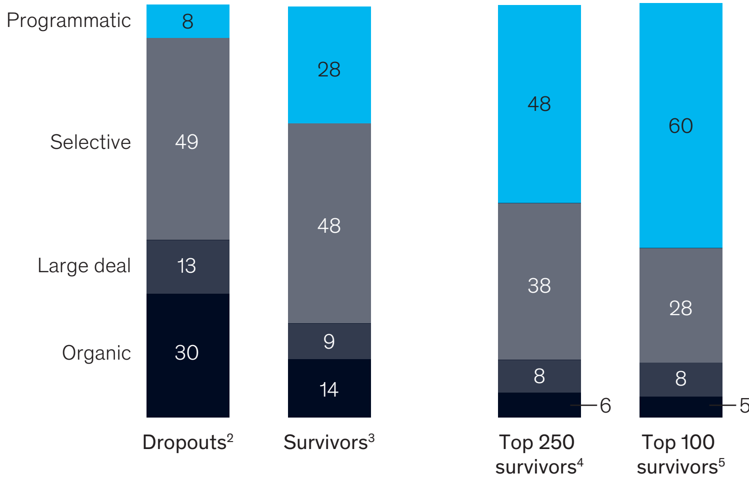
The programmatic model may not be the right fit for every company, of course. Some businesses may contend with organizational limitations or industry-specific obstacles (consolidation trends and regulatory concerns, for instance). Regardless, it can be instructive for companies with *any* type of M&A program to understand how some companies are taking advantage of the programmatic approach.

[4] 2019 McKinsey Global M&A Capabilities Survey.

Exhibit 2

Programmatic acquirers comprise nearly one-third of the companies that remained in the Global 1,000 over ten years.

Distribution of 2007 Global 1,000 in 2017,[1] %



[1]Global 1,000 comprises companies that are among the top 1,000 by market capitalization; excludes companies headquartered in Africa and Latin America. Figures may not sum to 100%, because of rounding.
[2]Companies in Global 1,000 on Dec 31, 2007, but not on Dec 31, 2017 (n = 178).
[3]Companies in Global 1,000 on both Dec 31, 2007, and Dec 31, 2017 (n = 686).
[4]Companies among top 250 companies in Global 1,000 on both Dec 31, 2007, and Dec 31, 2017 (n = 157).
[5]Companies among top 100 companies in Global 1,000 on both Dec 31, 2007, and Dec 31, 2017 (n = 65).

Source: Global 1,000 2017; Thomson Reuters; McKinsey analysis

Strategy and sourcing

Most of the programmatic acquirers we interviewed said they work hard to connect their strategies with their M&A priorities. The hard work starts with a return to first principles: the development of a blueprint for bringing strategic goals into deal-sourcing discussions. An effective M&A blueprint delineates the limitations of pursuing certain deals and provides a realistic snapshot of market trends—for instance, “Which market-shaping forces are the most promising within our sector, and how are our competitors likely to evolve?” Additionally, the M&A blueprint can help programmatic acquirers identify whether or not they may be the best owner in any deal or transfer of assets—for instance, “What are our sources of competitive advantage, and what capabilities are we trying to acquire?” Finally, the blueprint can help companies assess how realistic it may be to expect success from a deal—for instance, “Are assets readily available, or are they overpriced? Do we have the relationships required to carry out this transaction? Are regulatory constraints too much to overcome?”

These were the kinds of questions senior leaders at one consumer-products company asked themselves as part of a recent deal. The leadership team strongly believed the company needed to expand its presence in China and asked the M&A organization to identify potential acquisition targets. The debate over which regions to focus on went on for several weeks, until senior leaders and the M&A team realized they needed to revisit the base strategy. In a series of fact-finding meetings that took place over

Sidebar

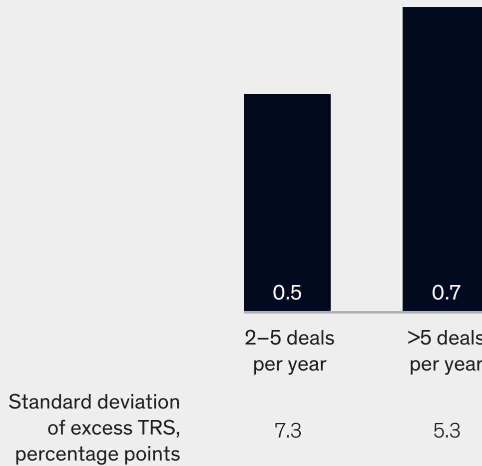
The staying power of programmatic acquisition

In our ongoing research, we track the largest (by market capitalization) 1,000 global companies, measure excess total shareholder returns they created compared with industry peers, and look at the type of acquisition strategy these companies deployed. The data confirm that programmatic acquirers continue to perform better than industry peers; indeed, the more deals a company did, the higher the probability that it would earn excess returns (exhibit). Precisely because these companies are doing deals systematically, we believe they are building lasting, distinctive capabilities in M&A.

Exhibit

Among programmatic acquirers, making more than five deals a year raised the probability of earning excess returns.

Median excess TRS for programmatic acquirers that remained in Global 1,000 from Dec 2007 to Dec 2017,[1] %



[1] TRS = total returns to shareholders. Global 1,000 comprises companies that are among top 1,000 by market capitalization; excludes companies headquartered in Africa and Latin America.

Source: Global 1,000 2017; Thomson Reuters; McKinsey analysis

an eight-week period—and referring back to their M&A blueprint—the senior leaders and the M&A organization identified the amount of capital required to meet their goals, specific market trends and customer segments in China, and the potential advantages the company could confer to a target (primarily, its global distribution network). Once senior leaders at the consumer-products company had systematically explored such questions, they were able to gain quick agreement on a handful of potential targets in specific regions, several of which had not even been mentioned during the initial discussions.

Due diligence and integration planning

The programmatic acquirers we interviewed said they often tackle due diligence and integration planning simultaneously—holding discussions far ahead of closing about how to redefine roles, combine processes, or adopt new technologies. Having the right resources at the ready seems to be a key tenet for these companies. It was for one consumer-products company that, at the outset of its merger with a target, modeled the optimal sequence for migrating general and administrative tasks from both companies to a centralized shared-services group, thereby jump-starting the overall integration process.

Corporate culture and organizational health—both their own and that of the target companies—also seem to be important concerns for programmatic acquirers. Our research shows that programmatic acquirers are more likely than peers to pay close attention to cultural factors during both diligence and integration processes.[5] For instance, the integration team at one technology company closely tracked the balance of employees who would be selected for the combined entity from across both the parent company and the target. If any area of the business was not achieving a balance that matched the relative scale of the merger, team leaders intervened. Additionally, employee selections could not be approved without ratification from the integration team. If two candidates were deemed equally suitable for a role, the team tilted its selection to the target-company candidate, recognizing that managers in the acquiring company likely already had a built-in unconscious bias in favor of the homegrown employee. If neither candidate was considered suitable, the team moved quickly to recruit externally (for more, see “The secret ingredient of successful big deals: Organizational health,” on page 65).

M&A operating model

A programmatic approach won’t work if you don’t define the program and don’t treat M&A as an enduring capability rather than a project or occasional event. Our research shows that, compared with peers, programmatic acquirers often focus on building end-to-end M&A operating models with clear performance measures, incentives, and governance processes. For these companies, the devil is in the details. Potential acquisitions are not evaluated ad hoc, for instance. Instead, all the decision makers

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[5] 2019 McKinsey Global M&A Capabilities Survey.

and the criteria they are using are clearly defined and made transparent to all stakeholders. “If it’s truly a program, then for each type of opportunity, you need to say, here are the targets that would constitute a doubling down, here are the targets or products we’d like to have, and here are the targets for the distribution we want,” one partner at a private-equity company explained to us. “It has to be systematic.”

To that end, one technology company treats M&A in much the same way it does customer acquisitions: it uses a customer-relationship-management-like tool to manage its M&A program. The tool is an online database of hundreds of companies that the technology company actively monitors as potential targets. Using a series of customizable dashboards, the corporate-development team updates the database and tracks statistics about acquired companies and which targets are in which phases of acquisition. (Business-unit leaders are also tasked with keeping this information up to date.) The corporate-development team generates reports, and the head of M&A analyzes the data and tracks progress on deals. The tool enables accountability across all phases of M&A; it is even invoked during executives’ performance reviews.

A clear takeaway from our research is that practice still makes perfect. By building a dedicated M&A function, codifying learnings from past deals, and taking an end-to-end perspective on transactions, businesses can emulate the success of programmatic acquirers—becoming as capable in M&A as they are in sales, R&D, and other disciplines that create outperformance relative to competitors. Q

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Compound growth at MilliporeSigma

CEO Udit Batra describes what it took to fuse two vibrant R&D organizations, as well as the business value realized from their integration.

Expectations may have been tempered when Merck KGaA, Darmstadt, Germany, a 350-year-old, global pharmaceutical and chemical company, and its EMD Millipore division acquired Sigma-Aldrich in 2015 for $17 billion. After all, the business landscape is littered with the remains of "transformational" deals that fail to deliver.

Not so, in this case. Four years after the deal closing, the merged entity, MilliporeSigma, as it is known in Canada and the United States, has established its place as a leader in the market for life-science tools. The parent company gained the critical e-commerce capabilities and geographic reach it needed to grow, and the merged entity is now reaching more customers than ever.

In this conversation with McKinsey's Roberta Fusaro, MilliporeSigma CEO Udit Batra describes the strategy that motivated the deal, the customer-centric focus that animated the integration process, and the ways in which he and his colleagues approached myriad operational, organizational, and cultural challenges.

The *Quarterly*: *Let's start by helping readers understand MilliporeSigma's business. What products do you provide to customers?*

Udit Batra: We have a portfolio of more than 300,000 products that we market to researchers, regulated laboratories, and manufacturers. We sell filters, pipettes, high-grade research chemicals: essentially, all the products you'd need in a lab to conduct experiments. We also offer what we call "process solutions": the devices, systems, and compounds required in manufacturing environments to make and then purify small molecules and biologics that then become drugs. These range from bioreactor systems to chromatography equipment to filtration equipment to needles and filling equipment. The third part of our business is applied solutions, which is a mix of both segments.

The *Quarterly*: *How has your industry been changing?*

Udit Batra: Technology is dramatically changing the way drugs are discovered and developed. Take toxicology testing as an example. Traditionally, discovery teams have spent roughly $300 million to $400 million on toxicology studies before a drug gets into early-stage clinical studies. Now, we have technologies where you can do screenings in in vitro settings with genetically modified cell lines that often mimic what's happening in the human body—in many cases, better than rodent or primate models. Imagine the amount of savings you could generate and how much you could speed up drug discovery and development if you were to substitute toxicology studies on animals with in vitro tests.

The *Quarterly*: *What other big changes are underway beyond technology?*

Udit Batra: Researchers' expectations have also changed. In the old days, scientists would order the compounds, equipment, and any materials they needed over the phone or through a catalog. They'd get their order probably five or ten days later. Now, researchers expect the same fast service and delivery they receive when they order retail products from online sites like Amazon: with a deep and easily searchable list of product categories and delivery 24 to 48 hours from the time they initially thought of the experiment.

Finally, you don't have this dichotomy of emerging and developed life-science markets as much as you used to. More cell-therapy trials are going on in China than in any other country in the world. Many CDMOs [contract development and manufacturing organizations] and CMOs [contract manufacturing organizations] are using our products in China, much more so than in the developed world. So we're learning how technology is developing in China and adapting that and bringing it back to developed markets.

The *Quarterly*: *What was the strategic rationale for the merger between EMD Millipore and Sigma-Aldrich?*

Udit Batra: The previous chairman of EMD Millipore and leaders in the Merck family saw the impact of emerging technologies, connectivity, and globalization in the marketplace, and they wanted to stand up a successful scale player in the life-

science-tools industry. EMD Millipore was already strong in the process-solutions segment, with a broad portfolio of products to serve early-stage biotech customers. We had also built up expertise in regulatory and quality-control domains, both of which are key success factors in the process-solutions space.

The story was quite different in the research-solutions space, however. To succeed there, you needed a wide portfolio of small lab products, as we had, but our portfolio was not broad enough to include certain chemicals and reagents. You also needed to be able to share this portfolio with customers in a very simple way. Think of going to a retail store: If products are not well organized on the shelves, how will you find what you need? Here, we saw ourselves falling short.

Sigma-Aldrich's e-commerce platform gave us a simple interface with customers. We wanted to provide customers—especially small biotech companies that are often able to do experiments but not scale them up—with a one-stop shop. EMD Millipore could sell you what you needed to purify a protein; Sigma-Aldrich had the cell-culture media you needed to actually make the protein. We wanted upstream and down-stream processing to come together with this integration and to load legacy EMD Millipore products on SigmaAldrich.com. Finally, we wanted to expand our presence in North America—where Sigma-Aldrich already had a toehold in research and applied solutions—and build on EMD Millipore's existing reach in Europe and Asia.

The *Quarterly*: *What was the state of play when you arrived at EMD Millipore?*

Udit Batra: When I joined EMD Millipore as CEO in 2014, I didn't know about the proposed deal. At that time, it wasn't absolutely clear which approach would be best: organic or inorganic growth. The chairman and family said, "Here's what we're thinking: go explore, come back in six weeks, and tell us what you think." I got together with my team, and we considered the options. We estimated that if EMD Millipore went it alone, it would take five to ten years to get into the research-solutions market. We'd need to build an e-commerce platform and set up an organization that could manage all this complexity. Acquiring Sigma-Aldrich could accelerate everything. We proposed it to senior leadership after the six-week exploration period. Six weeks after that, in July 2014, we developed the financial case and presented it to the Merck family. In September 2014, we announced the acquisition.

The *Quarterly*: *The relative speed of that decision seems counterintuitive when you think about this being a 350-year-old company.*

Udit Batra: I had been told when I joined the company, "Well, we're very fast." I responded, "Right. There are four different boards in the company where you have to present quarterly results. How can we be that fast?" But being more than 70 percent family owned puts the company in a unique position. I'll give you an example: There was a point when a very small group of us were negotiating the final deal. We had gone to the limit that had been approved by our board as a premium, and the other side was asking us to go higher. Our chairman went into another room, picked up the phone,

and got permission from the head of the Merck family to increase the premium just a little bit. Waiting for another board meeting, another month, maybe even another quarter to get the permission we needed could have delayed the momentum we already had in the deal. Instead, we were able to get to terms quickly.

The *Quarterly*: *How did you go about bringing these two companies and cultures together? What were your first steps?*

Udit Batra: We started by explicitly defining what needed to happen in the period between when the deal was announced, in September 2014, to when it would close, which turned out to be November 2015. Rakesh Sachdev, the CEO of Sigma-Aldrich, and I had to balance our respective teams' enthusiasm for the change with the need to keep them doing their day jobs. There were a lot of good ideas coming from both sides. We heard a lot of "we could do this together, we could do that together." But we had to follow a careful process because we didn't have regulatory approvals yet. And during this interim period, we wanted to ensure that teams remained focused on existing customers. We convened a small planning team comprising leaders from both organizations to build a fact base on the joint portfolio, the financials, the organization, the customers—everything. This team worked independently; the process was kept entirely separate from the existing management and existing operations so as not to disrupt what was already working.

The *Quarterly*: *How did you organize and govern the merged company?*

Udit Batra: We established several core teams. My team, the life-science executive team, would meet monthly to make decisions on administrative topics. We also set up several oversight committees. One focused on identifying, monitoring, and managing innovation efforts across the merged organization. Another committee focused on operations—for instance, ensuring that we were managing our joint supply chain properly and harmonizing processes. These committees were created specifically for the integration, but we've maintained the ones that still make sense in the postintegration world—like supply chain.

We set it up so that most of our functions and systems radiated out from our parent company. That included HR systems, compensation systems, procurement systems—the only exception was IT. One of the biggest value drivers for the deal was the e-commerce platform. EMD Millipore did not have a great e-commerce platform, so we did not know what "great" looked like. We thought it best to let the Sigma-Aldrich team do what it was already doing best while we observed, so we kept the e-commerce, digital, and even IT-infrastructure teams separate at the beginning.

The *Quarterly*: *How did you track your progress?*

Udit Batra: We established something we called the integration-steering committee to make sure that integration efforts writ large were being managed and examined day in and day out and that we were on target with our goals. It included me, our CFO, and the CEO of Sigma-Aldrich.

Udit Batra

Vital statistics
Born January 7, 1971,
in New Delhi, India

Married and has 2 children

Education
Holds a PhD in chemical engineering from Princeton University and a BS in chemical engineering from the University of Delaware

Career highlights
MilliporeSigma
(2014–present)
CEO, life science

Merck KGaA Darmstadt, Germany
(2011–14)
CEO, consumer health

Novartis Vaccines and Diagnostics
(2009–11)
Head, global public health and market access

(2008–09)
CEO and country president, Australia and New Zealand

(2006–08)
Head, corporate strategy

Johnson & Johnson
(2004–05)
Global brand director, wound care

Fast facts
Board member, Greater Boston Chamber of Commerce and Massachusetts Biotechnology Council

Vice chairman, Mass High Technology Council

Advisory-council member, University of Delaware and Princeton University departments of chemical engineering

Central to everything was a relentless focus on the customers. To that end, we created a war room, where we monitored things like order-fill rates, delivery rates, customer-satisfaction scores, and other detailed customer-oriented metrics. Looking at revenue synergies, we wanted to put all EMD Millipore products on to the Sigma-Aldrich e-commerce platform, and we wanted to make sure customers in Asia and Latin America had quick and easy access to Sigma-Aldrich products. On the cost side, we set detailed spending targets that were cascaded down into the organization, and we looked at them every month. We made sure to share as much information as we could with employees; transparency was crucial to the integration.

The *Quarterly*: *How did you manage the integration of talent?*

Udit Batra: We were worried about losing critical skills and institutional knowledge, particularly in IT and e-commerce; we felt like we didn't have enough expertise in this area to make critical staffing decisions. This is partly why we kept IT and digital functions separate. We were quite deliberate about giving them freedom, letting them maintain their culture, and observing what worked and what didn't. In the end, that proved to be the right approach.

We also knew that in any such integration, we would lose the top layer—because you can't have two CEOs, two CFOs, and so on. In this case, many of the Sigma-Aldrich executives took on different roles in the merged company. Initially, there were two integration heads, one from Sigma-Aldrich and one from EMD Millipore. After closing, there was only one. At the next level, on my team, we spent a lot of time considering how and where to place people. Everyone was evaluated based on merit and fit for available positions. I would say we had about a 50-50 split between EMD Millipore and Sigma-Aldrich people on my team, and, over time, the best of the best have thrived. At the research level, if you're a scientist, you're less concerned about bureaucratic processes and more concerned about having the freedom to pursue experiments. So from the scientists' perspective, things in the lab weren't changing that much.

The *Quarterly*: *Was there an overarching philosophy behind everything, something you could articulate to employees?*

Udit Batra: The overarching principle in all this was to simplify. We used an approach we call "logic and love." This was our language for change management. It refers to the balance we try to achieve between the hard aspects of transformation—like defining a clear strategy, metrics, and governance—and softer aspects, like encouraging brand unity and a sense of passion and purpose in our work. We reiterated to all involved that our purpose was to solve the toughest problems in life science in collaboration with the global scientific community. We were already working in a dynamic culture, full of curiosity, and we wanted our strategy, our brand, and our talent to reflect that. We didn't want employees at Sigma-Aldrich perceiving us as the big company in Germany coming in and imposing our processes.

The *Quarterly*: *Can you share examples of any tensions that emerged during the integration and how you alleviated them?*

Udit Batra: Well, when you acquire a publicly traded company, the center of its universe is wherever its headquarters is. St. Louis was the center of the world for Sigma-Aldrich, and suddenly, all decisions were being made in either Boston or Germany. We had to combat that perception directly. From the time I was announced as life-science CEO, I was going back and forth to St. Louis every week. Eventually, I was going every two weeks, and now I go once a quarter or even twice a year. And it

wasn't just me: members of my team visited with employees at more than 20 different sites within a 72-hour period just before the deal closed. We wanted to make sure that people understood that decisions were not being made in a vacuum.

There was tension initially with our IT organizations and the need to reconcile technology systems. This function had traditionally resided at our headquarters in Germany. But now there were two IT departments, and both wanted to showcase and maintain their own best practices. Keeping them separate initially helped to diffuse the tension, or at least it bought some time to take inventory of systems and capabilities and how those supported our new strategy. In all decisions, we followed the principle of first among equals—whoever had the better idea, the better system, the better process won the day. To that end, we convened working groups drawn from both IT organizations and from other functional groups in both companies to identify particular infrastructure requirements and issues. And by the middle of 2017, we were able to combine teams and address many of those pain points.

The *Quarterly*: *How do you think the integration looked through the eyes of your customers?*

Udit Batra: We waited to bring the sales forces together until the end because we wanted to get ourselves organized internally before doing anything to alter customer interactions or perceptions. We acknowledged that we would have a bit more head count for a while, but we deemed it a priority and found ways to cut costs in other areas. We said, "The focus has to be on preserving sales and customer service." We really didn't want to experience a decrease in either area. For the most part, customer-satisfaction scores showed that people were staying with us throughout the transformation.

Senior leaders use a specially designed "learning map" to guide employees through all the phases of integration.

It all starts with the top line, which sounds rather straightforward, but to get it done, you really need to make sure the processes are right. For instance, Sigma-Aldrich had a state-of-the-art e-commerce and distribution system. It used automation and had established centers that were shipping 15,000 to 20,000 small packages every day. EMD Millipore had built a system designed for shipping large products, like bioreactors and mixers, but had less success managing small products with fast turnarounds. We had to marry all these discrete EMD Millipore products to Sigma-Aldrich's systems. As I mentioned, we established a war room, where our head of supply chain was monitoring performance numbers daily and then sharing them with me at least once a week. In the case of distribution, for instance, fill rates became very important. How fast can a product be shipped once it's ordered? If a product or category of products could be shipped within 24 to 48 hours, it received a "1" score, and, if not, it received a "0" score. Then we took a weighted average to calculate fill rates. Before the acquisition, EMD Millipore had achieved fill rates of roughly 80 percent. Sigma-Aldrich was getting to the 90 percent mark. After the acquisition, the fill rate for the combined entity was at 95 percent.

The *Quarterly*: *It's been four years since the integration was finalized. What does MilliporeSigma look like today?*

Udit Batra: We've essentially outpaced the market in terms of sales growth since we announced the deal. We are gradually realigning all our SKUs into just a handful of umbrella brands and providing simpler ways for customers to interact with MilliporeSigma. Our margins are now 400 to 500 basis points higher than the next competitor, and our innovation intensity is now twice what it was when we started this process. In 2014, roughly 2 percent of our sales were driven by innovation of products launched in the previous five years. Today, that number is slightly shy of 5 percent.

We've reorganized ourselves to emphasize this innovation. Two years ago, we formed three "promise ventures," which are small, incubator-type businesses within MilliporeSigma. One is focused on gene editing and cell therapy, which are both hot areas in life science right now. The second promise venture is focused on building and selling end-to-end processing solutions for small biotech companies. We started off with three customers that wanted us to help them make their first processes to get their drugs into the clinic; within a year and half, we grew to about 15 customers, and we've established dedicated sites in Boston, France, and Shanghai to deal with the demand for these services. And the third promise venture is focused on digitizing the lab. It involves developing a platform where scientists can get data from their instruments, manage the inventory in the lab, and do it all remotely. It's kind of like the thermostat-monitoring technology you have in your house but for the lab.

Each promise venture has its own P&L [profit and loss] and is led by its own CEO. They've been successful enough that we are now thinking about what the next promise ventures should be. Fifty percent of our capex [capital expenditures] go into these growth drivers.

The *Quarterly*: *What advice would you offer to other companies that are undergoing integration or transforming themselves through M&A?*

Udit Batra: First, you must spend time listening and learning. And it doesn't have to be for an inordinately long time, but you need to get a comprehensive understanding of the situation. You can conduct deep, fact-based analyses; or you can read through analysts' reports or other literature; or you can just talk to people, colleagues. Probably, it's best to do all of those things.

Second, you must be the "simplifier in chief." Provide tools and processes people can use to guide them through the integration. We used learning maps, for instance, and introduced problem-solving frameworks to help focus the organization and remove some of the fear of change.

Third, focus on the top line before you focus on costs. It can be tempting to quickly go after cost targets, but you run the risk of losing sight of what had made these companies so successful in the past.

Finally, build a personal connection to the culture. As a leader, you need to present a fact-based case for change, but you also need to appeal to employees' desires to feel included in decision making and to be part of something bigger than themselves. When you walk around, people will know if you're interested in the products or the company mission or not. You cannot fake it.

The *Quarterly*: *How did your own personal-leadership style need to change?*

Udit Batra: Well, I think I have become much more deliberate about decisions. By that I mean, I ask myself if the decision is mine to make or someone else's, if it's the right time to make the decision, and what the second-order effects might be. I have also come to learn the difference between motivation and inspiration. Motivation can be fear based, or it can be financial. But inspiration has to come from a personal connection, a place of authenticity. To lead an integration, you need a little of both. You must also personally feel inspired by the possibilities in acquisition and integration—because these are difficult, demanding business transformations. Q

Udit Batra is the CEO of MilliporeSigma. This interview was conducted by **Roberta Fusaro,** a member of McKinsey Publishing based in McKinsey's North American Knowledge Center.

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The secret ingredient of successful big deals: Organizational health

Creating value from a merger is not easy. Acquirers that get it right start with an overlooked advantage: a healthy organization.

by Becky Kaetzler, Kameron Kordestani, and Andy MacLean

For years, McKinsey research has shown that a programmatic approach to M&A generates the most value in deal making. The least successful approach? Large (greater than 30 percent of an acquirer's market capitalization), infrequent deals.[1]

That said, the variance is high, and major acquisitions can work to your advantage—particularly if your organization is healthy. Our latest research finds that acquisitions by healthy companies tend to perform better than do those by less healthy ones. We've also identified three critical behaviors (selecting the right people, maintaining a strong external focus, and running a tight ship internally) that typify healthy organizations and are tightly connected with the creation of deal value. In this article,

[1] Based on an evaluation of M&A programs (as opposed to individual transactions) over varying ten-year periods.

we lay out those research findings and then illustrate them with examples of healthy acquirers in action.

Organizational health and the big deal

For almost two decades, our Organizational Health Index (OHI) has been monitoring health across a hundred countries and well over a thousand companies, aggregating the views of millions of employees and managers on management practices that drive nine key organizational dimensions—or "outcomes," as we call them. We assign scores to each practice and outcome, allowing a company to see how it compares with others in the database. Time after time, companies with a healthy culture dramatically outperform their peers. In fact, publicly traded companies in the top OHI quartile generate three times the total returns to shareholders achieved by those in the bottom quartile.[2]

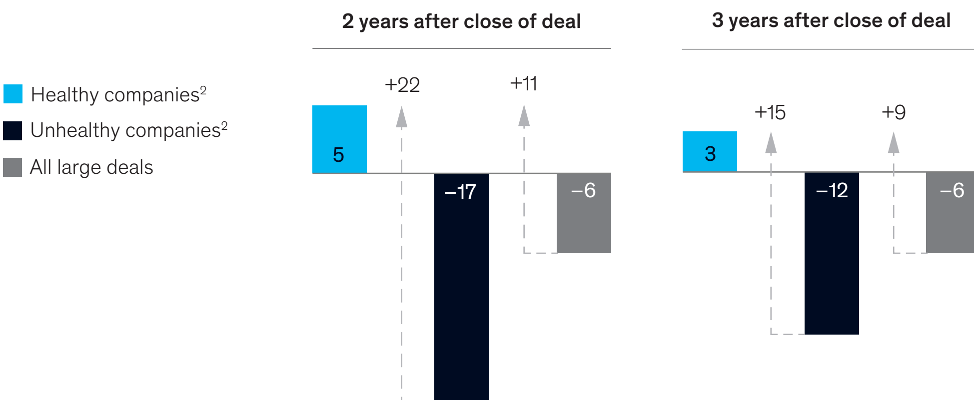
The numbers suggest that organizational health matters immensely in the M&A context too. Our research finds a strong correlation between the preclose organizational health of the acquirer and the postclose financial performance of the newly combined company. Acquirers in the top half by OHI score gain, on average, 5 percent in excess total returns to shareholders (TRS) compared with industry peers after two years, while the change in excess TRS of unhealthy companies is –17 percent over the same period (Exhibit 1).

[2] Based on McKinsey's Organizational Health Index data collected over more than 15 years. The index aggregates the views of employees and managers on the daily cultural behaviors they observe across a set of 37 management practices.

Exhibit 1

Unhealthy acquirers destroy value, while healthy acquirers create value and tilt the odds toward success.

Median change in excess total returns to shareholders,[1] %



[1] Measured using companies' excess total returns to shareholders compared with their industry peers, to isolate effects from those of broader industry trends. Gaps are measured in percentage points.
[2] Healthy companies defined as those with Organizational Health Index scores within top 2 quartiles; unhealthy companies defined as those within bottom 2 quartiles.
Source: Organizational Health Index by McKinsey

The behaviors that matter most

Since deals in which an acquirer is adding more than 30 percent of its market capitalization are almost axiomatically transformational, the stakes are high indeed. They're also getting higher. In 2018, the upsurge in large deals raised the total value of announced deals globally by 17 percent. So it's understandable that would-be acquirers invest substantially in target scanning and number crunching as part of their due diligence. Yet most don't match that effort when it comes to *self*-diligence. Leaders considering a large acquisition, our findings suggest, should first assess their organization's own health to better gauge whether or not to take the merger plunge.

When considering whether your own organization measures up, it's important to recognize that there is no single blueprint for organizational health. Distinct sets of approaches work best for specific situations. That said, three behaviors that are typical of heathy organizations also are strongly correlated with the creation of deal value. We're not suggesting that these attributes—talent management, external focus, and internal discipline—are a substitute for performing other critical M&A practices. Rather, they are more like prerequisites for getting big deals right (Exhibit 2). Healthy companies are more likely to deliver on these priorities throughout the merger process because they are an extension of characteristics that those companies display in the ordinary course of business and are part of the organizational fiber.

Exhibit 2

Three behaviors of healthy organizations are strongly correlated with the creation of deal value.

Behavior	Related organizational-health practices
Talent management Selecting the right people	**Talent acquisition—**selecting the best candidates to deliver the new vision and strategy by searching across both companies, as well as externally
External focus Keying on stakeholder communication	**Customer focus—**seeking and acting on customer feedback with tailored approaches where appropriate **Business partnerships—**collaborating with external partners to enhance performance of the newly merged company **Capturing external ideas—**bringing in best practices/methods from outside the organization to invigorate the company and spark innovation
Internal discipline Running a tight integration process	**Financial management—**maximizing economic performance and synergies through clear oversight and control of finances at all levels **Role clarity—**supporting individual accountability by creating a clear structure for roles and responsibilities **Performance transparency—**linking results to incentives and recognition; making them transparent internally to motivate employees to perform **Consequence management—**providing attractive incentives for high performers and clear consequences for underperformers

Source: Organizational Health Index by McKinsey

Talent management: Selecting the right people

Our research shows that getting the talent side right is the most important organizational-health lever in creating large-deal value. Given the pull of institutional loyalty and the press of long-standing personal relationships, decisions about employees can be particularly fraught during a merger. Effective merger integration calls for selecting the right employees from both the acquiring and acquired companies and, when necessary, from outside them. That's hard to do under any circumstances but much harder from a standing start.

In the merger context, just as in day-to-day operations, a rapid, systematic approach to talent selection is imperative. At one technology company, the integration team closely tracked the balance of candidates who would be selected from across both companies. If any area of the business was not achieving a balance that matched the relative scale of the combination, team leaders intervened. Additionally, no selections could be approved until the central team had ratified them. If two candidates were deemed equally suitable for a role, the team tilted its selection to the target-company candidate, recognizing that acquirer managers likely already had a built-in unconscious bias in favor of the homegrown employee. If neither candidate was considered suitable, the team moved quickly to recruit externally. One pharmaceutical company we know also imposed a rule that unsuccessful candidates at any given level could not simply be passed on to compete for roles at the next-lowest tier. Decisions on "in" or "out" were direct and quick—and fair. By policing the policy strictly, the company was able to keep more junior, higher-potential employees from leaving the fold.

External focus: Keying on stakeholder communication

The behaviors that a company demonstrates in maintaining a strong external focus factor decidedly in large deals as well. Healthy organizations understand the importance of what their customers and partners value. If that compass fails, the complexity of fitting acquirer and target together can lead the merged organization to turn inward and critical integration decisions to be made without proper consideration for external stakeholders. Competitors will also have an easier road to attack if customer relationships are perceived as vulnerable or if brand authenticity is inadvertently diluted.

There is a huge scope for miscommunication and misinterpretation during the merger period, when, by definition, the companies undergo massive change. One acquirer we know successfully mitigated this risk by having senior leaders clearly articulate the value proposition for customers, spelling it out in a written letter, and directing account managers to make sure the message was communicated to customers in person. The considered touch of a face-to-face meeting, combined with consistent and carefully crafted messaging, reinforced the importance of external focus. Another successful acquirer closely tracked the volume of orders from existing customers from the moment the deal was announced. Any drop-off in normal volume was immediately flagged for intervention, and sales leaders were primed to zero in on the cause. The company aggressively kept in front of new challenges and successfully navigated through any merger turbulence.

Internal discipline: Running a tight integration process

Finally, it makes sense that applying behaviors essential to running a tight ship internally would pay off for companies undertaking a large deal. Internal discipline in the acquisition context starts with a standardized approach to deal screening, continues during due diligence with clear metrics on a target company's financial position, and proceeds through preclose planning and beyond as the nuances of individual contracts, customers, and commitments are made clear. To ensure that controls are enforced to their fullest effect, one acquirer moved its best financial talent to priority areas where it believed rigor was lacking—and communicated strongly what its expectations were and why it was making the changes. Another high performer made sure to identify which portion of its target's projected revenues depended upon the success of specific R&D projects. The company then ring-fenced these initiatives from being unduly disrupted by cost-savings programs and kept a close eye on their progress to ensure that accountability and expectations would remain clear.

Healthy companies apply the same level of rigor to the realization of synergies. A successful acquirer we know formally reviews progress on synergies, through carefully designed indicators, every two weeks. Consequences for success or failure in meeting performance goals are made clear, with direct action from the CEO when called for. Especially in large deals, even the best-laid plans can temporarily go awry. It's essential to reestablish a clear structure for roles and responsibilities without delay. With that in mind, one high-performing acquirer not only pronounces a clear set of "rules for the road" to define norms and expectations, it also implements a "buddy" mentoring program that pairs up the acquirer's personnel, who already understand existing rules, with the target company's employees, who need support as they adopt new—and more rigorous—practices. Another company publishes its sales results internally every month and circulates them to a broad audience across all its businesses to make sure that everyone is focused on the right metrics and that progress is absolutely transparent.

Conducting a transformational merger is one of the biggest bets a CEO can make. It can also be one of the most value destroying. Many would-be acquirers invest disproportionately in hard analytics and intricate projections on synergies they can realize from the target. But, too often, a company will pull the trigger on a major acquisition without first conducting an honest assessment of its own capabilities. That's a mistake. If you're not confident in your organization's health—and particularly in its talent-selection capacity, its external orientation, and its bedrock of practices and controls—chances are, your deal will fall flat. In other words, before you take on the responsibility of coming together with someone else, it pays to know yourself. Q

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Demystifying deal making: Lessons from M&A veterans

Two longtime experts in mergers and acquisitions describe what works—and what doesn't—in corporate deal making, including how to approach the role of activist investors.

In mergers and acquisitions (M&A), nothing quite beats experience. This is particularly true of so-called programmatic M&A, a systematic approach to finding and transacting a steady stream of deals over time along a common theme.[1] To help demystify the deal-making process—including what works and what doesn't—we asked two seasoned executives: Michael Carr, the coleader of global mergers and acquisitions at Goldman Sachs; and Russell Fradin, an operating partner at private-equity firm Clayton, Dubilier & Rice and former CEO and chairman of Aon Hewitt Corporation (and a McKinsey alumnus). Carr and Fradin spoke with

[1] See Chris Bradley, Martin Hirt, Sven Smit, and Andy West, "Research shows that smaller M&A deals work out better," *Harvard Business Review*, May 9, 2018, hbr.org.

McKinsey's Robert Uhlaner at a panel discussion at McKinsey's Global Business Leaders Forum in New York earlier this year. The following is an edited version of their conversation.

The *Quarterly*: *What practical steps can business leaders take to make M&A more effective?*

Michael Carr: There's often a sense of mysticism about M&A, and the [pressures of M&A] can lead people to throw everything they've learned out the window. So first, lay out the rationale: Why are we doing this, and how does it fit within our business and our team? Next, lay out the steps, because there's always going to be disruption in the process, and it often comes from external forces like competition from other buyers, so you need to be ready to respond. Most importantly, make sure your people are prepared, that they know their roles and what the delivery is supposed to look like. Once you have that, more than half the battle is taken care of. After all, these are just companies, and companies are full of people and processes.

Russell Fradin: In terms of programmatic M&A, you have to answer the question "What's the program?" And the program is you're either trying to do more of what you already do, or you're trying to buy a new product that you can leverage with your sales force or distribution, or you're trying to buy distribution in new geographies. Then you need a strategy that says, "In terms of our category, here are the targets that would constitute a doubling down, here are the targets or products that we'd like to have, and here are the targets for the distribution we want." Go about it in a systematic way.

Two other reasons to do M&A are diversification and capability building. [In my experience,] those two are likely to fail. Today, a lot of companies want to buy digital capabilities, and I'd be careful. I don't want to insult anyone, but do you really think the hottest AI [artificial intelligence] start-ups are looking to become part of [a hundred-year-old company]? In other words, are you really going to get the best of the bunch? If you're a strategic buyer, and capability building is the rationale, you need the people to stick around [after the deal], because what you're really buying is people—it's a mass-hiring situation. And then you get into questions like "Do I need retention bonuses? How do I teach them about the company?" Typically, if you're buying like for like, or a product that's in your industry, there is a greater likelihood of the cultures being a match. [Some companies are] just looking to cash out. I don't want to say it's never a good idea to buy capabilities, but, in general, if you're looking at the latest blockchain start-up or the latest AI company or the best analytics company—you need those people to stay. If you're looking at a company that just wants to cash out, it's a good time to run for the hills.

Finally, I've found that having M&A strategy and business development reporting to the CFO is a bad idea. The CEO shouldn't have that input filtered. I always kept the business-development function reporting directly to me. The CFO also had a key vote, but you don't want all the good ideas killed before they get to you.

The *Quarterly*: *How important is it for targets or potential targets to perceive a company as a good acquirer? And what, to your minds, does "good" look like?*

Michael Carr: In the M&A world, everybody develops a reputation, and unfortunately the reputation usually is built on the last bad transaction that they've executed or failed to do. As investment bankers, we spend a lot of time making sure the target knows what they're getting into. This will sound like a cliché, but what is the acquirer's ethos? Why are they who they are, and how do they operate? Are they honest people? Is this an organization that has a genuine culture? Of course, a lot of M&A is about earnings-per-share growth and other understandable and observable factors, but these ephemeral topics, the human element, [also are critical].

The *Quarterly*: *What are some ways that successful management teams create value from deals?*

Russell Fradin: First, a lot of what the market values is organic growth, so be careful not to think that M&A is going to solve all your problems. But M&A can accelerate organic growth if you do it right.

You have to have a clear strategy and be very well networked in your industry—and I don't mean just the CEO, but the entire management team. I used to include in all my regional managers' bonus plans that they had to raise [M&A] ideas, because the best ideas often come from the field.

The *Quarterly*: *How would you describe the impact of activist investors on M&A velocity and decision making?*

Russell Fradin: Having come from the management side, my answer will probably surprise you. And that is: more often than not, the activists are right, and management doesn't want to face it. When I recently joined the board of a public company, I asked them if they've looked at how an activist would attack them. If a company hasn't, that tells me it's not on their minds. What do you think the activists would be picking on? If management is not open to that alternative viewpoint, it's not a good thing. The CEO of one company where I'm a director simply published the cash [allocation] on their website—how much would go to stock buybacks, how much to dividends, how much to growth. An activist would look at that and say, "There's nothing to do here. They've already said they'll return the bulk of their cash to shareholders." But don't underestimate how smart these folks are. It's always the 20 percent where activists are wrong that management will pick on, not the 80 percent where the activists are right.

Michael Carr: Everybody tends to forget that shareholder activism has been around for a long time. Carl Icahn is over 80 years old! Shareholder activism, like it or not, is just part of a very complex market; it's a part of how markets function.

But activism has changed a lot, and activism defense has changed a lot. We measure this very carefully. When the [US Securities and Exchange Commission filings] that list shareholder positions—including activist positions—are published, we see a series of activist cases develop. And within 40 to 50 days after the positions are published, there will be either a settlement—and that settlement usually entails changes at the board level—or a proxy fight starts. Over the past several years, 85 percent of companies that have encountered activist investors chose to settle, because shareholders don't like proxy fights; [they] are very expensive and time consuming.

Many shareholder activists make a living out of criticizing companies' portfolios of businesses, and there are times when they're absolutely right. It's extremely disruptive to your organization when you sell a business, but everybody has to make those hard decisions. The best CEOs have the guts and the ability to sell businesses that aren't earning their cost of capital. The private-equity model is interesting because they have the luxury to choose when to sell, and the best investors are those who have the discipline to sell. Companies often don't have that luxury, and they also have to address the perceived stigma of selling a business.

However, if you feel that your business is starting to degrade, or the market in which it operates has some structural challenges, you will need to act. You need to be your own activist. Get ahead of it, because otherwise you won't have enough time to put together the necessary effort to beat the clock. Q

Michael Carr is the coleader of global mergers and acquisitions at Goldman Sachs; **Russell Fradin** is an operating partner at Clayton, Dubilier & Rice, the former president and CEO of SunGard, and an alumnus of McKinsey's New Jersey and Stamford offices. This panel discussion was conducted by **Robert Uhlaner,** a senior partner in the San Francisco office.

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Getting personal about change

The need to shift mind-sets is the biggest block to successful transformations. The key lies in making the shift both individual and institutional—at the same time.

by Scott Keller and Bill Schaninger

A surefire way to shoot yourself in the foot when you're leading a large-scale change effort is to ignore what's on the minds of your employees. In research we conducted for our recently published book, *Beyond Performance 2.0* (John Wiley & Sons, July 2019), we found that executives at exactly zero companies that disregarded an analysis of employee mind-sets during a change program rated the transformation as "extremely successful." Conversely, executives at companies that took the time and trouble to address mind-sets were four times more likely than those that didn't to rate their change programs as at least "successful."

Those numbers reflect the power of mind-set shifts. In human systems, they help to achieve the same effect as the transformation of a caterpillar into a butterfly or a tadpole into a frog: when employees become open to new ways of looking at what's possible for them and their organization, they can never return to a state of not having that broader perspective, just as butterflies and frogs can't revert to their previous physical forms. To achieve such a metamorphosis, leaders must first identify the limiting mind-sets, then reframe them appropriately, and finally make sure that employees don't revert to earlier forms of behavior. In this article, we take readers through the process to shift mind-sets, with a particular emphasis on why the final stage is so important and so difficult.

Identify the root causes of behavior that helps or hinders

The story of the Manchester Shoe Company, told by Benjamin Zander in his book *The Art of Possibility*, neatly encapsulates the significance of a positive mind-set. In the early 1900s, inspired by a desire to enter a faraway market, two traveling salesmen were sent as a beachhead into the region. A few days later, two telegraphs came back independently. One said, "Situation horrible. They don't wear shoes!" The other said, "Glorious opportunity; they don't have any shoes yet!" Imagine what would have happened if the company had acted only on the first message.

Now consider Gary Hamel and C. K. Prahalad's management fable of four monkeys sitting in a cage staring at a bunch of bananas accessible only by steps hanging from the roof. Whenever the monkeys try to climb the steps to reach the bananas, a blast of cold water blocks them. After a few days, realizing there's no point in trying to get the "forbidden fruit," they naturally give up. Some humans in the room then remove the water hose and, at the same time, replace one of the original monkeys with a new one. On seeing the bananas, it starts up the steps, but the other simians, being social creatures, pull it down before it gets blasted by water. The new monkey is startled, looks around, and tries repeatedly to scale the ladder, only to be repeatedly pulled back. Finally, the new monkey accepts the group code of conduct and doesn't bother to go for the bananas.

Over the next few weeks, the onlookers remove the rest of the original monkeys, one at a time, and replace them with new monkeys that have never seen the water. By the end of the experiment, with perfectly ripe bananas sitting on the platform above, and monkeys that have never seen a jet of water, none of the animals tries to climb the steps. They've all learned the unwritten rule: "you don't grab the bananas around here."

Hamel and Prahalad created this story not to represent any actual findings from the field of primatology but instead as a potent and memorable way to demonstrate a wider truth about organizational life—namely, that mind-sets ingrained by past management practices remain ingrained far beyond the existence of the practices that formed them, even when new management practices have been put in place.

Here are three business examples that underscore the perils of ignoring this lesson. Example one: a bank that identified how its high performers succeeded in cross-selling decided to roll out a change program with support scripts and good profiling questions for the other bankers to use—and was dismayed to find that these moves had a negligible impact on sales. A second example: a telco introduced a dramatically simplified process and rating system for performance reviews only to find that its leaders still avoided delivering tough messages. Finally: a manufacturer invested hundreds of millions in a knowledge-management technology platform meant to discourage hoarding and encourage collaboration—only to declare, several months later, that the system had been a complete failure.

In all these examples, the companies did a good job of recognizing the behavioral change needed to achieve the desired goals. Yet they didn't take the time, or use the tools available, to understand why smart, hard-working, and well-intentioned employees continued to behave as before (see sidebar, "Uncovering unconscious mind-sets").

At the bank, for instance, two seemingly good but ultimately performance-limiting mind-sets accounted for the failure of the new sales-stimulation tools and training. The first was "my job is to give the customers what they want"; the second, "I should follow the Golden Rule and treat my customers as I would like to be treated." At the telco, employees had a deep-seated, reasonable-sounding belief that "criticism damages relationships." At the manufacturing company, people had an underlying conviction that "around here, information is power, and good leaders are powerful leaders."

Sidebar

Uncovering unconscious mind-sets

The primary tool for uncovering subconscious mind-sets is an interview technique known as “laddering,” grounded in the theory of personal change set out by Dennis Hinkle in 1965. The ladder employs techniques such as role playing, posing hypothetical questions, provoking participants, prompting storytelling, and drawing linkages between current and previous statements. These efforts prompt people to reflect on their deepest motives and eventually lead them to state the values and assumptions they use to construct their personal world.

Although the laddering technique is powerful, its limitation is that it’s hard to scale in large, diverse organizations. A complementary technique, which provides for gathering a broader and deeper fact base about what’s going on beneath the surface, uses focus groups and visual cues. This approach involves putting a hundred or so pictures on a table and asking participants to choose the images that best represent their feelings on a given topic—for example: “What most energizes or frustrates you about the organization?” “What is your greatest hope for the organization?” “Which image represents what it’s like selling to customers?” “Which image represents how it feels to be in a performance review?” “Which image represents how collaboration and knowledge sharing work around here?” Pictures trigger a more honest, emotive, and visceral conversation than stock questions that start with “Tell me about . . .”

The third tool for more broadly understanding organizational mind-sets comes from the social-science methodology known as qualitative data analysis (QDA). This technique mines rich sources of textual data (such as reports, websites, advertisements, internal communications, and press coverage). It then uses linguistic techniques (narrative, framework, and discourse analysis) to identify recurring themes and search for causality. One basic and straightforward QDA method that many people are familiar with is the use of word clouds.

The single biggest barrier to rapid personal change is our propensity as leaders to say, "Yes, that's the problem and the shift we need. If only others would change how they think and behave, we would make more progress."

The upshot? By looking at—and acting on—only observable behavior, company leaders overlooked its underlying root causes. Consequently, the change efforts of all three organizations led to disappointment.

Reframe the root causes

Once the root-cause mind-sets are identified, the next step is to reframe those beliefs and thereby expand the range of reasonable behavioral choices employees make, day in and day out. That creates the caterpillar-to-butterfly effect described earlier. Would different beliefs, for example, have inspired expanded and better-informed behavioral choices for average-performing bankers? If so, which beliefs? Suppose they believed that their job—indeed, the way they add value for others—was to "help customers fully understand their needs" rather than "giving customers what they want." Also, what if instead of applying the "Golden Rule," bankers applied the "Platinum Rule": treating others as *they* (rather than bankers) want to be treated.

And what if the telco executives, in their performance-management discussions, had believed that "honesty—combined with respect—doesn't damage relationships; in fact, it is essential to building strong ones"? And what if the manufacturing managers had thought that "sharing information rather than hoarding is the best way to magnify power"? Had they believed that, the company very likely wouldn't have needed an expensive (and ultimately futile) knowledge-management system to help employees reach out to one another and share best practices.

Beneath each of the reframes described above, it's important to note, lies a deeper shift in worldview. For example, moving from the giving-customers-what-they-want mind-set to helping them fully understand what they really need reflects a move from subordinate to peer. Recognizing that honesty builds rather than destroys relationships reflects a shift from victimhood to mastery. And choosing to believe that power is expanded by sharing information, not that hoarding information is power, focuses on abundance, not scarcity.

The best examples of naming and reframing are not only profound (using practical, relatable terms that reflect these deeper changes in worldview) but also insightful (raising the subconscious to consciousness in ways that expand possibility), memorable (so issues can easily be raised and discussed in day-to-day work), and meaningful (specific to the organization and evoking a "that's so us!" response).

In this way, a retailer found it vital to shift from "listening and responding" (a reactive mind-set) to "anticipating and shaping" (a proactive one), and an engineering company that wanted to improve the way it captured external ideas found that it was consistently overoptimistic about results and underestimated its competitors. This company came to realize that these shortcomings were driven by a "winning means being peerless" (expert) mind-set, which led to increasingly insular behavior. Changing to the learner mind-set—"winning means learning more and faster than others"—prompted employees to look for best practices in competitors and beyond.

Human-health analogies reinforce the message of business examples. Consider the predicament of people with heart disease. Years of research have shown that most cardiac patients live considerably longer if they cut out smoking and drinking, eat less fat, reduce their stress levels, and exercise regularly. Indeed, many patients make a real effort to do so. Yet study after study has shown that 90 percent of people who have undergone surgery for heart disease revert to unhealthy behavior within two years.

Dean Ornish, a professor of medicine at the University of California at San Francisco and founder of the Preventive Medicine Research Institute, decided to reframe the underlying mind-set beneath the patients' narratives. He wanted to change it from "If I behave this way, I won't die" (fear driven) to "If I behave this way, my life will be filled with joy" (hope driven). In his words, "Telling people who are lonely and depressed that they're going to live longer if they quit smoking or change their diet and lifestyle is not that motivating. Who wants to live longer when you're in chronic emotional pain?" How much better would they feel, he thought, if they could enjoy the pleasures of daily life without suffering any pain or discomfort? In his experiment, 77 percent of his patients managed to make permanent changes in their lifestyles, compared with a normal success rate of 10 percent.

Make the change personal

Reframing the root causes of mind-sets that block change is a critical step in the right direction and can sometimes create the desired shift in behavior on its own. At the aforementioned bank, for example, once employees were exposed to the Platinum Rule, they could immediately see how much more productive following it would be. They simply had never previously thought about the impact on customers of the way bankers had been relating to them.

More often than not, however, employees struggle to change their behavior for reasons that are more emotional than intellectual. The single biggest barrier to rapid personal change, after all, is our propensity as leaders to say, "Yes, that's the problem and the shift we need. If only *others* would change how they think and behave, we would make more progress."

At one company we know, for example, leaders were asked to estimate how much time they spent tiptoeing around other people's egos: making others feel that "my idea is yours," for instance, or taking care not to tread on someone else's turf. Most said 20 to 30 percent. Then they were asked how much time they spent tiptoeing around their own egos. Most were silent. Psychology explains this dynamic as a very predictable, and very human, "self-serving bias." It involves viewing our own actions favorably and interpreting events in a way beneficial to ourselves. This explains why 25 percent of students rate themselves in the top 1 percent in their ability to get along with others. It's why, when couples are asked to estimate their contribution to household work, the combined total routinely exceeds 100 percent.

In many behavior-related areas, we human beings consistently overestimate how much we are part of the solution, not the problem, and role modeling change is one of these areas. On average, when leaders are asked if they "role model desired behavior changes," a full 86 percent report that they do. When the same question is put to people who *report* to these leaders, it receives only a 53 percent average positive response.

How best, then, to overcome this bias and help leaders and employees commit to changing *themselves*? Our own journey has led us to the deep conviction that offsite, workshop-based learning journeys of small groups of 20 to 30 employees are the most powerful intervention. These are typically centered on in-person working sessions, over two days, led by facilitators experienced in the principles of adult learning and knowledgeable in techniques developed in the field of human potential. The workshop methodology is grounded in the "U-process"—a social technology developed during a ten-year partnership between Generon International, Otto Scharmer and Peter Senge from the Massachusetts Institute of Technology, and the Society for Organizational Learning. The U-process has three phases:

- *Sensing.* This typically involves a senior leader who has already been through the workshop and shares the company's change story, describes her or his own personal change journey, and answers questions from participants.

- *Presencing.* This involves participants exploring their personal "iceberg" of behavior. It includes working through modular, discussion-based content and questions that equip leaders to achieve new levels of self-awareness and self-control. "Where and why do I act out of fear rather than hope? Scarcity rather than abundance? Victimhood rather than mastery? And what would be the result if I made different choices?"

- *Realizing.* In this phase, participants make explicit, public choices about personal mind-sets and behavioral shifts; identify "sustaining practices" that will help them act on their insights; and reflect on how they will engage their personal networks for the challenges and support they will need during the rest of their personal change journey.

Following these workshops, small groups typically convene to offer peer accountability and advice. After a number of weeks, there is a further facilitated session to take stock of changes in behavior.

We acknowledge that this approach will sound unduly "soft" to some. But we've seen it have a transformational impact on everyone from Dutch engineers to American investment bankers to Middle Eastern government officials to employees of South Korean conglomerates. While some organizations put all their employees through such a workshop, they can achieve most of the impact through a critical mass of people leaders, which the field of epidemiology has shown to be, typically, 25 to 30 percent of the total. In these cases, all leaders eventually shed the "if only *they* would change" mentality and replace it with a profound sense of "if it's to be, it's up to *me*."

Not every successful change program we have seen uses these techniques, but in our experience every change program that used them (in the context of other recommended interventions) has been successful, and in time frames far faster than most leaders had expected. The effect can be particularly positive when organizations grapple with how to thaw what's often referred to as "the frozen middle"—a change-resistant layer of middle managers.

Reshape the work environment

Victor Frankl was an Auschwitz survivor whose seminal book, *Man's Search for Meaning*, has long challenged and inspired readers across academic and professional disciplines. He summed up, in a compelling way, the full picture of what it takes to achieve caterpillar-to-butterfly-like personal change when he wrote: "Between stimulus and response there is a space. In that space is our power to choose our response." We find it helpful to use a shorthand version of Frankl's idea: S (stimulus) + T (how you choose to think about the stimulus) = R (response).

The S in this equation is vital for the aforementioned work on the T to fully take hold: after all, as the story of the monkeys illustrates, the work environment is a particularly powerful shaper of employee mind-sets and behavior, albeit a relatively slow-acting one. Nonetheless, if employees come out of workshops committed to change but find themselves back in the very same work environment that had ingrained their original mind-sets, it's far less likely that the new mind-sets will become truly personal—or permanent.

By way of analogy, imagine that you go to the opera on Saturday and to a sporting event on Sunday. At the climax of the opera, the very best part, you sit silent and rapt in concentration. You and the rest of the audience then offer a genteel clap. At the climax of the sporting event, also the very best part, you leap to your feet, yelling and waving and jumping up and down. You haven't changed; you are the same person with the same feelings, values, and needs. But your context has changed, and so has your mind-set about the behavior that is appropriate for expressing appreciation

and enjoyment—and therefore the behavior you choose to exhibit and the practices you choose to participate in.

When it comes to changing the stimulus (the *S*)—the work environment—employees are exposed to, we find that the four levers in McKinsey's "influence model" offer the most practical and proven guide (exhibit).[1] Our research and experience demonstrate that changes in thinking and behaving will be significant and sustained if leaders and employees see clear communications and rituals (the *understanding and conviction* lever); if supporting incentives, structures, processes, and systems are in place (the *formal-mechanisms* lever); if training and development opportunities are combined with sound talent decisions (the *confidence and skills* lever); and if senior leaders and influence leaders[2] allow others to take their cues from the leaders' own behavior (the *role-modeling* lever).

Many leaders wonder which of the four levers is the most important. Evidence shows that they all matter, with minor statistical variations in degree, and that people do not have to experience them in any particular order—the key is to ensure that all of them are experienced consistently. Communicating to employees that you want them to adopt sports-stadium mind-sets, practices, and behavior is no use if your evaluation

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

[2] See Lili Duan, Emily Sheeren, and Leigh M. Weiss, "Tapping the power of hidden influencers," *McKinsey Quarterly*, March 2014, McKinsey.com.

Exhibit

The "influence model" is a practical and proven guide for changing the mind-sets and behavior of employees.

systems, and the leadership moves that employees see, are those of the opera house. If you want people to think like sports fans, you must create a stadium environment that encourages and enables them to think and act differently.

We've discussed the importance and value of both the stimulus (the *S*) and the thinking (the *T*) separately, but in reality they are profoundly linked. One person's mind-sets (the *T*) drive that person's behavior (the *R*), which becomes the role-modeling part of the *S* for those who interact with this person—a testament to the importance of starting changes in the *T* at the top.

It's no accident that we've used a lot of stories in this article. Storytelling is powerful: it goes beyond facts and figures to stimulate and shape mind-sets. Thinking in terms of stories is also a helpful reminder that change is ultimately personal, as every story is open to individual interpretation and individual meaning. Along the same lines, if you want to lead change, you must take on both the contextual and personal dimensions. Mastering them is a challenge but also can be incredibly rewarding—not just for the organizations and people you're trying to lead but also for you as a leader and, ultimately, as a person. Q

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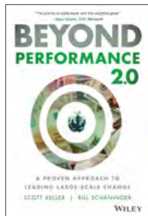


This article is adapted from the authors' new book, *Beyond Performance 2.0: A Proven Approach to Leading Large-Scale Change* (John Wiley & Sons, July 2019).

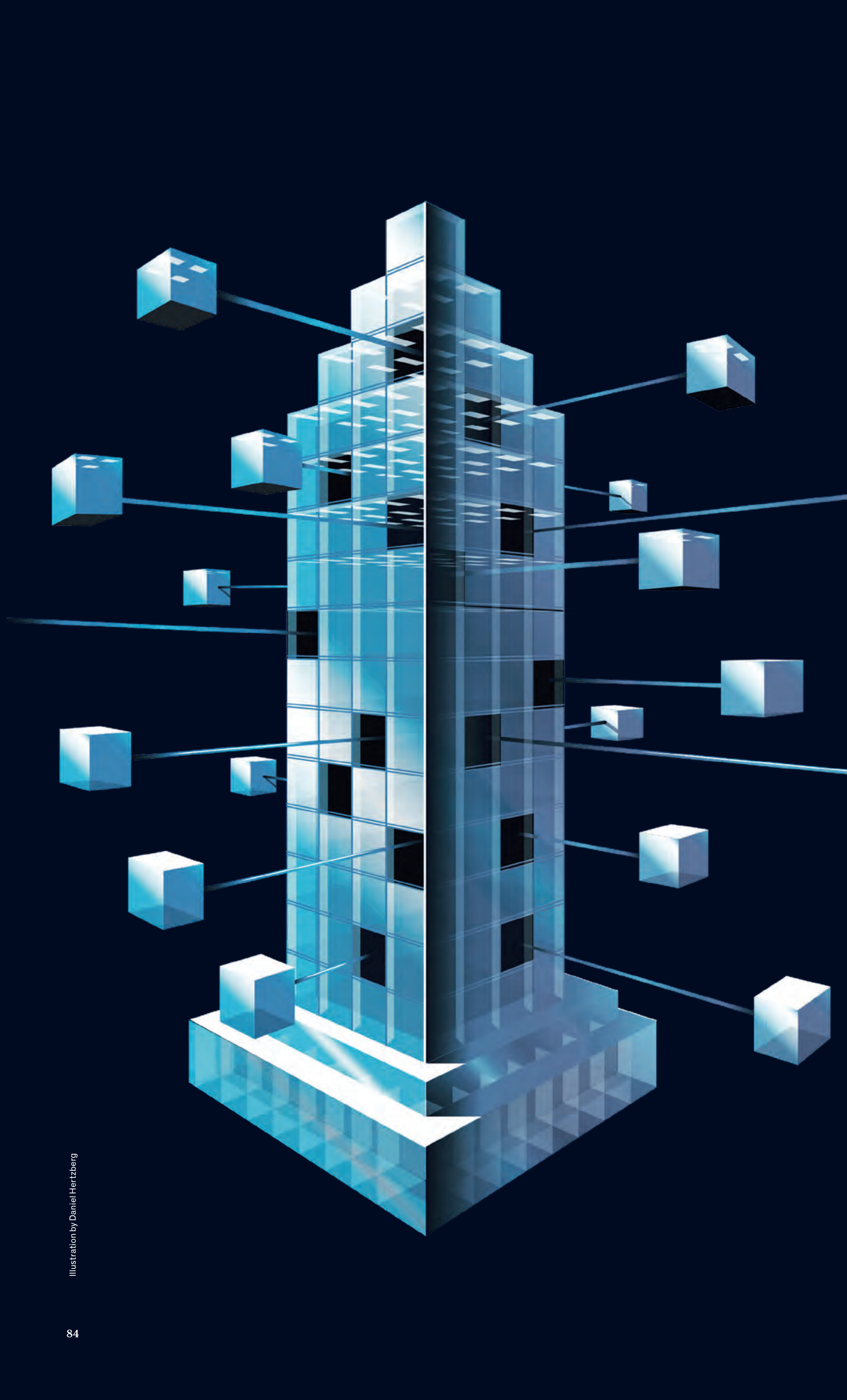
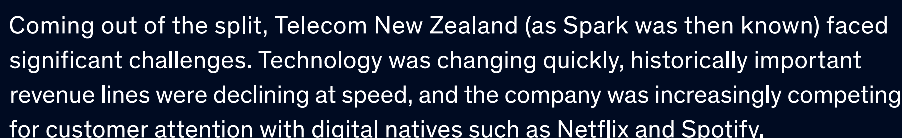


Illustration by Daniel Hertzberg

All in: From recovery to agility at Spark New Zealand

Key members of the telco's top team describe the challenges and rewards of going agile rapidly—and the power of a "no plan B" approach to change.

Big organizational changes are tough to pull off for any company, and arguably harder still for one with roots as a state-owned monopoly in a relatively small market. Yet for Spark New Zealand, the country's incumbent telecom operator, embracing change has been a way of life since late 2011, following the demerger of its fixed-access network.



Coming out of the split, Telecom New Zealand (as Spark was then known) faced significant challenges. Technology was changing quickly, historically important revenue lines were declining at speed, and the company was increasingly competing for customer attention with digital natives such as Netflix and Spotify.

In response, Telecom New Zealand embarked in 2013 on a turnaround program to lower its costs, rebalance its portfolio, and build the "performance muscle" the company would need to thrive. Telecom's longer-term goal was ambitious: turn away from its legacy infrastructure–oriented focus and aspire to become a true digital-services provider—effectively embracing the disruption sweeping the sector. Along with this move came a new name: Spark New Zealand, in 2014.

Making the shift, however, required a faster operational cadence. This led company leaders in 2017 to make the bold decision to implement agile work practices company-wide and, effectively, to take an agile approach to go agile. The resulting launch moved some 40 percent of Spark's employees into cross-functional teams (or tribes), comprising people from IT, networks, products, marketing, and digital. The agile transformation of the rest of the business began immediately after and has since reached all parts of the organization.

In this commentary, former managing director Simon Moutter, CEO Jolie Hodson (the company's former customer director, who succeeded Moutter in July), and

HR director Joe McCollum describe the arc of change at the company, as well as how they are confronting the challenges together as a “leadership squad.” Taken together, their observations underscore the importance of a joined-up top team in securing change—even when the changes require significant mind-set shifts for themselves personally.

This commentary is adapted from interviews conducted by McKinsey’s David Pralong, Jason Inacio, and Tom Fleming.

Time for a reset

Jolie Hodson: I joined Telecom New Zealand—as it was then known—as CFO in 2013, coming from a different industry. It was interesting to watch the behaviors and see how siloed an organization we were at that point. I recall some of the early conversations. Invariably, the sentiment would be, “We’re largely all good here; you should go have a look at *that* part of the company over there, because there’s something going on there you should be across.” The other thing I noticed was a lot of statements started with “Simon says,” like the children’s game. And I thought: hmm, this is curious, because I didn’t get the sense that Simon was that kind of leader. I think it was revealing about accountability and people’s mind-sets and people feeling they needed to use someone else’s power to have certain kinds of conversations. At this point in time, the company’s level of organizational health was low, and we knew we had a massive job to do.

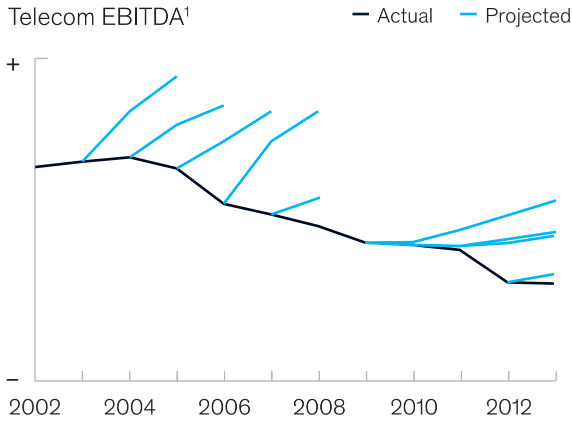
Joe McCollum: Back then, the analysts regarded us as one of the poorest-performing telcos in the sector. If you’re an organization in a fast-changing industry, and the rate of change externally is greater than the rate of change internally, then pretty soon you’re going to be out of step. It showed up as a lot of senior people playing out of position, in duplication of responsibilities. People honestly believed that the “good old days” would one day return and everything would be fine, which lulled us into believing we had all the time in the world to bring a new product to market. Whereas, in reality, you’ve got two, three months.

The result was missed targets. Drawn on a chart, it looked like a hairy spider leg—the result of all the business plans saying that performance would go one way when the actual performance of the company is going the other way. Yet here we were, happily writing business plans that purportedly solved the problem [see exhibit].

Simon Moutter: When I returned to Telecom as CEO in 2012, what I found was a company that was still in decline; we had a group of very capable people, but we were way too comfortable with losing. There was too much of everyone trying to do each other’s jobs, thinking they all had a veto right. It’s hard to get anything to happen when you need 30 people to say yes but only one person to say no [to stall a decision]. We had a lot of work to do giving teams clear roles to play and the accountability to deliver—this was critical in getting the organization reset. We also needed big investments in leadership and management capability, because those skills go soft when you’re in a losing company for a long time.

Exhibit

Hitting reset: In 2013, Telecom New Zealand looked back on a trail of missed targets.



[1]EBITDA = earnings before interest, taxes, depreciation, and amortization.

Source: Spark New Zealand Telecom

Jolie Hodson: We needed a mind-set of accountability and the daily rhythm it takes to be a retailer. We also needed to be much sharper about how we spent our money—getting everyone to value a dollar like it was their own. If I think of Everest as an analogy, then getting to base camp was all about business turnaround—buying into businesses that provided growth, exiting ones we didn't need to be in, slimming down the organization where we needed to—and getting the mind-sets right. And by the end of 2015, we had achieved a dramatic shift in mind-sets and put the company back on a growth trajectory.

The other thing that happened was that Simon made a courageous call about our brand. We didn't believe the Telecom brand could evolve in the way we needed to support the journey we were on. So Simon made the call to shift to Spark. And we've not looked back since then [see sidebar, "'Is this a scam?': Taking a rebrand from skepticism to support"].

Go agile to be agile

Jolie Hodson: As we looked around [after the turnaround phase], we thought: Do we have the "oxygen" to get to that next level? How do we make the choices? And what's really going to get us there? We didn't think it was so much about the *what*—we knew the goals we should be focused on and what we needed to do. Agile was much more about *how* we would get there.

Simon Moutter: The decision that we made in late 2017 to go "all in" with agile was not without experience of agile. What we felt wasn't so much doubt about whether agile was a good thing or not, it was deciding: Can it be a powerful thing if we apply it to the whole business rather than to areas that we would know it to be suited? I admit that at first I wasn't really willing to engage strongly in considering it—until I saw a groundswell from our people and from the leaders who reported to me that they were convinced. They believed in it and were also up for what it implied and what we would have to do to make it real.

Our leadership team visited a range of agile companies—some born agile, others that had built agile units, and one or two that had tried large-scale transformations. What I was looking for was a model that would work for a highly performance-driven business that has a lot on the go at any one time, by necessity, and was very focused on delivery.

I was impressed when we visited ING; I thought ING's model was structured, performance driven, and very applicable in our context—"agile for grown-ups," if you like. It was less about beanbags and foosball tables and more about real delivery action, and that gave me confidence that there was an outcome that—if we could deliver it—would make a big and enduring difference.

Joe McCollum: With all the bells and whistles, you can have a lot of fun with agile if you're a start-up looking down the barrel at an unbelievable level of growth. But if you're a big company in a low-growth industry, then it's very different. We're in a very constraint-driven world and knew that in our industry, "agile for kids" wouldn't work. Having regained the performance ethic, we needed to use agile to hold onto it—and to strengthen the performance muscle that we had put into this company. For us, it was about "How do we get better at what we're doing?" We saw agile as the next logical progression.

Jolie Hodson: We came back to New Zealand and went away for a couple of days as a leadership squad. Simon was pretty clear that as a business this wasn't a decision that only some of us could make. We were either all in and hugely committed or we weren't going to make it. There isn't a halfway ground with agile, certainly not going agile at this scale—because the old way of working would absolutely rub up against the new way of working. To be clear, we were doing this for improved customer experience, speed to market, and to empower our people. If we had two models clashing, it would be like being in molasses.

Joe McCollum: We sat around the table and said, look, we can move the company into agile; we've got two ways of doing it. We can either sit back and task ourselves with getting everything right, maybe dabble about with customizing the model, the language, and then we'll move to agile in two years' time. Or, why don't we give it a big run now instead? We'll try and get as much stuff right as we can manage; we'll have a bit of faith in the agile model in terms of design and effort. We'll put it all into agile, and we will openly tell our world: "We're going agile to be agile." Which means that we're not arrogant enough to think that we've got it right from the outset. We're totally open to learn and change.

Simon Moutter: You've got to do a lot of personal counseling of yourself, and the team needs to stay tight. It's not a situation where you can have the leadership team start to show any cracks in their intent. It's about belief, about being super-committed, turning up multiple times a week as a team and working for hours if necessary to clear roadblocks, to solve a communication gap, to make a decision, to apply resourcing—whatever it takes to get to the outcome.

We thought the risks were higher going slow than going fast. When you're in a business like ours, you have to execute across a couple hundred initiatives in parallel, into multiple markets, across multiple infrastructures, with all sorts of different people. And we make our overall numbers as the sum of a thousand small numbers. It's not a straightforward path. The risk of getting caught in no-man's-land—with one foot in the old world and one foot in the new—felt much higher to us than the risk of jumping across the line with both feet and using the agile ways of working to get better at agile itself.

'Is this a scam?': Taking a rebrand from skepticism to support

by Simon Moutter

The old brand, Telecom New Zealand, was seen as meaning "landlines." It was valued by business customers, as well as the older, richer, whiter consumer demographic—but it wasn't working for younger New Zealanders or a more diverse New Zealand. It didn't sit well with a digital-services vision for the future. Taking the decision to change our name was probably the biggest decision I'll ever make in my corporate career, because the brand was known to every New Zealander and draws on a history that is more than 100 years old.

To make the rebrand work, it had to become the centerpiece of the transformation story. We thought of it as a symbolic act, and a symbolic act in leadership terms allows you to motivate your people in a way that says: "We're making it real; we're not just turning up with lipstick on a pig." It also said to New Zealanders, "Give us another chance. We understand we got offside, and we're trying to tell you we're different."

Initially, the announcement was received with surprise. In fact, the immediate reaction was, "Is this a scam?" The first calls we got from the media were, "Did you guys know someone's out there making a release that says you're changing your name?" The skepticism externally was also quite high—it was 80 to 85 percent opposed. But we brought it to life very quickly, and within a few months it was 80 to 85 percent supported by customers.

Over the course of the six months between announcing our intent and doing the rebrand, the people inside the organization also shifted strongly from surprise and skepticism to support. They could see how it was showing up and how it was driving real commitment in the leadership groups to deliver a new, outstanding customer experience. But it was earned. It wasn't just "Simon says we're changing the name." Our people waited to be convinced, which is a good thing, actually.

Simon Moutter is the former managing director of Spark New Zealand.

We weren't prepared to spend more than eight months to get from the start of the program to what we called "flip day," the day we moved the engine room of the company into an agile model. And we took a "no plan B" approach. We simply never entertained the idea of failing, and I think that mentality is critical. If you have a get-out-of-jail card, you almost inevitably roll back to it.

New ways of working

Simon Moutter: We've been able to build excitement and a sense of pride around becoming the first telco in the world to go "all in" agile. We were able to engage our staff in the excitement of that possibility—that it wasn't like any old restructure that we've had in the past; it wasn't like shuffling deck chairs on the *Titanic*. It was genuinely an inspirational new possibility, pivotal to delivering on our ambition to become a digital-services company.

Our people bought into that vision quite quickly, and we backed it up with the most massive internal-communications program I've ever been associated with. It was extraordinarily well handled by the team, but it was a heavy load on leaders. A lot of face-to-face fronting up, lots of work to keep everyone excited about the potential.

Of course, we had people who were concerned, who were doubtful, who wondered if it might not be for them or if they were too old to get it or whatever. We had all of those emotions, but, actually, 98 percent of our people made the leap to say, "Well, I'm going to try it, this sounds like it could be a good thing." They recognized that it creates a lot of opportunities for people.

Jolie Hodson: When you're thinking about your organization in a completely new way, you can start with a clean piece of paper. What do we want it to look like? What is the mix of experiences? What are the capabilities we need? We took risks on people—people leading tribes and chapters—much bigger risks than we probably would have in the past. We've changed the leadership profile, which is a good thing. It's meant some people have been able to accelerate very quickly by having courage, taking risks, demonstrating new mind-sets.

Joe McCollum: In our pre-agile world, we would have had seven or eight layers between the top and bottom of the company. Now, across much of the company, we have three. The result is that things are massively faster. When you talk to people, you hear things like, "We're getting stuff done now in two weeks that used to take us three months." Emails have dropped off significantly, because back when the developers lived in one part of the building, and the marketing people lived over there, and the product people were in another part of the building, just to organize a meeting was 27 emails. All of that has gone. Now, there's ten of us sitting around a table. In fact—and not surprisingly—there's been a big drop-off in the use of our designated meeting rooms because of this. When you have a multidisciplinary team already working together around a table, why bother getting up and de-camping to a meeting room in another part of the building when they could simply stay where they are and solve the problem in real time?

The decision making is also a lot richer now, and transparency improved immeasurably. I can't stress this enough. Otherwise, you're in a world where people come in to work, they do their little bit, they go home, but they may have no idea where that fits into the big scheme of things. Agile puts direct ownership and real-time accountability with the squad so that they have absolute clarity about where it all fits now. That's where the engagement comes from—employee engagement goes off the chart because people have richer jobs, they've got a broader perspective, and they're focused on solving problems. They don't feel like hamsters—they feel like they're part of a squad that's on a mission.

Jolie Hodson: If you think about getting a product to market the old way, it could be quite slow, involving an idea working its way through multiple groups. In an agile setting, you're starting with having all the people in the squad who can largely give you an end-to-end capability. We even have customers work with us on some of these squads, too, which exponentially speeds up the time from idea to design to commercialization.

For example, we've partnered with Network for Learning to provide the fiber broadband and security layers to 2,500 New Zealand schools. In the past, the design process alone would take many months, with lots of documents flowing back and forth before testing or any migration of schools even started. Whereas in an agile model, we've already designed the new solution, rolled out the proofs of concept for different-sized schools, and migrated half of the schools in eight months. This would never have happened at that pace in the past. And it's changed the way we work with the customer. They didn't come to the squads to observe—they were coming to be part of the change, to have tasks and responsibilities like any other squad member. It helps them refine their own thinking and helps us build a much stronger working relationship.

Simon Moutter: I'm a crusty old guy from a long way back. [Laughs.] And having become a believer in agile rather than being born that way, I boil down the advantage to the fact that a squad can make a single choice off its backlog, and the minute they do, all ten people are very focused on outcomes delivered in short cycles. And they hold each other to account; it's the peer-to-peer accountability that delivers it. They're empowered by their ability to make choices and get on with it, with a high degree of confidence that they're doing the right thing.

Leadership challenges

Jolie Hodson: In a more command-and-control environment, the mind-set is about working in your narrow center of functional expertise, getting your stuff done, and moving it to the next area of the business. Agile, by contrast, is very much focused on: "How do I work across this group to deliver the outcome?"

There's a fluidity that's new; you've got a 90-day set of priorities, and at the end of those 90 days if we haven't achieved the outcomes then we may not progress the initiative further. That's quite different for a leader who is used to having their own sandbox, where they know the resources they have at the start of the year, and—so long as they're doing what they said they'd do—they might otherwise take the attitude of "speak to the hand."

Behaviors like listening and collaboration become more important. Curiosity and openness to other perspectives are critical too. You're creating a little silo of a tribe, but it's vital that these tribes work well across the company to get things done for customers.

Simon Moutter: By and large, decision making in a hierarchy occurs inside business units. A well-organized business unit will have most of the degrees of freedom it needs to solve problems, reallocate resources. It doesn't often have to branch across to other units to make trade-offs. That's not the case in our model. Decision making requires more clarity around priorities, and mechanisms for collaboration.

Joe McCollum: It puts pressure on leaders to be doers. There's a risk in traditional organizations that leaders get a lot of status, a lot of control, and they lose sight of what's really going on. But if you're leading a squad, 70 to 80 percent of your time is working with the people in the squad—it's not a "stand back," supervisory role. This may sound a bit unfair, but the shiny, presentation-orientated leadership skills where somebody gets up and looks good in a presentation—it doesn't mean anything here. It's the squad—the team—that looks at it and says, "Well, Bob's a good presenter, but Bob doesn't do very much in terms of delivery. Whereas Mary, who's very quiet, gets a lot of stuff done. If we have a choice, we'd rather put Mary on the team than Bob."

Becoming an agile top team

Simon Moutter: Most leadership teams in large, complex corporate environments function more like a working group than a team, because individual accountabilities tend to prevail over the team dialogue. They each have a business unit, and they're consumed mostly by the issues and decisions of that particular business unit. The overall coordination is a smaller part of the conversation.

Agile is very different. Now, you're the CEO, but you're also part of the leadership squad. It's an extremely tight team mission; it's hard work, but fun. But it's not simple to reset your leadership model. In our town-hall meetings, I used to say that I've been a hierarchical manager all my life and I'm pretty damned good at it. [Laughs.] And so this was a big change for me, too, to think about leading in an agile context. It's going to be challenging to anyone used to calling all the shots.

We work on a 90-day cycle—what we call the Quarterly Business Review, or QBR—and what this means for leaders is we must be alert and ahead of the game. We need to pick up problems early so we're not turning up halfway through to do a "rug pull" on a tribe or squad. I think there's a lot of sanctity in that "90 days of certainty" method—that every tribe and squad has the right to 90 days of certainty with the QBR. And I'll admit we've still got a lot of improving to do.

But as we have improved, as squads get results in a self-determining way, it's very empowering. When I think of the old adage that true empowerment requires forceful leadership, the forceful leadership in this model comes from coaching, from helping provide extreme clarity around what the vision is, what the main strategic platforms are, and therefore what each tribe's mission is.

Jolie Hodson: I think for us as leaders, it was quite a vulnerable time, because most of your career you've worked a certain way. Agile is a great opportunity to learn something new and develop, but it takes vulnerability to stand up there and say, "I know I'm here to lead you through this, but I'm learning too." To use the analogy of baking a cake, in the past you'd bake the cake, you'd ice it, and just when you're about to put the candles on you'd go and share it for feedback. Now, you're still beating the eggs and you're out there sharing it at this early stage to see what works and what doesn't.

Diversity—an unexpected benefit

Simon Moutter: I think the single biggest "aha" moment for me was about three weeks after we had set up our first front-runner tribes, which were the ones getting the internal learnings to help us on the journey to "flip day" as a company. When we walked on the floor, I could see the dramatic change that was occurring.

We've always had a diverse organization when you count up the numbers, but like many organizations it shows up in career groupings. For example, our IT team had an Indian influence, our marketing and HR teams had more younger women, and our network engineers were more likely to be older, Caucasian men. And like any traditional organization, the teams tended to work as compartments. When we saw them all together, sitting at multidiscipline squads around tables, we realized what a dramatic change this would be. That moment actually started us down a path we hadn't anticipated, to launch a major program around diversity and inclusion. It caused us to change the way we thought about employment, contracts, pay equity—because you could see that any unfairness would be exposed instantly in our new model.

It's been powerful for the organization to really see why inclusivity matters. We had a diverse organization, but we didn't have inclusivity right. Focusing on both is just the right thing to do, and we've all been struck by how much better it is when a diverse squad becomes truly inclusive. They know how to work together as a group, every voice comes to the table, and it's extraordinary how much better the outcomes are and how much better the workplace feels.

Jolie Hodson: Agile by its nature starts to break down barriers between groups, between cultures. "Where have I come from? What have I done before? Oh, you're marketing, you must be in the 'coloring in' department. You're tech, so you won't know anything about what customers want." Squads break all that down very quickly because they are your team, your buddies, the ones you work with every day to deliver to your customers. And, because squads are limited to no more than ten people and have a clear mission and purpose, everyone has to have a voice. There isn't a place for anyone to just cruise along.

You can see the change in people as you go through this. For example, at the start, if I visited a squad with a customer, you'd have some very extroverted people who'd be happy to jump up and speak to what the squad's doing. As time went by, the whole squad could do that really easily. It's great to see that growth in people; it's not an unintended consequence, it's one of the benefits of the approach, but to see it in real life after around six, seven months of working this way is pretty amazing.

Spark's next phase

Simon Moutter: It never sat well with me when I left old Telecom in 2008, because I didn't feel like I'd left the company in the right shape. That was a significant driver for me in coming back as CEO in 2012. By contrast, today it makes me proud that we are genuinely seen by the vast majority of New Zealanders to be part of the solution, not part of the problem. Spark is seen as a positive company, an innovative company, and our brand and reputation would be the strongest proof point of that position being recovered. Over the past two years or so, we've been winning a range of business awards, a number of which we weren't even getting nominated for before. We also have a degree of execution excellence now that has been noticed by investors. We say it, we do it.

The success is showing up in the "hard" numbers; our mobile market share is up eight percentage points, to 40 percent, since 2013—a huge turnaround. And it shows up in "barbecue conversations." When you are introduced to someone you've never met before at a barbecue or social event, and they ask, "What do you do for a living?" there's no need to mumble under your breath anymore and get ready for an onslaught of criticism. Back then, it was uncomfortable and inevitable that you would suddenly become the center of attention for all the wrong reasons. Today, people are proud to say they work at Spark, and the conversation immediately moves to all the new technology, or even: "Well, can you help me get a job there?"

Joe McCollum: Remember, we moved to agile to improve customer experience, improve speed to market, and, finally, to empower our people, and the hard numbers are beginning to stack up. From the "soft number" side of things, it's also been pretty good. We've improved our customer NPS [net promoter score] results—across all customer journeys and interactions—and we've seen almost a doubling of our employee NPS scores. In some key areas of the company, our eNPS results are +80—which is extraordinary.

And we're just getting started. On the agile maturity scale of 1 to 5, in most parts of the company we're really only at a 2 or 3. We're less than halfway through the journey, and we're already seeing significant benefits. Once we're further along, there are doors that will open for us that we simply can't envisage at the moment—a bit like a computer game where the next level reveals hidden doors in hidden walls. When we think of the new business opportunities—whether it's 5G, streaming, adjacent businesses—and the world-class customer-service backbone we're building, all combined with a super-engaged workforce, it's just such a winning combination. We're miles ahead of where we were six to nine months ago, and I think we will be miles ahead again in another six to nine months. I'm very excited about the next chapter of our story.

Simon Moutter: The next phase for Spark is to move beyond just being about connectivity. We can't achieve our purpose unless we support customers with all the things connectivity is used for—for example, the digital services that help people run a better business or live a more efficient or amazing life. I think we've set up a foundation to do exactly that. And we've got an outstanding leader in Jolie Hodson to take hold of

the helm. She has been a key part of our journey to date and knows what it takes, and I think she'll add great value as CEO from here. It's Jolie's turn; she's earned it, and I'm absolutely thrilled that the board has chosen to run with her. It's fantastic for the company and fantastic for her.

Jolie Hodson: If I think about where we were even three or four years ago, and the ways we've evolved from both a customer and business perspective, it's clear we've taken a real step forward. We've been creating a foundation in terms of the infrastructure and the IT, and especially in terms of our people. And if I stand back, it was our ability to shift from a company that was largely declining to one that's growing that I would be most proud to stand behind.

And not only are we growing into our positive financial results, but the perception around us has changed. We're seen as innovative, ready to try new things. When we do something, we do it with vigor. People want to be with us, work with us, and that's a fundamental change.

We're clear on the strategy we've developed and what we want to continue to do: focus on the future of wireless, engage our customers in ways that matter to them—including support and services. We started the journey with Spark Sport, and we see opportunities in cloud security, data, and other areas as well. And now, when we face any of these new areas, we have an organization that has the confidence, courage, and muscle memory to change—and understands that although there's ambiguity, change can lead to great new places. I'm excited about the opportunity in front of us—for our people and our customers, and for New Zealand as a whole. Q

This commentary is adapted from interviews conducted by **David Pralong,** a senior partner in McKinsey's New Zealand office, **Jason Inacio,** a partner in the Sydney office, and **Tom Fleming,** a member of McKinsey Publishing based in the Chicago office.

Jolie Hodson is the CEO of Spark New Zealand, succeeding Simon Moutter in July 2019. She joined the company in 2013 as CFO, was appointed CEO of Spark Digital in 2016, and became customer director in 2018.

Joe McCollum is the HR director at Spark New Zealand. Prior to joining the company, in 2012, he served as HR director at a number of companies, including most recently DMGT, EMI (now UMG), and Misys (now Finastra).

Simon Moutter is the former managing director of Spark New Zealand. From 2003 to 2008, he was chief operating officer of Telecom New Zealand; he rejoined the company in 2012 as managing director after having spent the intervening years as CEO of Auckland International Airport.

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Confronting overconfidence in talent strategy, management, and development

Best practices are well understood. But are companies following them as closely as their leaders claim?

by Tera Allas, Louis Chambers, and Tom Welchman

Many leaders we encounter insist that their talent- and people-development strategies are sound—and that their organizations are good at implementing them. Is this confidence warranted, and are companies living up to their leaders' assertions? Could these leaders be succumbing to the same optimism bias that motivates three out of four people to imagine that they are above-average drivers? The answers to these questions matter: companies with very effective talent management enjoy higher total returns to shareholders than less effective competitors do.[1]

The findings of a recent survey of 500 managers in the United Kingdom, part of a research project we conducted in collaboration with the Confederation of British Industry (CBI),[2] suggest that CEOs and HR leaders in particular may be taking a rose-tinted view. Asked to evaluate 21 generally accepted talent practices—in areas ranging from recruitment, employee engagement, and talent strategy to talent development and team efficiency—56 percent of survey respondents said that their organizations have adopted no fewer than 16 good practices. More than one-quarter said their companies have adopted all 21 (see sidebar, "A sampling of the 21 best talent practices by category").

When we looked at the responses by role, we noticed that CEOs and HR leaders appeared more bullish than the other managers: 64 percent of both HR leaders and CEOs said their companies were high adopters (deploying 16 or more of the practices), but only

[1] See "Winning with your talent-management strategy," August 2018, McKinsey.com.

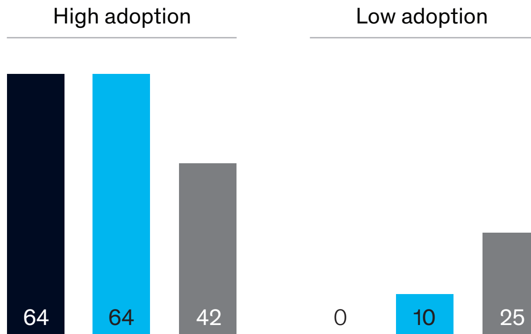
[2] See "Great job: Solving the productivity puzzle through the power of people," Confederation of British Industry, May 2019, cbi.org.uk.

Exhibit 1

CEOs and HR leaders are more upbeat than others in assessing the adoption of talent best practices.

% of respondents

Organization's adoption of talent best practices[1]



[1]High adopters deploy 16 or more of 21 generally accepted talent practices; low adopters deploy 5 or fewer.
[2]N = 28. While the sample size in this survey was small, a similar mismatch between senior leaders' and other managers' views of organizational performance has been recorded in many other studies.

Source: Confederation of British Industry–McKinsey survey of 501 UK managers, 2018

42 percent of all other respondents in our survey agreed. Similarly, CEOs and HR leaders were less likely than the others to say their companies were low adopters (Exhibit 1).

Corporate leaders also appeared optimistic about specific talent practices. CEOs, for example, were two times more likely than other respondents to say their companies excelled at "know[ing] who the best people are and put[ting] them to work on the most important business priorities." And they were also nearly twice as likely as others to say that managers and leaders at their companies "are evaluated against their people performance, not just their business performance."

Leaders: the limiting link?

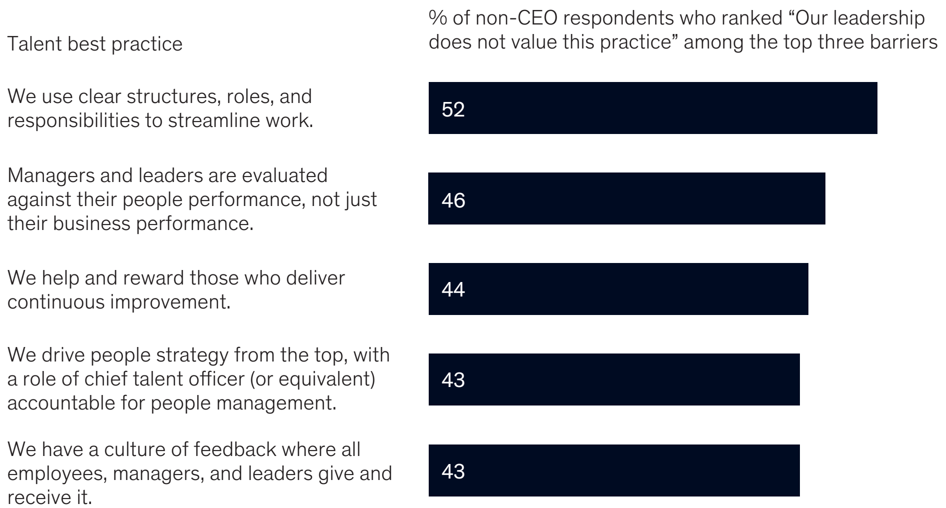
When survey respondents admitted that their companies had difficulty implementing the practices, they tended to identify company leaders and management as the biggest impediments. "Our leadership does not value this practice," for example, was cited by one-third of the non-CEOs—more than any other barrier—as a top-three reason various talent practices hadn't been embraced (16 percent of CEOs also cited this barrier).

The talent practices for which non-CEO respondents felt leaders' lack of support was most consequential were related to ways of working, talent engagement, and talent strategy (Exhibit 2). For example, 52 percent of non-CEO respondents

said that the company leadership didn’t value the use of “clear structures, roles, and responsibilities to streamline work,” while an additional 46 percent said that the company leadership didn’t see the value of performance evaluations that judged managers—and senior leaders—on their people-management skills as opposed to just business performance. About the same proportion said leadership didn’t value “help[ing] and reward[ing] those who deliver continuous improvement.”

Exhibit 2

Company leadership is one of the biggest impediments to adopting talent best practices.



Source: Confederation of British Industry–McKinsey survey of 501 UK managers, 2018

Idea in action

To encourage new behavior, one UK-based multinational made 20 percent of every manager’s annual bonus contingent on their scores from direct reports on a variety of leadership practices. As the quality of leadership improved, the company noticed a secondary benefit: encouraging line employees to give upward feedback made them more fluent in the practices and improved their own leadership skills as well.

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Short-term views

A closer look at the survey evidence highlights signs of short-termism in vital areas such as talent strategy, talent development, and recruitment.

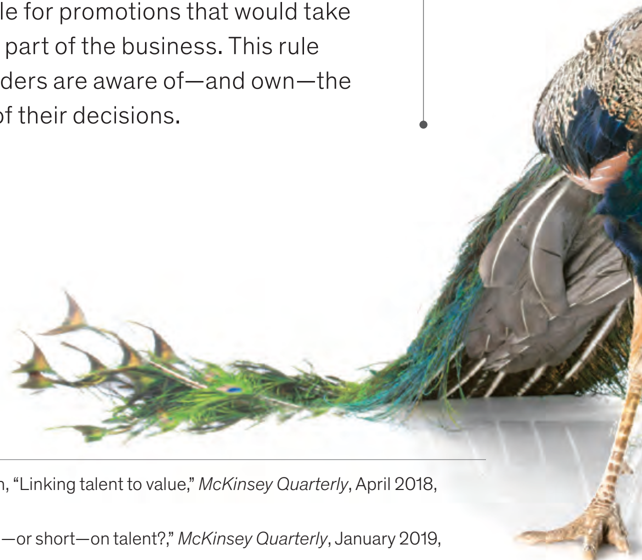
For instance, when we asked respondents what prevented their companies from identifying the best people and putting them to work on the most important business priorities, 37 percent said that "this practice does not fit our culture" and one-third that "we have more important things to worry about." This is despite evidence suggesting that companies that regularly reallocate talent to match strategic priorities are more than twice as likely to outperform their competitors.[3]

Respondents also cited "more important things to worry about" as the principal reason their companies didn't adopt more skills-based training (41 percent), followed closely by perceptions that training was too expensive. These views are notable given the looming skill gaps expected to arise from disruptive technologies and the fact that many senior executives say their organizations are unprepared to address the skill gaps they anticipate.[4]

Other preoccupations seem to take priority over good recruitment practices, too: 37 percent of the respondents said they have more important things to worry about than changing recruitment processes to improve workplace diversity—despite a growing body of evidence linking gender, ethnic, and cultural diversity to positive business outcomes.

Idea in action

To encourage long-term thinking, the UK-based multinational adopted a rule requiring all senior leaders to spend three years in their roles before becoming eligible for promotions that would take them to another part of the business. This rule ensures that leaders are aware of—and own—the consequences of their decisions.



[3] See Mike Barriere, Miriam Owens, and Sarah Pobereskin, "Linking talent to value," *McKinsey Quarterly*, April 2018, McKinsey.com.

[4] See Megan McConnell and Bill Schaninger, "Are we long—or short—on talent?," *McKinsey Quarterly*, January 2019, McKinsey.com.

Take stock, make changes

Taken together, our findings suggest that many companies in the United Kingdom (and beyond) should take a close look at their talent practices, particularly as the more demanding and diverse millennial generation comes of age. Workers are paying attention: a 2018 survey found that poor management was the top reason UK employees weren't happy in their current roles.[5] And British workers are hardly alone: comparable studies in the United States suggest that employee dissatisfaction with the company's leadership is commonplace.[6]

The path to improvement for companies anywhere, we find, starts with soul-searching, as well as recognizing that the view from the middle of an organization may be less sanguine than the view from the top. Leaders must be prepared to deal with what they learn from employee surveys or external benchmarking exercises. A real commitment to talent can't be built through half measures or, worse, faked. As one survey respondent put it, if verbal messages are "not backed up by [leadership] actions . . . then you can't expect HR to think it's a priority. In order for a good practice to be implemented . . . the senior leadership team have to genuinely want it to succeed."

Idea in action

To keep people development top of mind, the executive committee of the UK-based multinational spends four to six hours a quarter examining the development of the company's top 150 leaders, stress-testing roles and geographic priorities and benchmarking the company's talent against the market. Because the process is "bottom up," with discussions from the business informing the executive-committee debate, it helps build coalitions that support talent development more broadly, while signaling to employees that the company takes the issue seriously. Even when faced with a highly challenging external environment, described as a "crisis" by one senior leader, the company demonstrated resolve by maintaining the process throughout, when it might have felt tempting to deprioritize it.

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[5] *Job exodus trends—2018 employee sentiment poll*, Investors in People, January 2019, investorsinpeople.com.

[6] For example, Gallup's *State of the American Workplace* (2017) finds that just one-third of US workers feel engaged at work and that only about one in five strongly believes that performance is managed in ways that motivate people to do outstanding work.

A sampling of the 21 best talent practices by category

Talent strategy
We drive people strategy from the top, with a role of Chief Talent Officer (or equivalent) accountable for people management, and CEO support as required.

Recruitment
We are actively changing our recruitment practices to try to improve diversity in the workplace.

Engagement
We have a culture of feedback where all employees, managers and leaders give and receive feedback to each other.

Development
Our performance management process is fair.

Ways of working
We are open to flexible working models such as remote working and job sharing, with this being the default for most jobs.

For all 21 of the practices, download the article PDF on McKinsey.com.

Elevating people leadership on the management agenda often requires elevating the chief human-resources officer (CHRO) or the most senior person in charge of talent if the role goes by another name. At a minimum, the person who holds it should report to the CEO and be accountable for organization-wide talent priorities linked to tangible business objectives. The board, which often becomes involved in succession planning, can also do much more to review and advise on the organization's talent performance.

When respondents admitted to difficulty in implementing some of the practices, they tended to identify company leaders as the biggest impediment.

As our colleague Dominic Barton and his coauthors noted in *Talent Wins*,[7] CEOs in some talent-oriented organizations insist that the CHRO and CFO be part of a core strategic inner circle that drives people strategy. Our research, highlighting a disconnect between the organization as a whole and the perceptions of CEOs and HR leaders, suggests that moving to such a model also will require a mind-set shift.

McKinsey has long emphasized the positive relationship between a company's organizational health—including people practices—and its performance. The upside potential is considerable. For the United Kingdom, our research found that if companies moved up just one decile in people performance relative to their peers, the resulting boost in labor productivity would be worth £110 billion, or 9 percent of the UK's nonfinancial business economy. At the very least, as the UK-based multinational has found, better practices improve employee engagement and boost productivity in a tangible way.

[7] For more about how leading companies approach people management, including how CEOs can energize their boards to help improve talent management and strategy, see Dominic Barton, Dennis Carey, and Ram Charan, *Talent Wins: The New Playbook for Putting People First*, Boston, MA: Harvard Business Review Press, 2018.

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Can artificial intelligence help society as much as it helps business?

The answer is yes—but only if leaders start embracing technological social responsibility (TSR) as a new business imperative for the AI era.

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In 1953, US senators grilled General Motors CEO Charles "Engine Charlie" Wilson about his large GM shareholdings: Would they cloud his decision making if he became the US secretary of defense and if the interests of General Motors and the United States diverged? Wilson said that he would always put US interests first but that he could not imagine such a divergence taking place, because, "for years I thought what was good for our country was good for General Motors, and vice versa." Although Wilson was confirmed, his remarks raised eyebrows due to widespread skepticism about the alignment of corporate and societal interests.

The skepticism of the 1950s looks quaint when compared with today's concerns about whether business leaders will harness the power of artificial intelligence (AI) and workplace automation to pad their own pockets and those of shareholders—not to mention hurting society by causing unemployment, infringing upon privacy, creating safety and security risks, or worse. But is it possible that what is good for society can also be good for business—and vice versa?

Innovation and skill building

To answer this question, we need a balanced perspective that's informed by history. Technology has long had positive effects on well-being beyond GDP—for example, increasing leisure or improving health and longevity—but it can also have a negative impact, especially in the short term, if adoption heightens stress, inequality, or risk aversion because of fears about job security. A relatively new strand of welfare economics has sought to calculate the value of both the upside and the downside of technology adoption. This is not just a theoretical exercise. What if workers in the automation era fear the future so much that this changes their behavior as consumers and crimps spending? What if stress levels rise to such an extent as workers interface with new technologies that labor productivity suffers?

Building and expanding on existing theories of welfare economics, we simulated how technology adoption today could play out across the economy. The key finding is that two dimensions will be decisive—and in both cases, business has a central role to play (Exhibit 1). The first

dimension is the extent to which firms adopt technologies with a view to accelerating innovation-led growth, compared with a narrower focus on labor substitution and cost reduction. The second is the extent to which technology adoption is accompanied by measures to actively manage the labor transitions that will accompany it—in particular, raising skill levels and ensuring a more fluid labor market.

Both of these dimensions are in sync with our previous bottom-line-focused work on AI and automation adoption. In our research, digital leaders who reap the biggest benefits from technology adoption tend to be those who focus on new products or new markets and, as a result, are more likely to increase or stabilize their workforce than reduce it. At the same time, human capital is an essential element of their strategies, since having the talent able to implement and drive digital transformation is a prerequisite for successful execution. No wonder a growing number of companies, from Walmart to German software company SAP, are emphasizing in-house training programs to equip members of their workforce with the skills they will need for a more automated work environment. And both Amazon and Facebook have raised the minimum wage for their workers as a way to attract, retain, and reward talent.

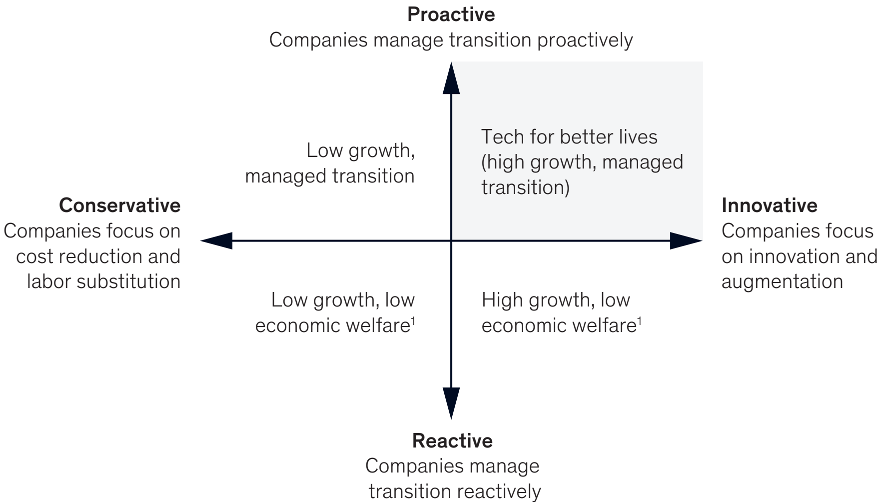
TSR: Technological social responsibility

Given the potential for a win–win across business and society from a socially careful and innovation-driven adoption strategy, we believe the time has come for business leaders across sectors to embed a new imperative in their corporate strategy. We call this imperative technological social responsibility (TSR). It amounts to a conscious alignment between short- and medium-term business goals and longer-term societal ones.

Some of this may sound familiar. Like its cousin, corporate social responsibility, TSR embodies the lofty goal of enlightened self-interest. Yet the self-interest in this case

Exhibit 1

Two dimensions will be decisive in aligning business and societal interests with the adoption of new technology.



[1] Welfare is a specific branch of economics that quantifies utility across the population and allows us to present well-being outcomes in monetary terms.

Source: McKinsey Global Institute analysis

goes beyond regulatory acceptance, consumer perception, or corporate image. By aligning business and societal interests along the twin axes of innovation focus and active transition management, we find that technology adoption can potentially increase productivity and economic growth in a powerful and measurable way.

In economic terms, innovation and transition management could, in a best-case scenario, double the potential growth in welfare—the sum of GDP and additional components of well-being, such as health, leisure, and equality—compared with an average scenario (Exhibit 2). The welfare growth to 2030 that emerges from this scenario could be even higher than the GDP and welfare gains we have seen in recent years from computers and early automation.

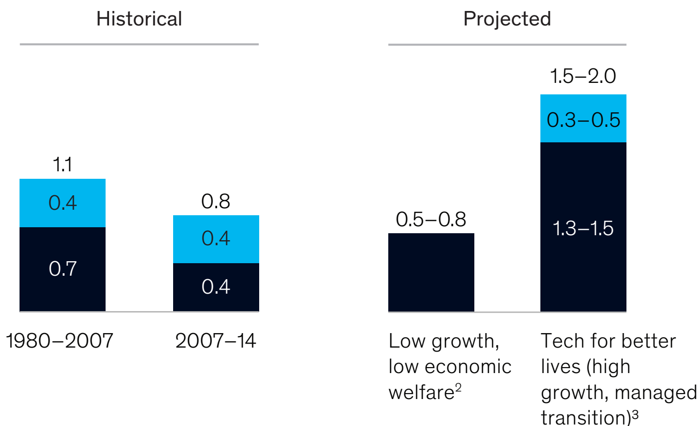
However, other scenarios that pay less heed to innovating or to managing disruptive transitions from tech adoption could slow income growth, increase inequality and unemployment risk, and lead to fewer improvements in leisure, health, and longevity. And that, in turn, would reduce the benefits to business.

At the company level, a workforce that is healthier, happier, better trained, and less stressed, will also be more productive, more adaptable, and better able to drive the technology adoption and innovation surge that will boost revenue and earnings. At the broader level, a society whose overall welfare is improving, and faster than GDP, is a more resilient society better able to handle sometimes painful transitions. In this spirit,

Exhibit 2

A best-case scenario of innovation and transition management could double the potential growth in welfare.

Average annual growth per capita from information and communication technology, EU–28 and United States, CAGR,[1] %



[1] Compound annual growth rate.
[2] Welfare is a specific branch of economics that quantifies utility across the population and allows us to present well-being outcomes in monetary terms.
[3] Figures do not sum to total, because GDP and non-GDP CAGRs are not additive.

Source: McKinsey Global Institute analysis

New Zealand recently announced that it will shift its economic policy focus from GDP to broader societal well-being.

Leadership imperatives

For business leaders, three priorities will be essential. First, they will need to understand and be convinced of the argument that proactive management of technology transitions is not only in the interest of society at large but also in the more narrowly focused financial interest of companies themselves. Our research is just a starting point, and more work will be needed, including to show how and where individual sectors and companies can benefit from adopting a proactive strategy. Work is already underway at international bodies such as the Organisation of Economic Co-operation and Development to measure welfare effects across countries.

Second, digital reinvention plans will need to have, at their core, a thoughtful and proactive workforce-management strategy. Talent is a key differentiating factor, and there is much talk about the need for training, retraining, and nurturing individuals with the skills needed to implement and operate updated business processes and equipment. But so far, "reskilling" remains an afterthought in many companies. That is shortsighted; our work on digital transformation continues to emphasize the importance of having the right people in the right places as machines increasingly complement humans in the workforce. From that perspective alone, active management of training and workforce mobility will be an essential task for boards in the future.

Third, CEOs must embrace new, farsighted partnerships for social good. The successful adoption of AI and other advanced technologies will require cooperation from multiple stakeholders, especially business leaders and the public sector. One example involves education and skills: business leaders can help inform education providers with a clearer sense of the skills that will be needed in the workplace of the future, even as they look to raise the specific skills of their own workforce. IBM, for one, is partnering with vocational schools to shape curricula and build a pipeline of future "new collar" workers—individuals with job profiles at the nexus of professional and trade work, combining technical skills with a higher educational background. AT&T has partnered with more than 30 universities and multiple online education platforms to enable employees to earn the credentials needed for new digital roles.

Other critical public-sector actions include supporting R&D and innovation; creating markets for public goods, such as healthcare, so that there is a business incentive to serve these markets; and collaborating with businesses on reskilling, helping them to match workers with the skills they need and with the digital-era jobs to which they could most easily transition. A more fluid labor market and better job matching will benefit companies and governments, accelerating the search for talent for the former and reducing the potential transition costs for the latter.

There are many aspects to TSR, and we are just starting to map out some of the most important ones. But as an idea and an imperative, the time has come for technological social responsibility to make a forceful entry into the consciousness and strategies of business leaders everywhere. Q

For the full McKinsey Global Institute report upon which this article is based, see "'Tech for Good': Using technology to smooth disruption and improve well-being," on McKinsey.com.

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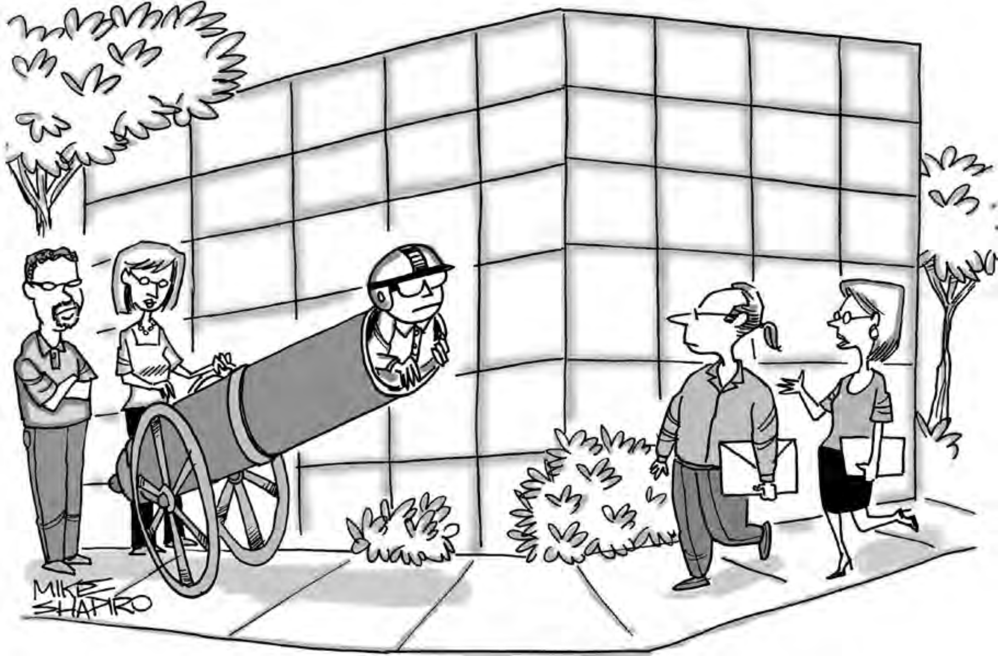
The need for speed



"I admire the digital team's commitment to speed, but I'm starting to get concerned."

The exhortation to "change at the speed of digital" often generates more anxiety than answers. New research provides clearer guidance. For more, see "The drumbeat of digital: How winning teams play," on page 28.

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