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How bold is your business transformation? A new way to measure progress

Organizations that successfully pull off a high-performing transformation don’t choose between either holistic performance or business reinvention. They pursue both.

by Cesar Okajima, José Pimenta da Gama, Sara Pliego, and Fábio Stul

Today’s volatile business environment continues to challenge organizations no matter their size, industry, or geography. Just a few broad trends tell the story: new digital entrants are gobbling up market share across industries; ecosystem-based strategies are gaining ground; and companies committed to environmental, social, and governance (ESG) criteria are increasingly attractive to employees and investors alike.

McKinsey’s research on corporate resilience shows that uncertain times call for leaders and companies to aggressively pursue the upside while also managing the downside. Successful leaders are transforming their businesses to meet this moment, going beyond cost cutting or updating the core business to reinvent the entire organization. This means not only improving financial performance but also focusing on customer experience, employee satisfaction, and positive societal impact.

However, years of McKinsey analysis reveal that successful transformations are difficult to pull off; in fact, a majority of them fail. Of those that do succeed, a tiny percentage deliver multiple times the value of median performers more quickly and sustain profitable growth over the long term. These fall into a class we call “transformative” transformations.

How can companies vault themselves into this exceptional group? Recent conversations with CEOs and other C-suite leaders show that they understand the need to transform and reinvent their businesses, but many are not sure about where to start or if the efforts they’ve already begun will actually create the value they’re targeting.

In this article, we look at the common traits of exemplary transformations, and at the value at stake for organizations that pursue this path. We reveal a new method of analyzing transformation progress, starting with asking the right questions, in ten categories, about both holistic performance and business reinvention. This approach can offer leaders an accurate baseline of where they are succeeding in their transformation efforts and where they have more work to do.

The pillars of successful transformations

Even among the small number of transformations that achieve their targets, there is a huge disparity of performance and outcomes.

Organizations that lead successful business transformations have five common characteristics. These companies do the following:

- think big, by setting ambitious goals and value-creation targets (delivering 2.7 times the value initially estimated)
- act on several levels at once, with more than 50 percent of the transformation's value generated from top-line initiatives
- move quickly and renew the pipeline, with nearly 75 percent of the value implemented during the first year
- focus on "rocks, pebbles, and sand" (that is, initiatives of all sizes); roughly 55 percent of the transformation's value comes from small initiatives that represent on average less than 0.5 percent of full potential
- create a culture that fosters change, which leads to superior total shareholder returns (three times higher than the peer average)

Transformative transformations go beyond these five actions, adding three more:

- reinvent the core business, leveraging digital and analytics
- develop or acquire new businesses to generate new sources of revenue
- revamp the operating model to focus on speed and innovation

McKinsey analysis shows that these transformations represent just 5 percent of all transformations but deliver 4.5 times the value.

In the broadest strategic sense, transformative transformations achieve a well-managed balance between improving performance holistically and reinventing the business, excelling in both. Holistic performance is measured along five dimensions that reflect organizational priorities: financial performance, organizational health, talent and capabilities, customer focus, and ESG impact. Business reinvention involves pursuing an ambitious and significant shift in a company's core operating model, portfolio, strategic moves, and digital and analytics capabilities.

Top performers understand that while a company can pursue outstanding holistic performance (by, say, doubling its bottom line), it still must develop its reinvention muscles to respond effectively in times of uncertainty. The opposite is also true: an organization can push to reinvent itself, but if it doesn't deliver financial results, the transformation won't be sustainable.

After committing to a transformation, the executive team should ask questions in ten categories about the holistic performance and business reinvention it is targeting to help the organization sharpen goals and carry them out rapidly (Exhibit 1).

A transformation tool for the C-suite

We've found that many CEOs and other C-suite leaders want to tackle big issues but need help with clarifying the most productive path forward. These issues include how to allocate resources effectively between new and existing businesses; how to determine whether a "big bang" scale-up or a sequenced transformation is more appropriate; how to go beyond managing ESG risks to creating value from ESG criteria; and how to handle large-scale organizational change in a way that is sustainable.

Exhibit 1

To build a 'transformative' transformation, leaders can start by thinking through the fundamentals.

Ask questions in 10 key areas of transformation

Holistic impact	Business reinvention
Performance How do financial and operational indicators compare with best in class? How is the company delivering versus its full potential?	**Operating model** Has the company deployed a customer-centric operating model with new ways of working and a nimble organizational design? How is the pace of decision making? Do mistakes get corrected quickly?
Organizational health How does the culture create energy, inspire people to change, and build the required set of behaviors that will deliver on business strategy and aspirations?	**New businesses** Is the company building and buying new businesses to drive growth? Is it innovating fast enough?
Talent and capabilities Is the company significantly reskilling and upskilling its current workforce? How are its core capabilities? Is it attracting new talent?	**Big strategic moves** Is the company pursuing "big moves" in portfolio management, programmatic M&A, and the dynamic allocation of resources needed to sustain its competitive advantage? Is it being thoughtful about where to compete?
Customer experience Is the customer the focus? Are the company's goals ambitious enough when it comes to customer experience?	**Analytics** Does the company use advanced analytics in day-to-day decision making, driving sizable and measurable value to the bottom line?
ESG Are environmental, social, and governance criteria central to the purpose, strategy, and culture of the company? How do these principles drive growth?	**Digital and technology** Is the company leading the reinvention of its customer journeys and processes with digital? Does it have the right technological infrastructure and architecture?

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To address these challenges and others, we developed the Transformation Speedometer, a tool that analyzes[1] a company's transformation maturity according to its specific contexts and needs through a score we call the McKinsey Transformation Index. It's rare for a company to outperform in every area of business reinvention and holistic performance; even the healthiest organizations have gaps. And even though leaders know their businesses better than anyone else, the results of this analysis can often surprise them, revealing relevant improvement opportunities.

Different companies, different scores, different paths

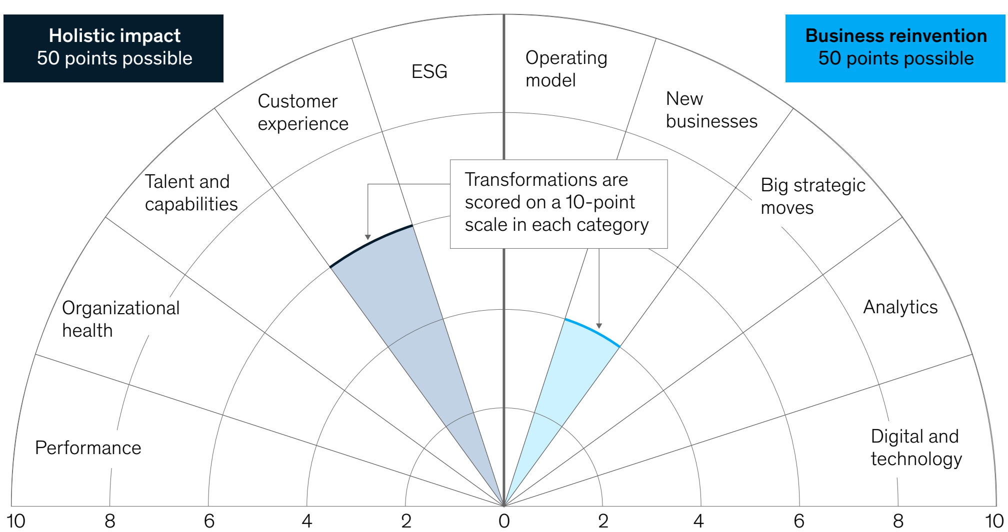
When following this method, company leaders give each of the ten categories cited earlier a rating from zero to ten. Out of a 100-point scale, companies that are lagging in their transformation progress rank below a 60; companies with solid-performing transformations rank from 60 to 80; and transformative transformations score above 80 (Exhibit 2).

[1] The Transformation Speedometer was designed as an assessment tool that leaders can use to score their organizational maturity on holistic impact and business reinvention measures. The McKinsey Transformation Index (MTI) score provides a baseline for more detailed data-based analysis.

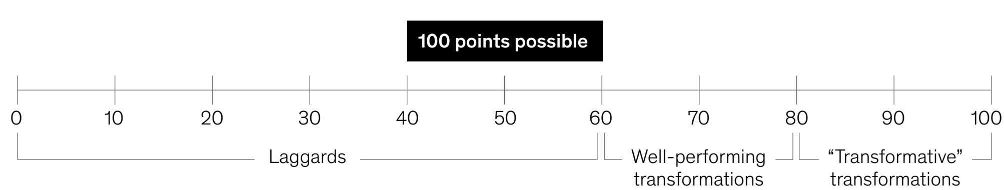
Exhibit 2

Measuring a transformation's maturity: How numbers tell a story

Transformation score, by category, 0–10 points



Combined total for holistic impact and business reinvention, points



Source: McKinsey Transformation Index

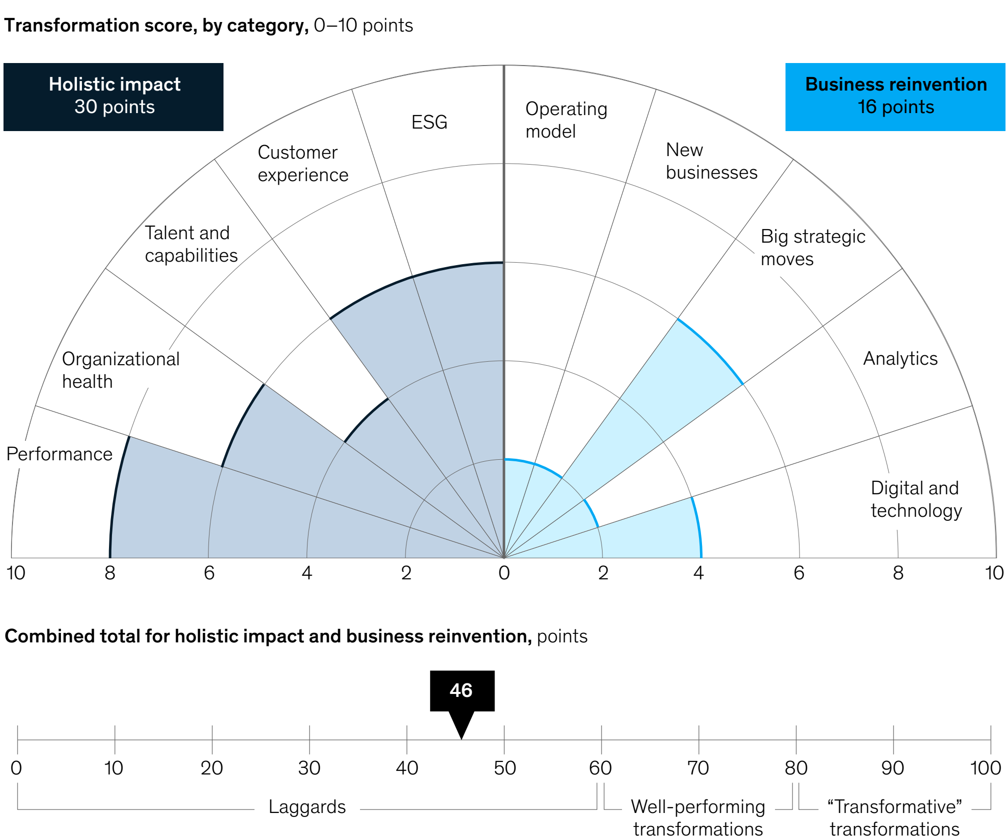
We've occasionally seen companies achieve a transformative transformation score higher than 80, with even scores across all dimensions. But the most common outperformers are companies that have a significant edge in a few dimensions—in which they are truly distinctive—while other areas have plenty of room for improvement. The way forward will depend on the organization and sector context, but in general, the scores can generate intense conversation among leaders about how to improve.

A global retailer had superior financial performance compared with peers and at-par customer experience and ESG practices. Although short-term financial results were strong, management realized that the business would be in danger if the company's reinvention skills weren't better developed. It had limited digital and e-commerce capabilities, which reduced its store-format efficiency and innovation. And it wasn't even scratching the surface when it came to launching new businesses and increasing revenue streams. Its operating model was also very traditional, with a waterfall format that reinforced hierarchical decision making rather than flexibility.

Company leaders decided that processes, systems, and talent management all had to undergo a full remodeling, with a particular focus on investing in analytics and digital capabilities as well as talent (Exhibit 3).

Exhibit 3

A global retailer had room to improve across most categories, with areas related to business reinvention needing more strategic focus.



Source: McKinsey Transformation Index

In another example, an incumbent equipment manufacturer with exceptional holistic performance wanted to strengthen its business reinvention dimensions. The company realized that despite solid growth in recent years, it had to modernize by investing in analytics that would help it more quickly identify customer needs and respond to new trends. It increased its organizational metabolic rate by improving its digital capabilities that, in turn, expanded sales channels, shortened time to market, and improved customer service overall (Exhibit 4).

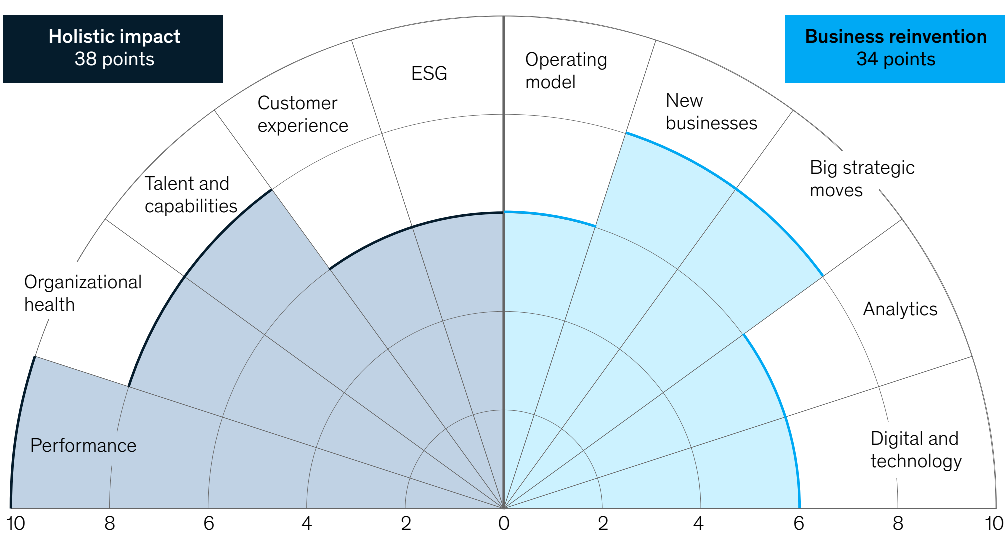
Turning scores into actions

This assessment can reveal several important insights for companies. First, it is almost impossible to excel in all ten categories. Making small improvements in all dimensions won't lead to the best results; acting quickly and boldly in a few will.

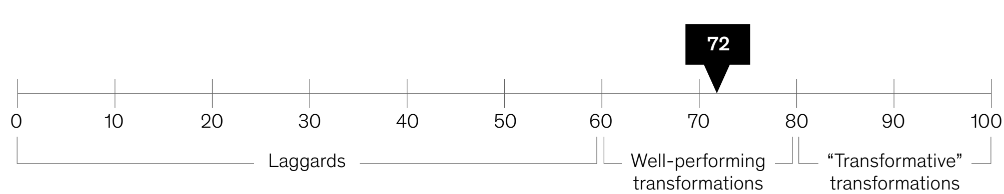
Exhibit 4

An equipment manufacturer with an outstanding track record pushed harder on digital and analytics to serve its customers better.

Transformation score, by category, 0–10 points



Combined total for holistic impact and business reinvention, points



Source: McKinsey Transformation Index

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Second, the assessment can support CEOs' and management teams' decision making as they define priorities for the months and years ahead. The speedometer does not measure management quality or depth; instead, it encourages frank discussion among senior managers about the maturity of their transformations—both in individual dimensions and at overall levels—and identifies potential blind spots.

Third, these discussions are critical for creating agreement among C-suite executives about how to allocate resources and how to define objective targets for measuring impact and assessing progress. For example, analytics often gets rated as a less developed category, with the chief data officer (CDO) struggling to get enough attention or resources. After the assessment, the CDO may be more empowered to articulate the sweeping benefits of data and analytics in value creation, customer focus, and other strategic priorities. In turn, the whole organization can shift to seeing analytics as a priority and create a plan to move forward using this rating system to monitor progress.

Finally, establishing ambitious goals and a shared vision helps maintain a high level of commitment to the work that needs doing.

Resilient businesses view moments of crisis or uncertainty as a time to transform themselves, generating more value in both growth and recovery cycles. As Ayrton Senna, the Brazilian car racing champion, once said, "You cannot overtake 15 cars in sunny weather, but you can when it's raining." By targeting holistic performance and business reinvention equally, companies greatly improve the odds that their transformations will create sustainable and disproportionate value. That's a formula for ensuring that an organization thrives in the future, rain or shine. Q

Cesar Okajima is a partner in McKinsey's São Paulo office, where **Fábio Stul** is a senior partner; **José Pimenta da Gama** is a senior partner in the Lisbon office; and **Sara Pliego** is an associate partner in the Barcelona office.

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