

# Five Frames of Transformational Change



**THE UNIVERSITY OF THE WEST INDIES**  
AT MONA, JAMAICA

18 June 2014

CONFIDENTIAL AND PROPRIETARY

Any use of this material without specific permission of McKinsey & Company is strictly prohibited

# Performance and health: An evidence-based approach to transformational change

- In the present competitive environment, **companies' long-term success is determined by their ability to adapt and change**. However, **most companies struggle to achieve substantial, sustainable change** over time
- The most extensive research effort of its kind has shown that successful, sustainable transformations can be reliably achieved by managing **both the performance and health of the transformation with equal rigor**
- We have developed a **five-stage approach** to rigorously manage performance and health during transformational change. This document will focus on the key aspects of managing health:
  1. **Aspire:** Align on where you want to go
  2. **Assess:** Determine the change-readiness of the organization to go there
  3. **Architect:** Determine how to get from here to there
  4. **Act:** Manage the journey as it unfolds
  5. **Advance:** Ensure sustainability and continuous improvement beyond the step change
- The **impact** of this approach has proven to be reliable and significant, creating measurably higher and more sustainable returns

# 1 4 facts shaping the world of organization

**Fact one**

**The nature of competition has shifted from scale and stability to innovation and change**

**Fact two**

**The gales of creative destruction are still raging**

**Fact three**

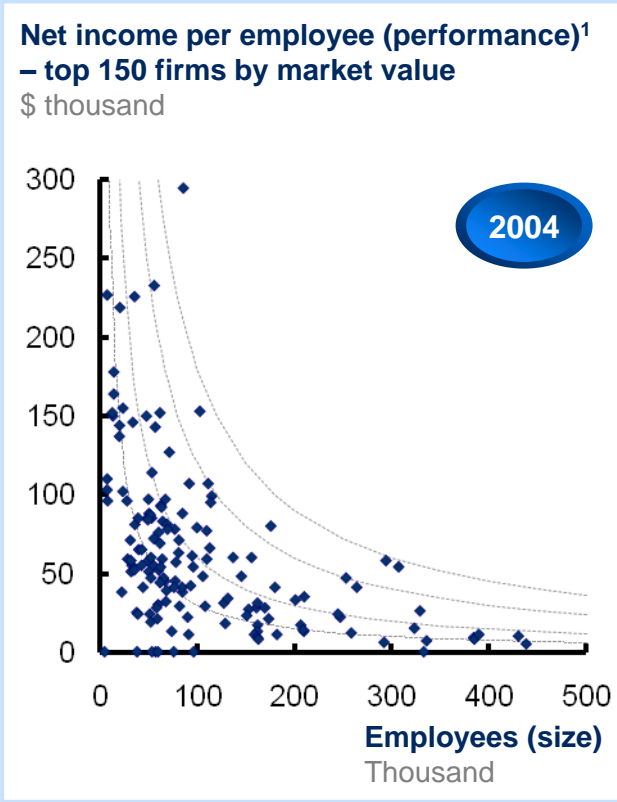
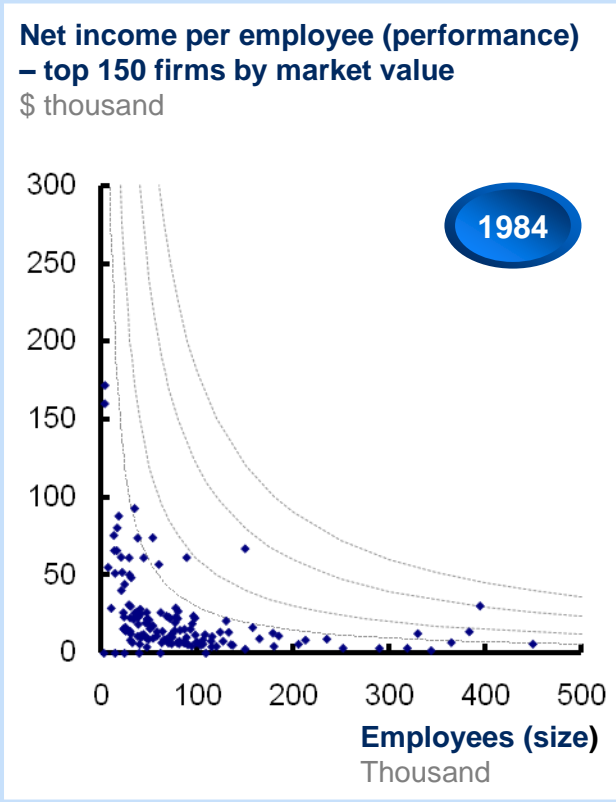
**Most transformation efforts fail ... and for predictable reasons**

**Fact four**

**It can be done**

# Fact 1: The nature of competition has shifted from scale (stability) to innovation (change)

Scale is no longer the key driver of value



Innovation and change are becoming ever more important

“  
Innovation is going to become king in any company”  
Jeff Immelt  
CEO of GE

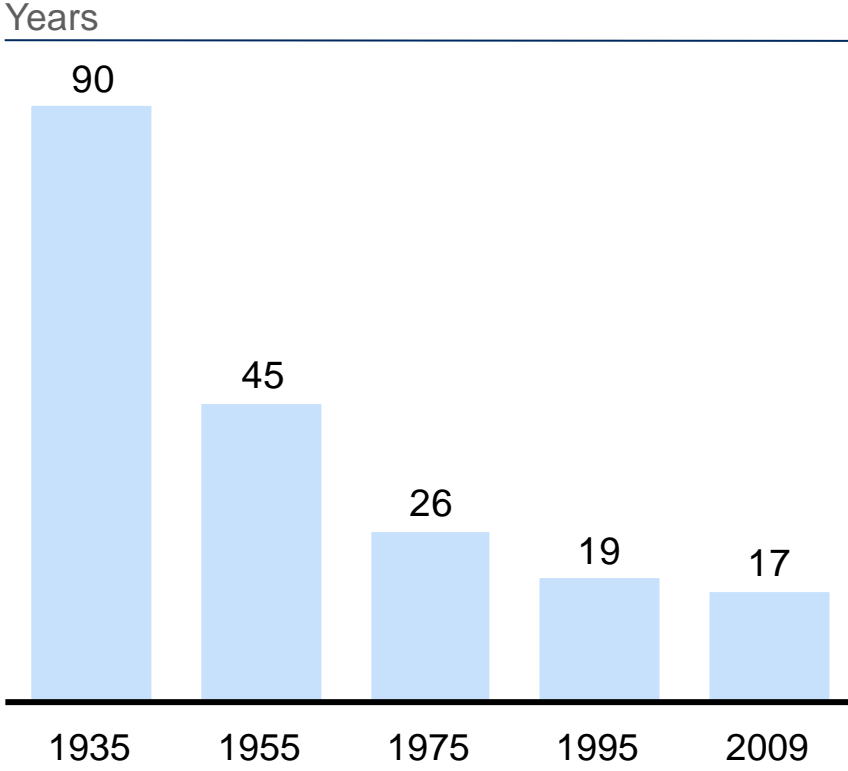
“  
Innovation may be an important element of other corporate strategies, but for us, innovation is our strategy”  
William E. Coyne  
Former SVP of R&D at 3M

“  
Up to 80% of a share's market value can be explained only by cash flow expectations beyond the next three years”  
Ian Davis,  
McKinsey & Company

# Fact 2: The gales of creative destruction are still raging

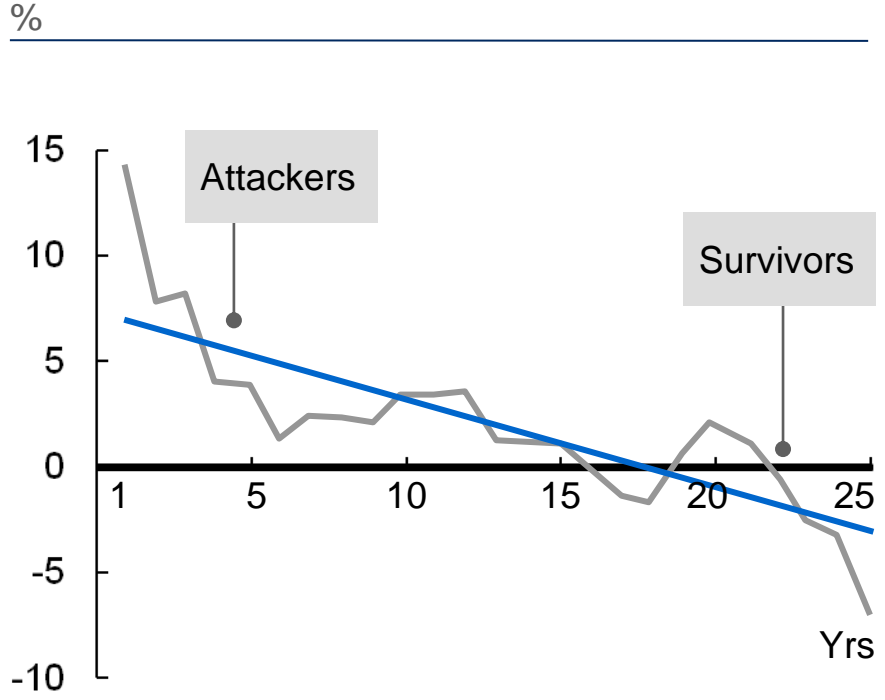
Half of the companies in present S&P 500 will not be there in 10-years time

Estimated life span of S&P 500 companies based on company exits



There seems to be a “survivors’ curse” where former winners struggle to remain competitive and effective

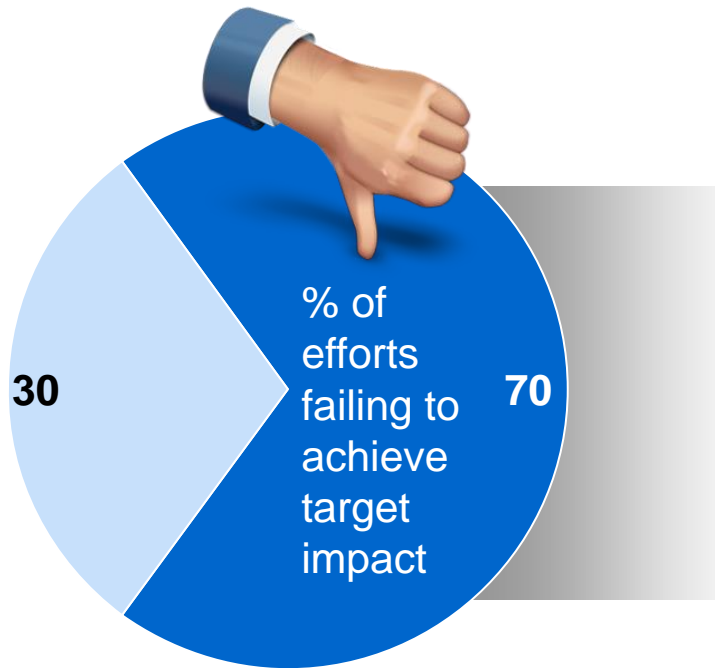
Total return to shareholders of new entrants relative to industry average



SOURCE: Datastream; web search; press search; McKinsey corporate performance analysis tool; Richard Foster and Sarah Caplan, *Creative Destruction: Why companies that are built to last underperform the market* – and how to successfully transform them, Doubleday/Currency, 2001

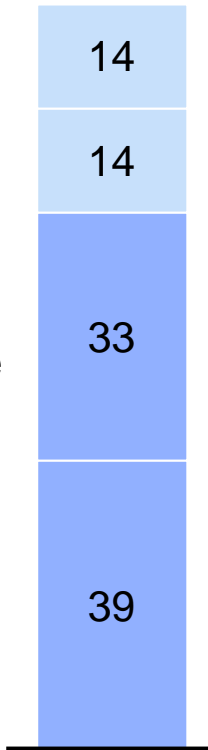
# Fact 3: Most transformation efforts fail ... and for predictable reasons

70% of change programs fail ...



... mainly because organizational *health* gets in the way

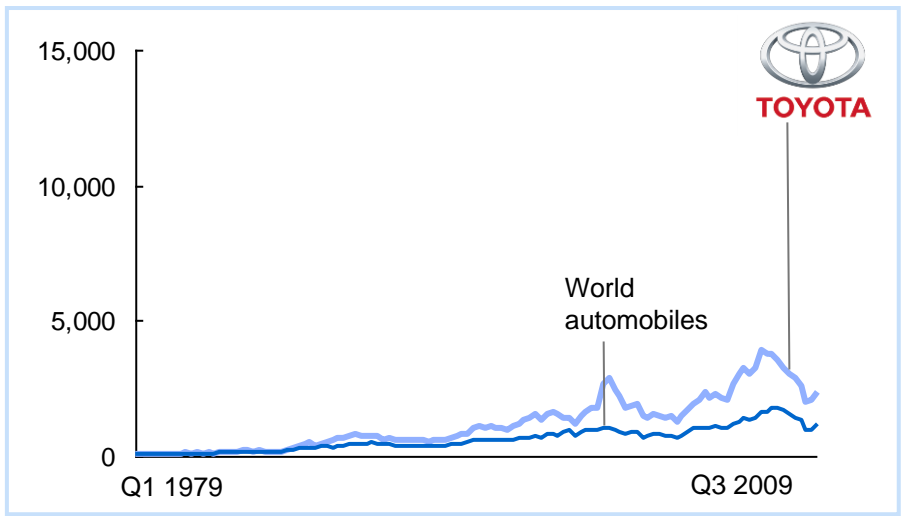
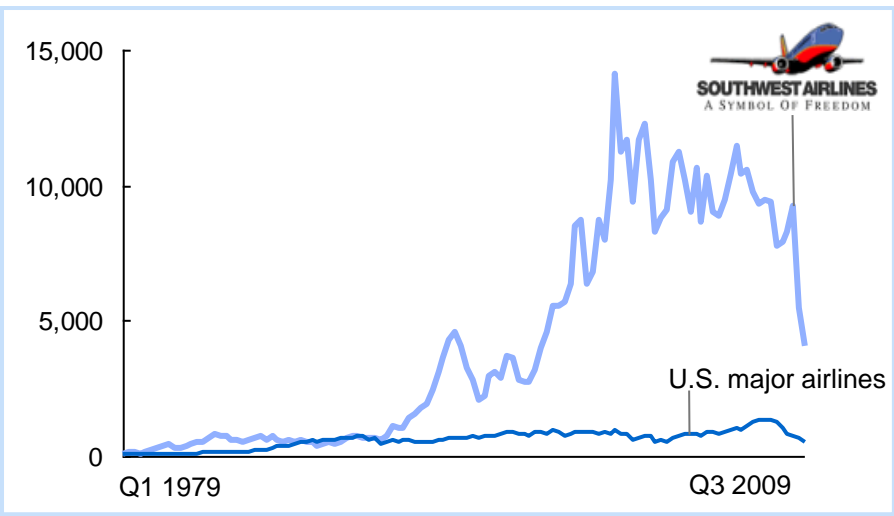
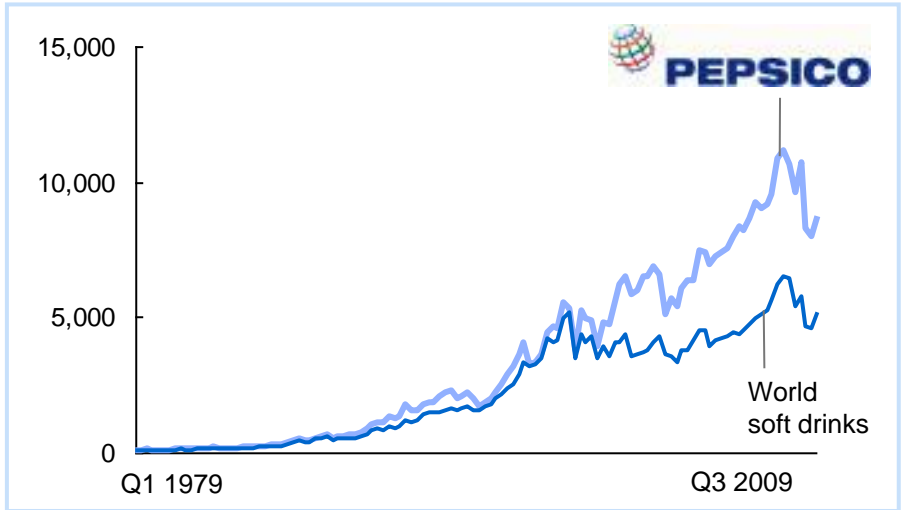
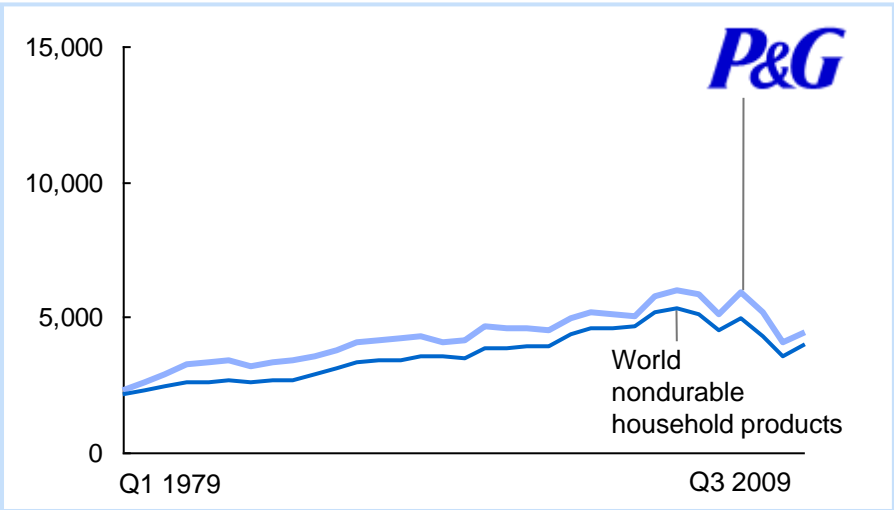
- Other obstacles
- Inadequate resources or budget
- Management behavior does not support change
- Employee resistance to change



**Organizational health factors**

# Some companies, however, demonstrate above-average performance over several decades

TRS, indexed (100% = Q1 1979)



SOURCE: Aaron De Smet, Mark Loch, and Bill Schaninger, *What winning looks like – the four archetypes of organizational health*, McKinsey & Company, 2008

# Performance and health: An evidence-based approach to transformational change

- In the present competitive environment, **companies' long-term success is determined by their ability to adapt and change**. However, **most companies struggle to achieve substantial, sustainable change** over time
- The most extensive research effort of its kind has shown that successful, sustainable transformations can be reliably achieved by managing **both the performance and health of the transformation with equal rigor**
- We have developed a **five-stage approach** to rigorously manage performance and health during transformational change. This document will focus on the key aspects of managing health:
  1. **Aspire:** Align on where you want to go
  2. **Assess:** Determine the change-readiness of the organization to go there
  3. **Architect:** Determine how to get from here to there
  4. **Act:** Manage the journey as it unfolds
  5. **Advance:** Ensure sustainability and continuous improvement beyond the step change
- The **impact** of this approach has proven to be reliable and significant, creating measurably higher and more sustainable returns



# We have invested in years of learning to uncover the key to successful transformations

## Survey

600,000

Survey respondents from more than 500 organizations participated in our “Organizational Health Index” research

6,800

CEOs and senior executives completed further surveys regarding transformational change

## Research

900

Academic journal articles and books reviewed

30

CEOs and chairpersons did face-to-face interviews with us

4

Leading academics reviewed, challenged, and augmented our findings

3

Years dedicated to developing and refining our understanding of organization and change

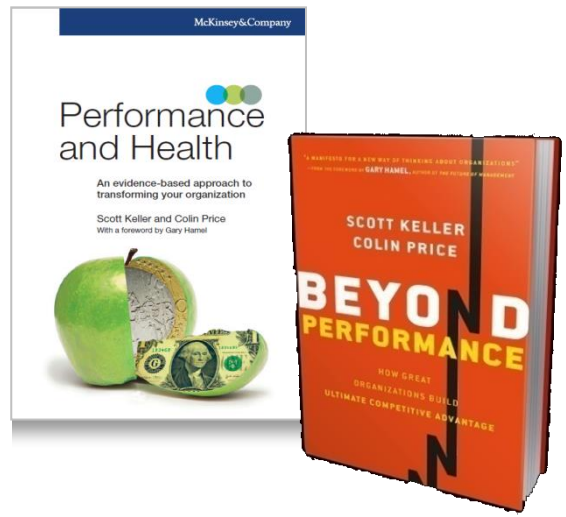
## Analysis

2

Books were published one internally, one externally

1

**Unified theory of change**



# The big idea: Companies need to manage performance and health with equal rigor to achieve successful change

## Performance

What an enterprise delivers to stakeholders in **financial** and **operational** terms (e.g., net operating profit, ROACE, TRS, net operating costs, and stock turn)



## Health

The ability of an organization to **align, execute, and renew** itself to **sustain** exceptional performance over time

“The narrow pursuit of shareholder value was the dumbest idea in the world”

– Jack Welch  
Former chairman and CEO of GE  
*Financial Times*, August 2009



“We have not achieved our tremendous increase in shareholder value by making shareholder value the only purpose of our business”

– John Mackey  
Founder and CEO of Whole Foods  
*Reason Magazine*, October 2005

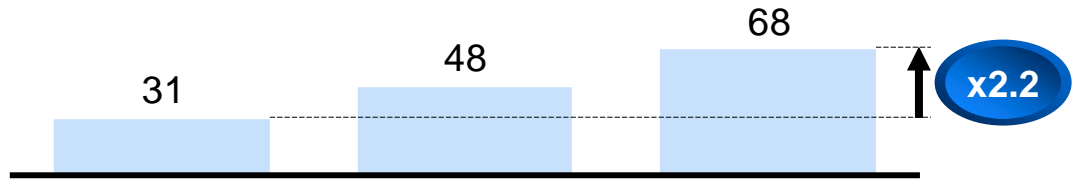


# Organizational health and company performance are mutually reinforcing drivers, now and in the future

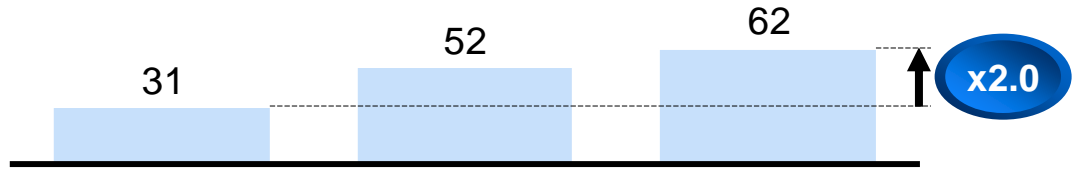
Likelihood that companies with specified level of health have above-median financial performance

%

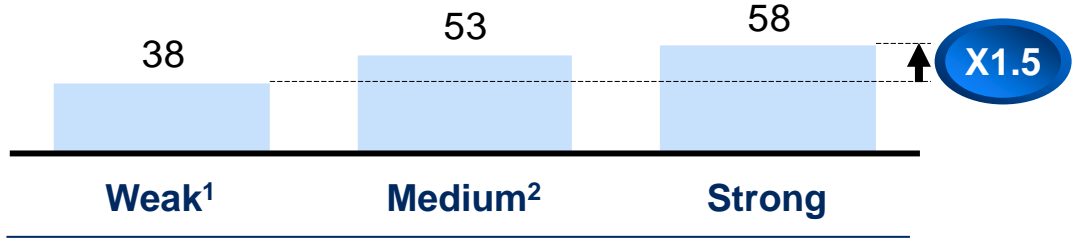
EBITDA margin



Growth in enterprise value/  
book value



Growth in net income/sales



Weak<sup>1</sup>      Medium<sup>2</sup>      Strong

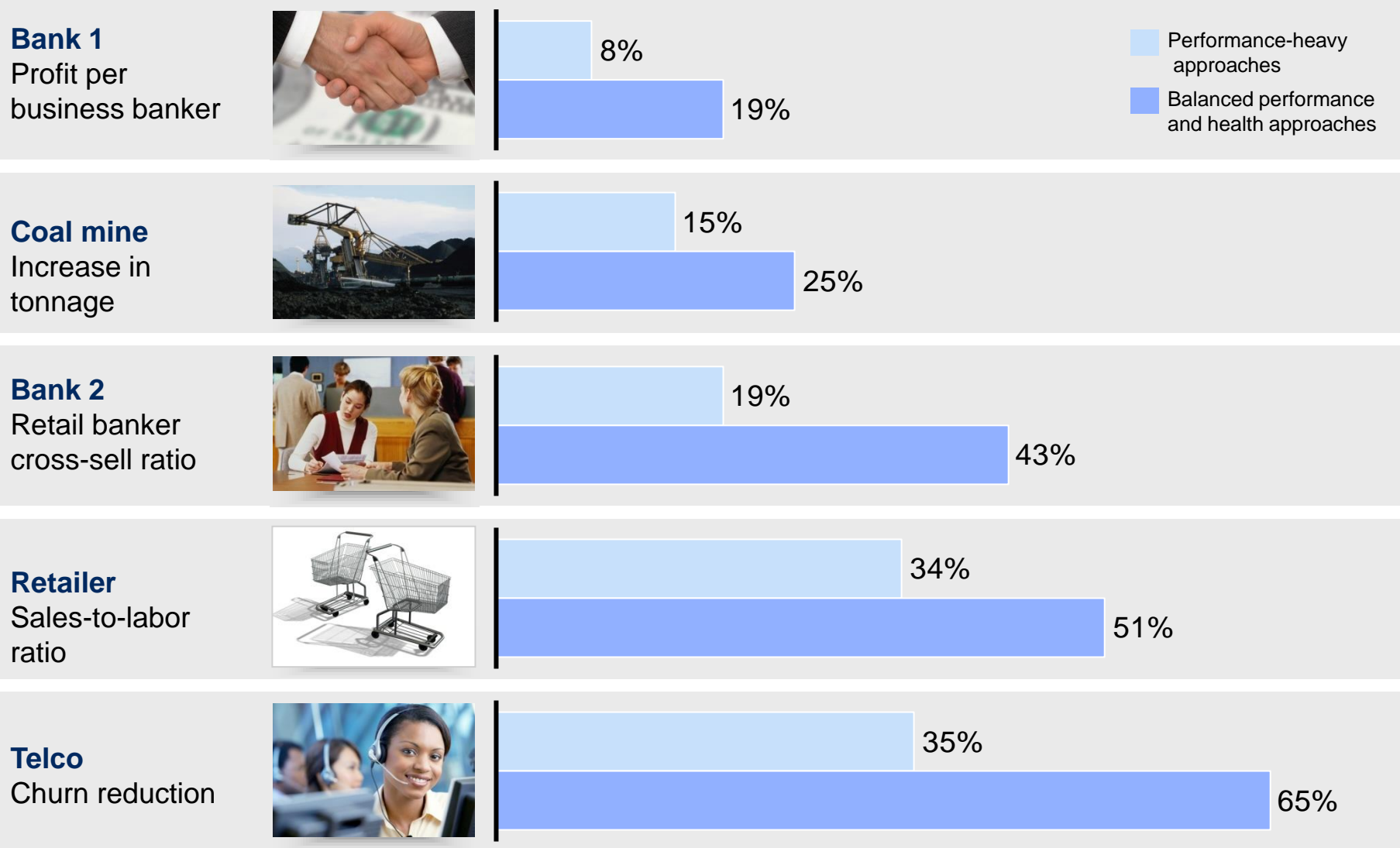
Health

Managing health is not something you can wait to do in the future – it is about the actions you take presently to perform



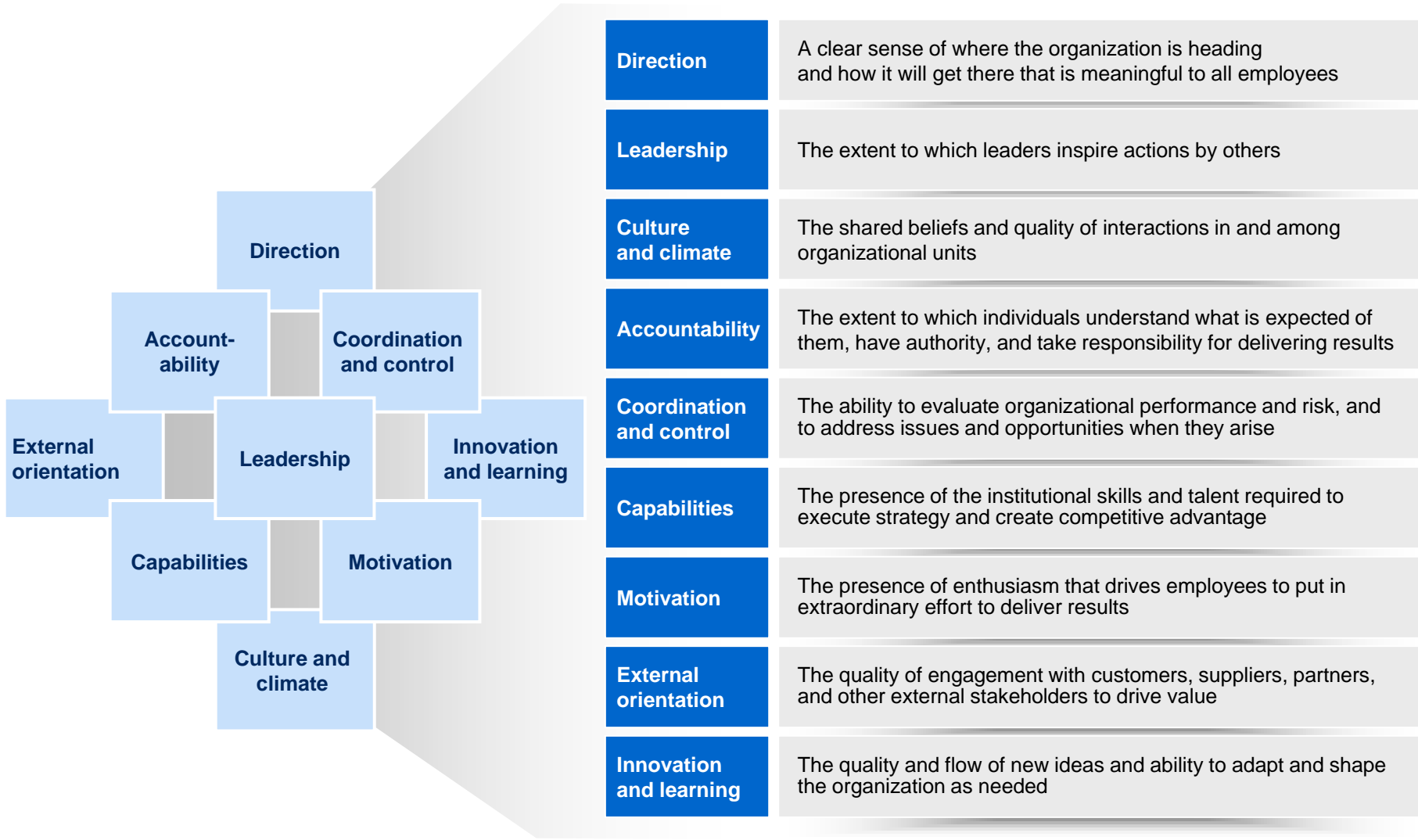
1 Also referred to bottom, mid-, and top quartiles in health assessment  
2 Comprises second and third quartiles

# The business benefits of a balanced approach to performance and health during transformations are proven and profound



SOURCE: Company data in longitudinal studies (two years) of control groups vs. experimental groups controlling for all possible distortions of trial

# Organizational health has 9 critical dimensions that must be proactively managed for organizations to transform successfully



# How healthy is your organization? Quick assessment

	<h2 style="color: #0056B3;">Ailing</h2> 	<h2 style="color: #0056B3;">Able</h2> 	<h2 style="color: #0056B3;">Elite</h2> 
<b>Direction</b>	Creates a strategy that fails to resolve the tough issues	Crafts and communicates a compelling strategy, reinforced by systems and processes ...	... and provides purpose, engaging people around the vision
<b>Leadership</b>	Provides excessively detailed instructions and monitoring (high control)	Shows care toward subordinates and sensitivity to their needs (high support) ...	... and sets stretch goals and inspires employees to work at their full potential (high challenge)
<b>Culture and climate</b>	Lacks a coherent sense of shared values	Creates a baseline of trust in and among organizational units ...	... and creates a strong, adaptable organizationwide performance culture
<b>Accountability</b>	Creates excessive complexity and ambiguous roles	Creates clear roles and responsibilities; links performance and consequences ...	... and encourages an ownership mindset at all levels
<b>Coordination and control</b>	Establishes conflicting and unclear control systems and processes	Aligns goals, targets, and metrics managed through efficient and effective processes ...	... and measures and captures the value from working collaboratively across organizational boundaries
<b>Capabilities</b>	Fails to manage talent pipeline or deal with poor performers	Builds institutional skills required to execute strategy ...	... and builds distinctive capabilities that create long-term competitive advantage
<b>Motivation</b>	Accepts low engagement as the norm	Motivates through incentives, opportunities, and values ...	... and taps into employees' sense of meaning and identity to harness extraordinary effort
<b>External orientation</b>	Directs the energy of the organization inward	Makes creating value for customers the primary objective ...	... and focuses on creating value for all stakeholders
<b>Innovation and learning</b>	Lacks structured approaches to harness employees' ideas	Able to capture ideas and convert them into value incrementally and through special initiatives ...	... and able to leverage internal and external network to maintain a leadership position

SOURCE: Alice Breeden, Aaron de Smet, Helena Karlinder-Ostlundh, Colin Price, and Bill Schaninger, *Building healthy organizations to drive performance: The evidence*, McKinsey & Company, 2009

# Performance and health: An evidence-based approach to transformational change

- In the present competitive environment, **companies' long-term success is determined by their ability to adapt and change**. However, **most companies struggle to achieve substantial, sustainable change** over time
- The most extensive research effort of its kind has shown that successful, sustainable transformations can be reliably achieved by managing **both the performance and health of the transformation with equal rigor**
- We have developed a **five-stage approach** to rigorously manage performance and health during transformational change. This document will focus on the key aspects of managing health:
  1. **Aspire:** Align on where you want to go
  2. **Assess:** Determine the change readiness of the organization to go there
  3. **Architect:** Determine how to get from here to there
  4. **Act:** Manage the journey as it unfolds
  5. **Advance:** Ensure sustainability and continuous improvement beyond the step change
- The **impact** of this approach has proven to be reliable and significant, creating measurably higher and more sustainable returns






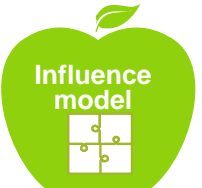

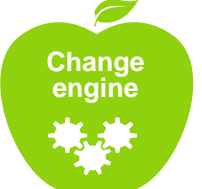


**“Everything should be made as simple as possible, but no simpler”**

**– Albert Einstein**





# To drive successful transformations, companies must manage both performance and health across all 5 stages of the transformation

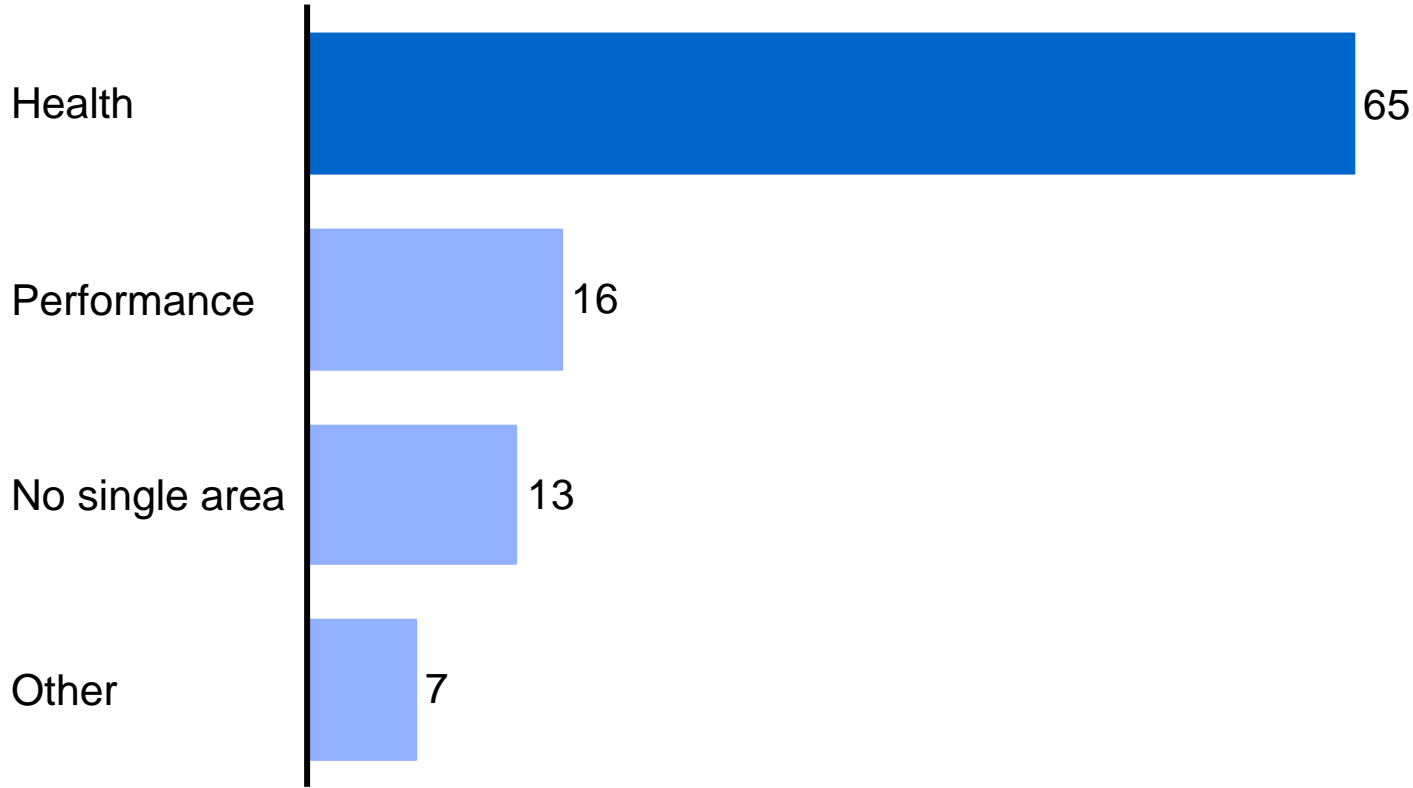
	Performance	Health
<b>1 Aspire</b> Where do we want to go?	 Setting the performance goals	 Defining explicit organizational aspirations with the same rigor
<b>2 Assess</b> How ready are we to go there?	 Determining gaps across technical, managerial, and behavioral systems	 Understanding the mindset shifts needed in the organization
<b>3 Architect</b> What do we need to do to get there?	 Developing a portfolio of initiatives to improve performance	 Architecting the implementation along the levers that drive people to change
<b>4 Act</b> How do we manage the journey?	 Designing the approach to rolling out initiatives in the organization	 Building broad ownership, taking a structured approach, and measuring impact
<b>5 Advance</b> How do we keep moving forward?	 Setting up mechanisms to drive continuous improvement	 Developing leaders to enable them to drive change

SOURCE: Scott Keller and Colin Price, Beyond Performance: How Great Organizations Build Ultimate Competitive Advantage. 2011

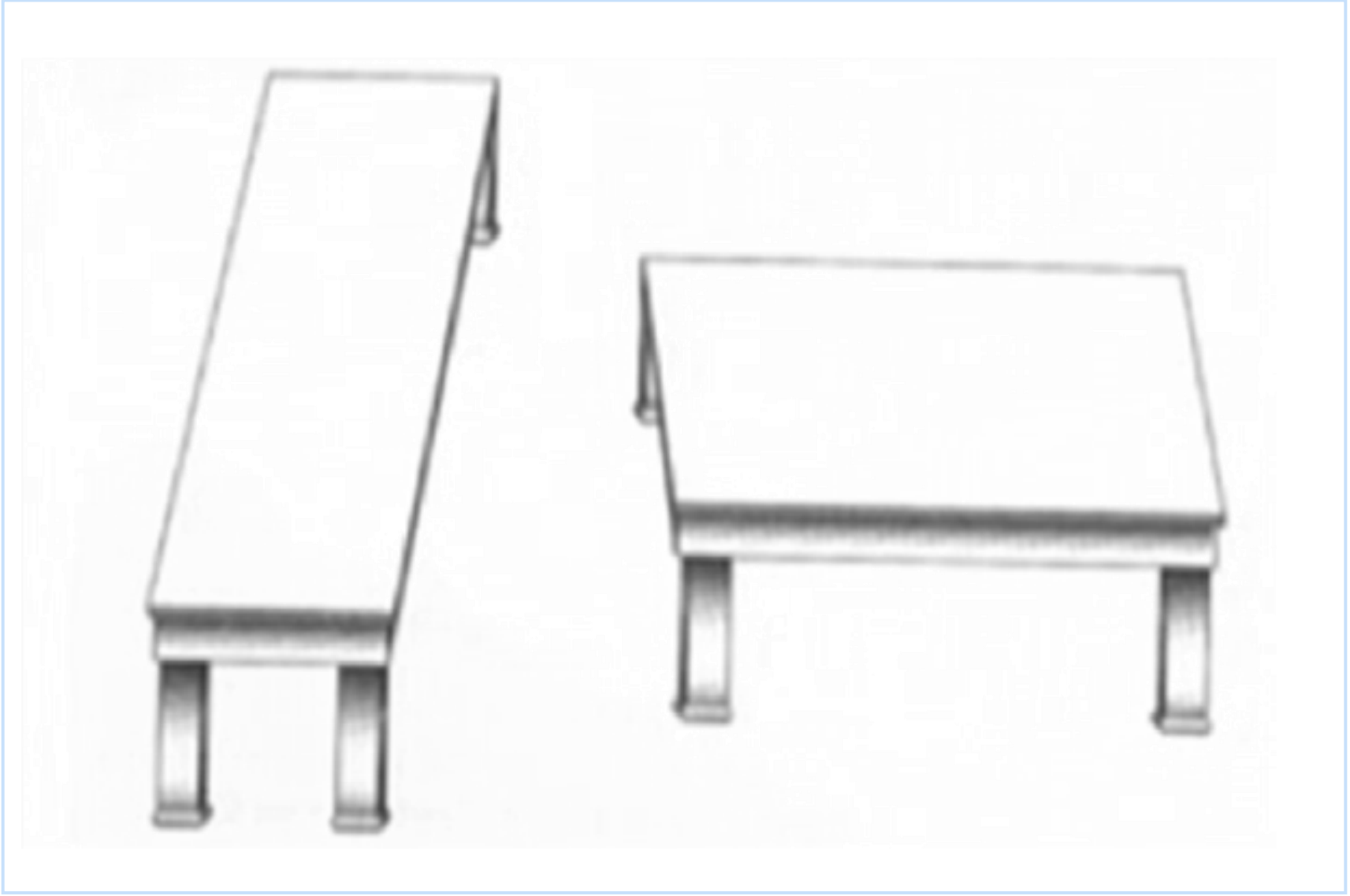
# Leaders want more insight into how to improve 'health'

In what one area do you wish you had more insights to lead the transformation?

%, N = 2,236

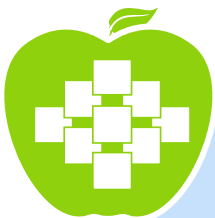


**Which table is longer?**

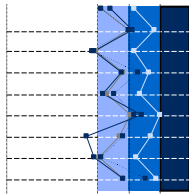


# Aspire – where do we want to go?

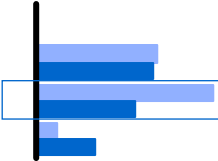
On the health side, this means setting the right organization aspirations



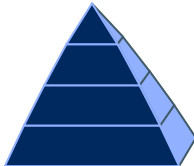
A runner, a boxer, and a swimmer are all healthy, but in quite different ways  
What kind of health aspirations are right for your organization?



Measure organizational health



Set the right health aspirations



Involve a broad leadership coalition

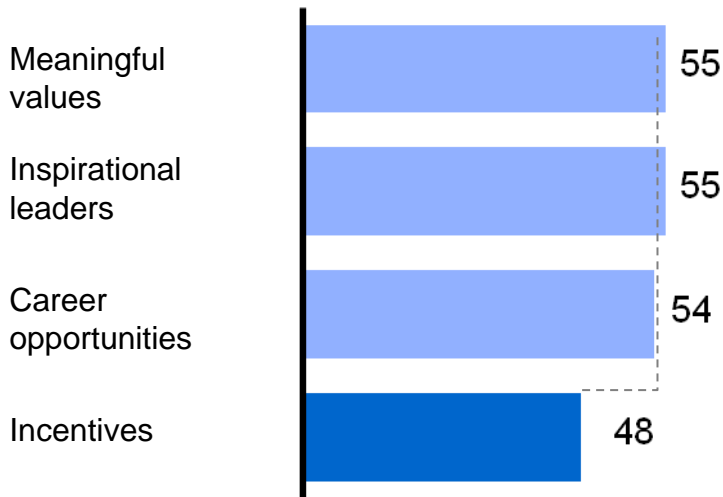
# Aspire – where do we want to go?

## Practices work in combination

% likelihood that a company will be top quartile in motivation if top quartile in this individual practice

Being top quartile in the following individual motivation practices<sup>1</sup> ...

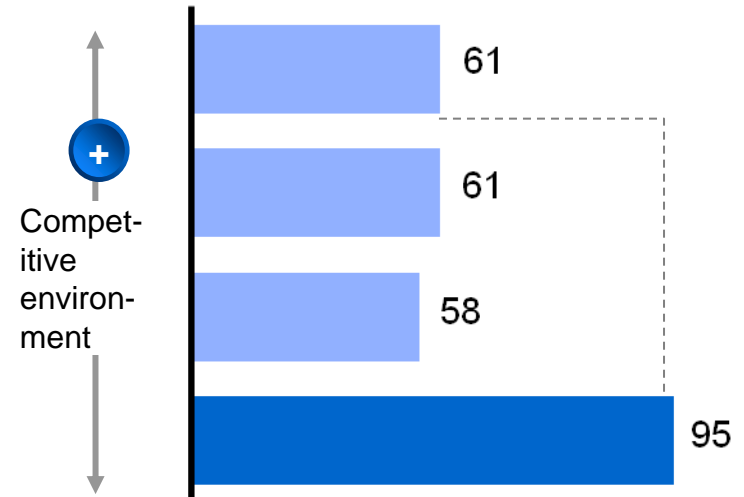
... results in the following % likelihood of being top quartile in overall motivation



Success in individual practices is important to the overall motivation outcome

The stand-alone practice from the left plus a “competitive environment” ...

... results in the following % likelihood of being top quartile in overall motivation



Being top quartile in both incentives and competitive environment is a potent combination

<sup>1</sup> Analysis conducted on four out of five Motivation practices

# Aspire – where do we want to go?

## There are 4 archetypical combinations for healthy organizations



### Leadership driven

- 1 Career opportunities
- 2 Open and trusting
- 3 Performance contracts
- 4 Inspirational leaders
- 5 Strategic clarity
- 6 People performance review
- 7 Operational management
- 8 Operationally disciplined
- 9 Consultative leadership
- 10 Consequence management



### Market focus

- Business partnerships
- Customer focus
- Competitive insights
- Government and community relations
- Financial management
- Capturing external ideas
- Process-based capabilities
- Shared vision
- Outsourced expertise
- Strategic clarity



### Execution edge

- Knowledge sharing
- Creative and entrepreneurial
- Employee involvement
- Talent development
- Internally competitive
- Personal ownership
- Bottom-up innovation
- Top-down innovation
- Meaningful values
- Consequence management

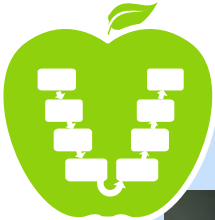


### Knowledge core

- Talent acquisition
- Role clarity
- Consequence management
- Financial incentives
- Personal ownership
- People performance review
- Career opportunities
- Performance contracts
- Professional standards
- Financial management

# Assess – how ready are we to get there?

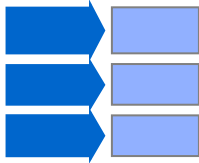
On the health side, this means understanding the few critical mindset shifts that are needed



**Understanding the key limiting mindsets in your organization**



**Identify liberating and limiting mindsets**



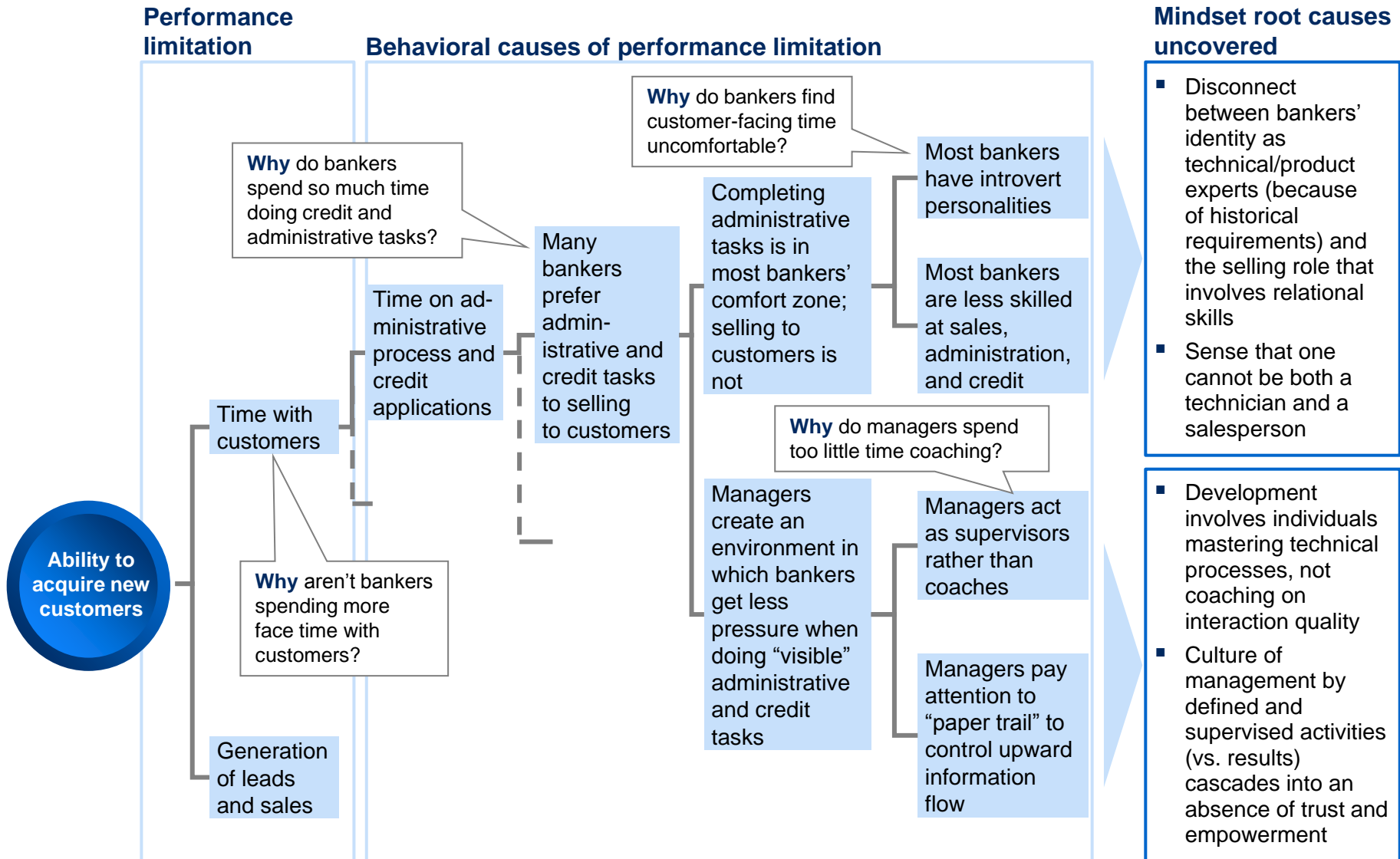
**Focus on the vital few**



**Assess both what is working and what isn't**

# Assess – how ready are we to get there?

## There are analytic methods available to uncover root-cause mindsets





# Assess – how ready are we to get there?

## Ultimately organizations should focus on a vital few mindset shifts

### From transactional ...

“I am responsible for quickly and efficiently meeting the needs my clients express.”  
“Probing my clients about their financial situation would be prying into their private affairs”

### ... to relational

“I am responsible for bringing the best of my company to clients and addressing their needs whether articulated or not”  
“I need to understand my clients’ full situation before I can give them the best advice”

### From silos ...

“I know what’s right for my area and no one else can achieve what I can”

### ... to collaboration

“I can learn from others and there is great value in ‘mining the seams’ together”

### From blame ...

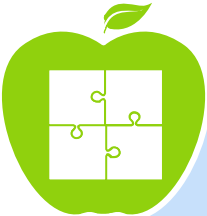
“There is a lack of clarity regarding accountabilities around here.”  
“I show up at each meeting so I can watch my back”

### ... to accountability

“I seek to clarify my and others’ accountabilities if they are unclear”  
“I trust others to do what they are supposed to do in a fair manner”

# Architect – what do we need to do to get there?

On the health side, this means architecting the implementation using the key levers that drive people to change



**Understanding how to make change happen at an individual level**



**Create the right context**



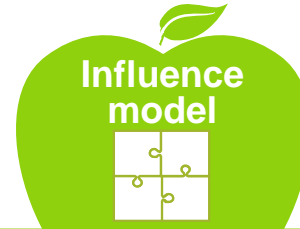
**Use performance initiatives to influence mindset and behavioral change**



**Expect and leverage irrationality**

# Architect – what do we need to do to get there?

## 4 levers are available to leaders to influence mindsets



### Role modeling

- Top team participates in customer metric reviews
- Every top team member co-leads a cross-business customer-centric initiative

### A compelling story

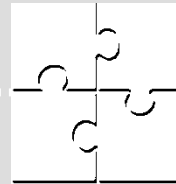
- Quantitative customer loyalty analyses shared broadly, proving value/link
- Transformation story
- Coordinated, memorable communications campaigns

### Skills required for change

- Top 300 leaders as “enterprise assets”
- New leadership behavioral standard
- 360-degree feedback and “field and forum” training on creating value across “silos”

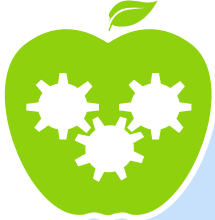
### Reinforcing mechanisms

- A number of cross-business councils
- Compensation and consequences linked
- Customer metrics and measurements built into all key business processes



# Act – how do we manage the journey?

On the health side, it means taking a structured approach, building broad ownership, and measuring impact



Ten teams,  
each with ten members  
were asked for their collective  
ten priorities

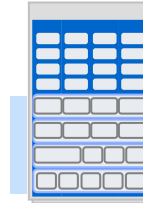


Heaven = 100

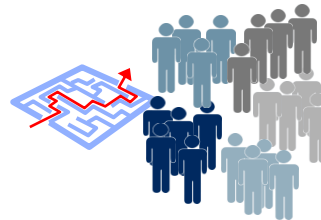


Hell = 1,000

Answer: 922



Take a structured approach



Build broad ownership for change



Measure and evaluate

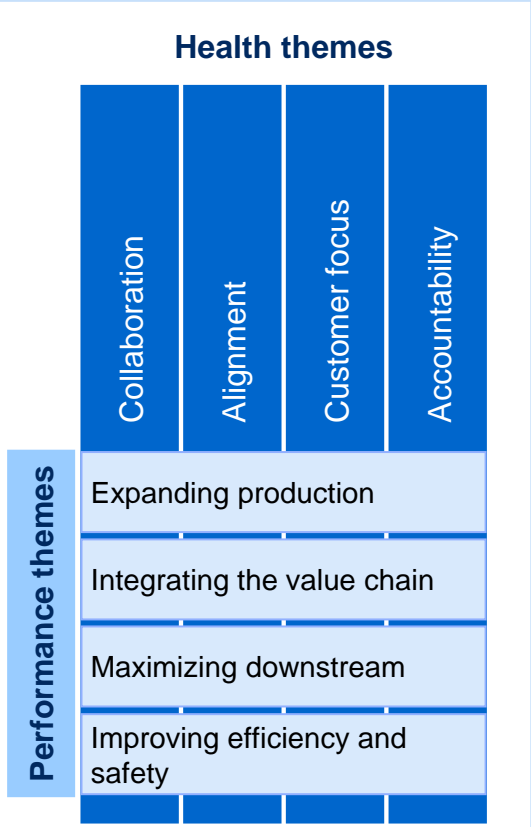
# Act – how do we manage the journey?

## Adopting a 3-level structure brings coherence to the journey

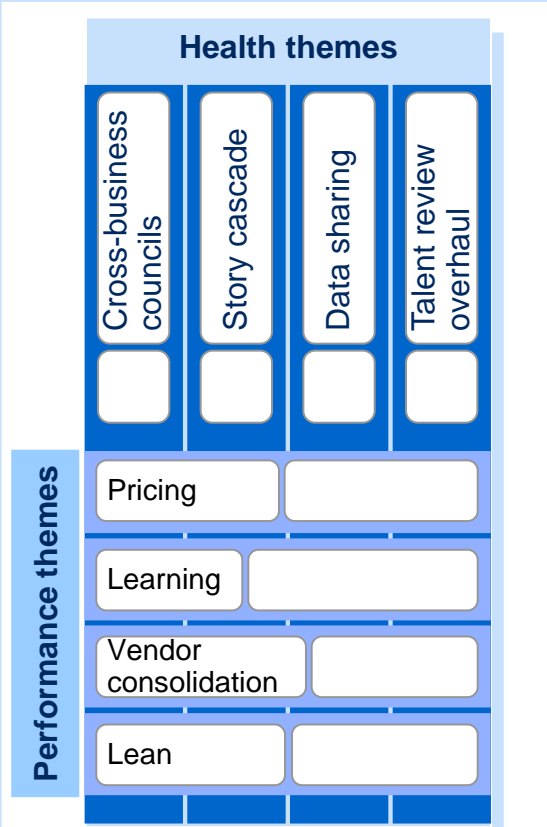
**Level 1: transformation headline**

To become a highly competitive integrated company, recognized as one of the top five energy producers worldwide and as the employer of choice in our industry

**Level 2: performance and health themes**



**Level 3: specific initiatives**



# Advance – how do we keep moving forward?

On the health side, this means developing leaders to drive the change

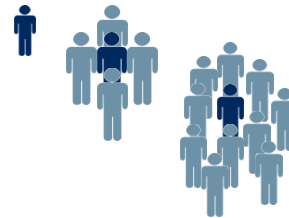


No organization can depend on genius; the supply is always scarce and unreliable. It is the test of an organization to make ordinary human beings perform better than they seem capable of ... **The purpose of an organization is to enable common men to do uncommon things**

– Peter Drucker,  
1954



**Develop centered leaders to drive continuous learning and improvement**



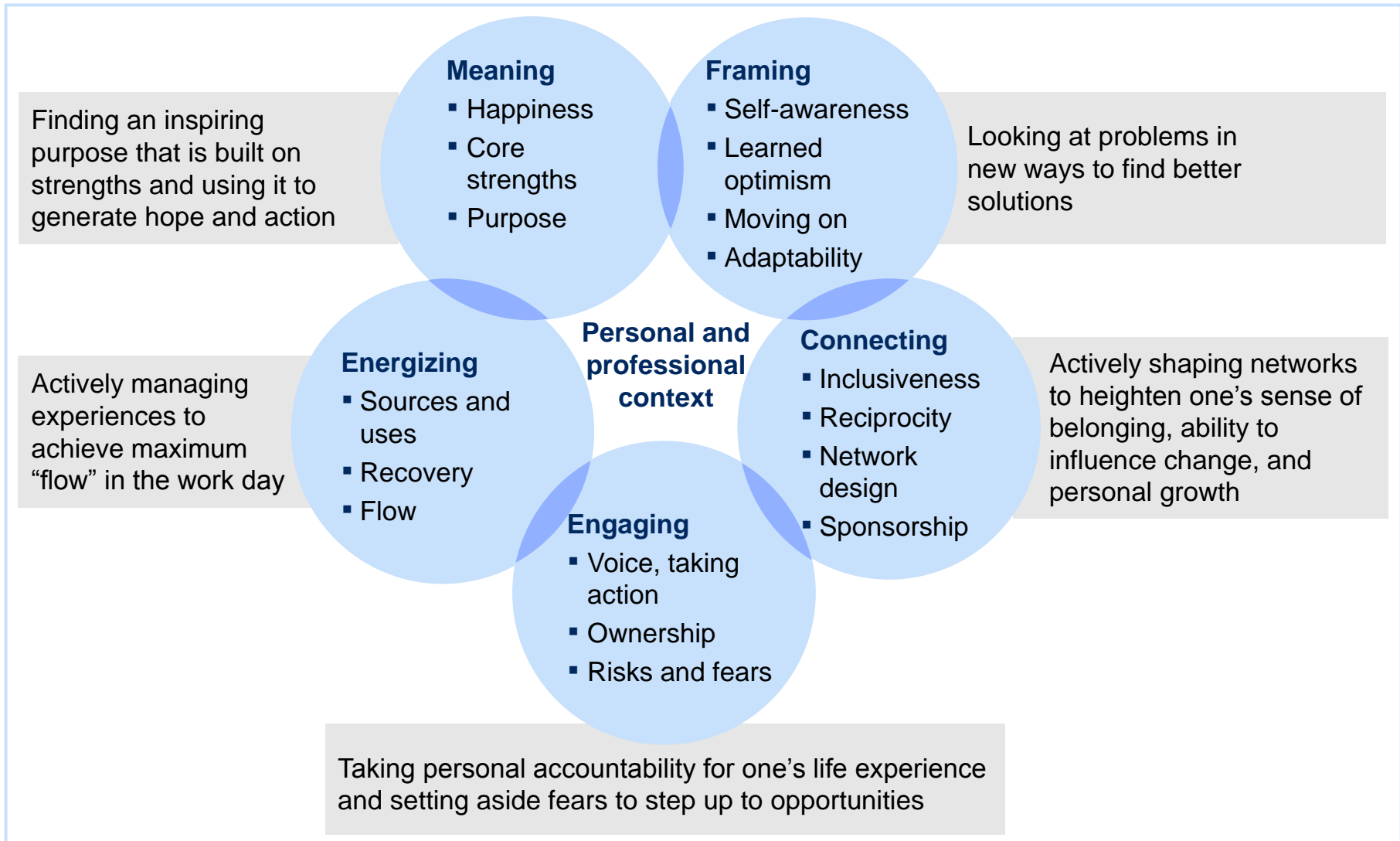
**Build skills in individual, team and organizational leadership**



**Apply adult learning principles**

# Advance – how do we keep moving forward?

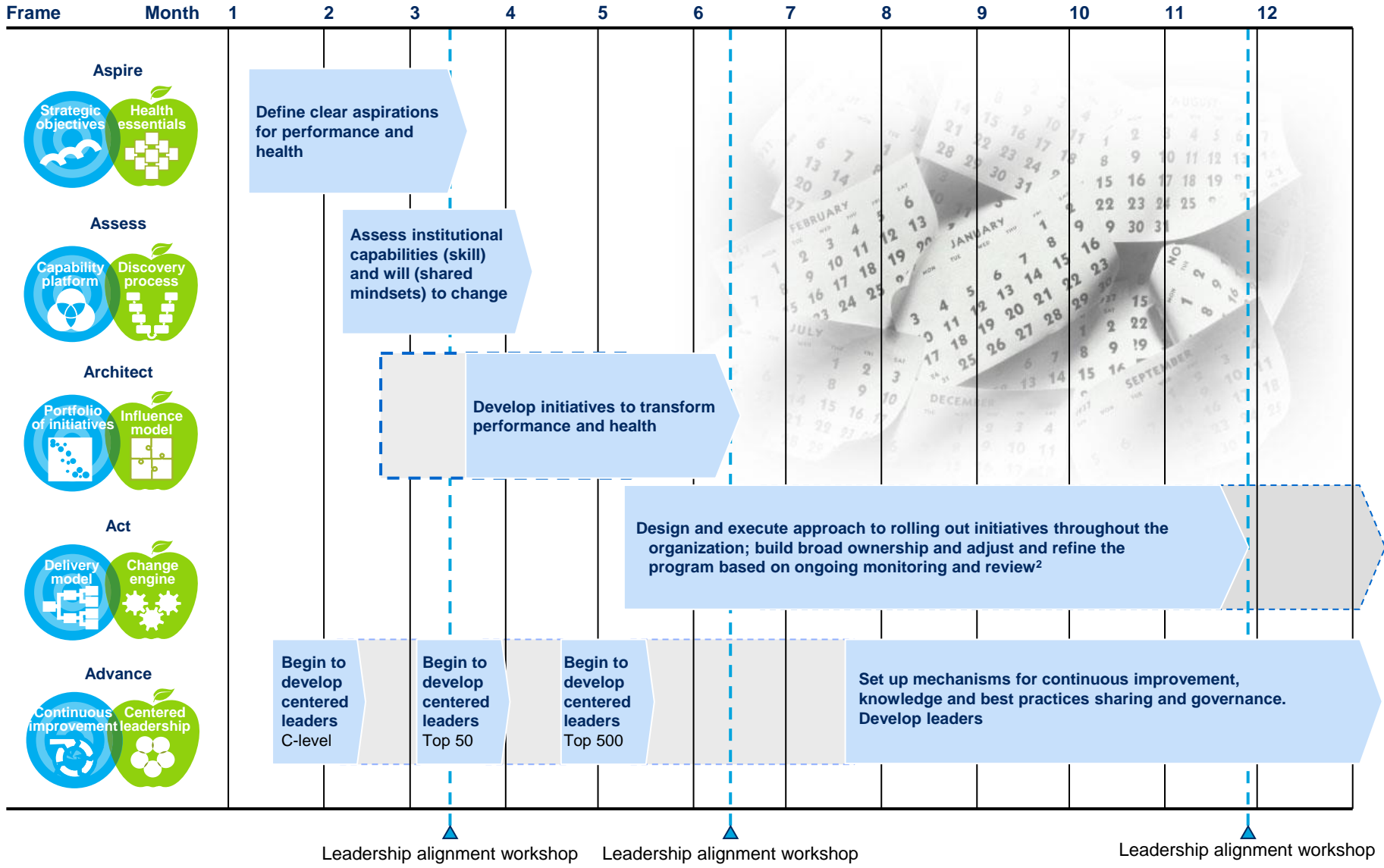
## The centered leadership model



# A typical transformation program covering all 5 frames can take from 12 months up to 2-3 years<sup>1</sup>

EXAMPLE

Objective



<sup>1</sup> Duration and resource need may vary significantly depending on type of transformation, specific company situation, and chosen company delivery model

<sup>2</sup> Usually takes from 3-6 months but could take up to 2-3 years depending on number of business units, functions, regions, and employees covered



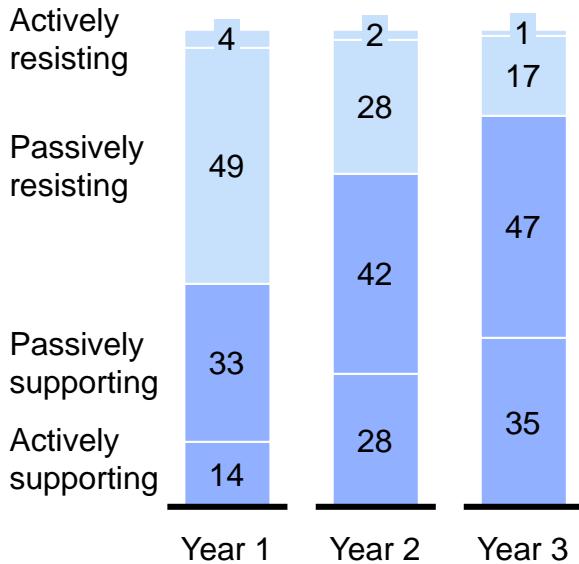
# Performance and health: An evidence-based approach to transformational change

- In the present competitive environment, **companies' long-term success is determined by their ability to adapt and change**. However, **most companies struggle to achieve substantial, sustainable change** over time
- The most extensive research effort of its kind has shown that successful, sustainable transformations can be reliably achieved by managing **both the performance and health of the transformation with equal rigor**
- We have developed a **five-stage approach** to rigorously manage performance and health during transformational change. This document will focus on the key aspects of managing health:
  1. **Aspire:** Align on where you want to go
  2. **Assess:** Determine the change readiness of the organization to go there
  3. **Architect:** Determine how to get from here to there
  4. **Act:** Manage the journey as it unfolds
  5. **Advance:** Ensure sustainability and continuous improvement beyond the step change
- The **impact** of this approach has proven to be reliable and significant, creating measurably higher and more sustainable returns

# 1 Impact national oilco achieved via its transformation

## Culture impact

### Employee support for transformation changes



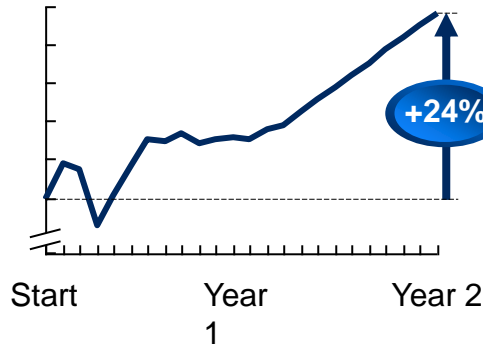
“Before, I had no hope we could change and thought the transformation would fail. But now, I believe we can succeed.”

Middle manager in critical position

## Business outcomes

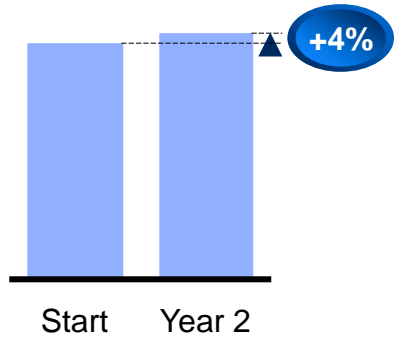
### Upstream

Oil production<sup>1</sup>, Bpd



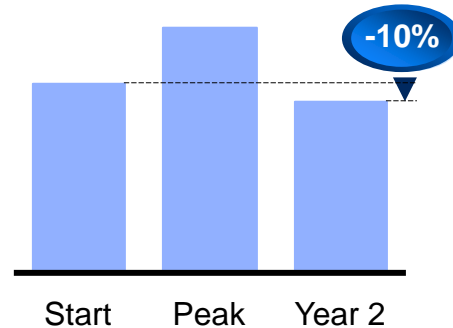
### Refining

Yield



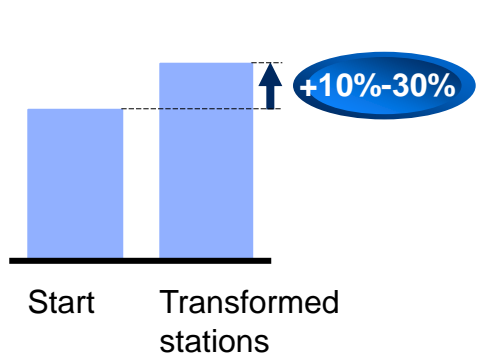
### Shipping and distribution

\$ cost per liter



### Downstream retail

Sales of brand X fuel, liters



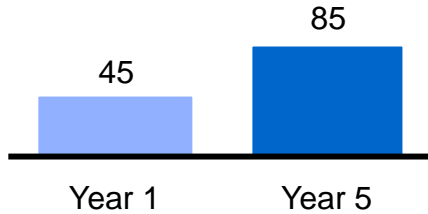
<sup>1</sup> Excluding new developments/fields

## 2 Impact bankco achieved along the value chain

### Culture impact

#### Job satisfaction

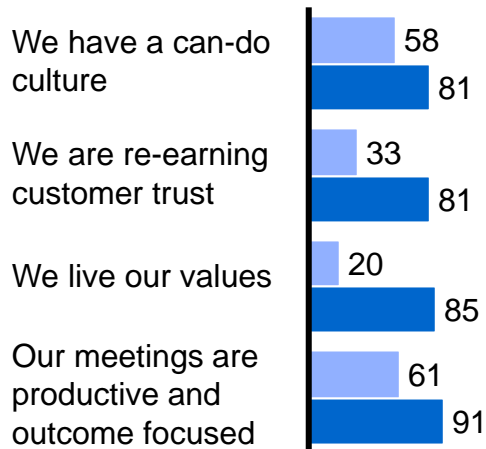
"I am satisfied with my job"  
% agreeing



#### Impact focus

% agreeing

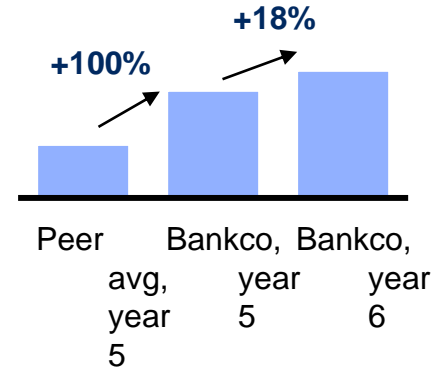
■ year 1  
■ year 5



### Customer impact

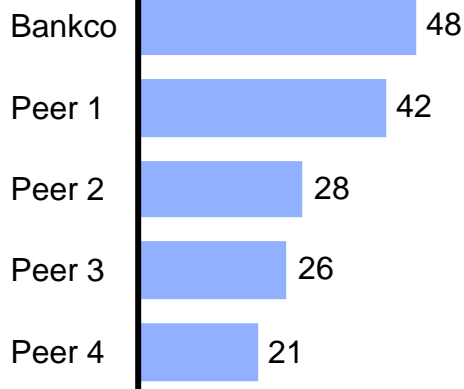
#### Transaction account net growth

%



#### Use of online channel, retail accts

%, year 5

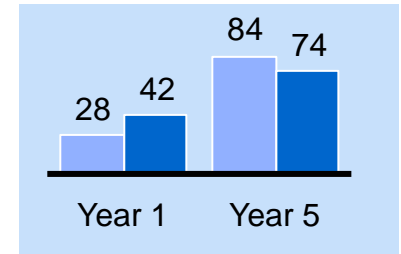


### Business outcomes

#### NPAT per FTE

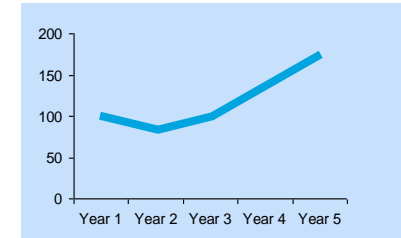
\$, indexed

■ Bankco  
■ Industry avg



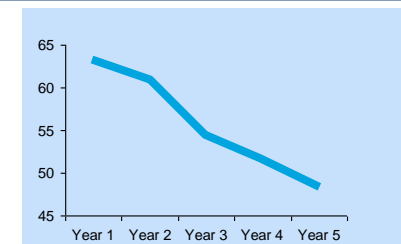
#### Total shareholder return

%



#### Cost – income ratio

%



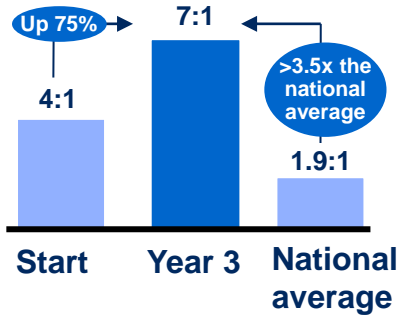
### 3 Bankco 'good to great' impact along the profit chain

Start  
Year 3

#### Culture impact

##### Employee engagement

Ratio of engaged to disengaged employees<sup>1</sup>

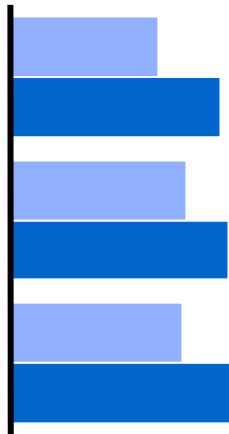


##### Collaborating for the customer

Our ways of working make it easy for customers to do business with us

Other work groups collaborate to serve our customers

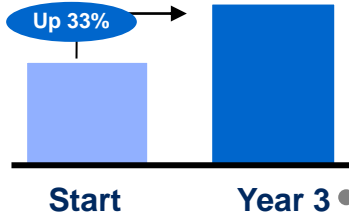
Customer problems get corrected quickly



#### Customer impact

##### Customer loyalty<sup>2</sup>

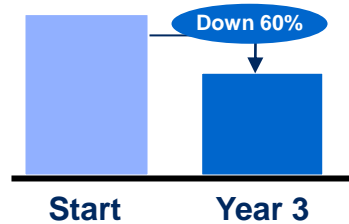
% customers answering 5 on a 5-scale



Customer loyalty has now moved into the top quartile of the Gallup database

##### Customer attrition

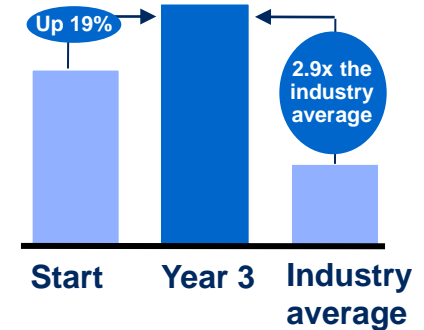
% customers



#### Business outcomes

##### Cross-sell

No. of products per household – retail banking



##### Growth

CAGR start – year 3

	Bankco	Indexed peer avg
Earnings per share	17x	(nil)
Total return to shareholders	220	100
Net revenue	280	100 <sup>3</sup>

1 The employee engagement survey measures items such as “I know what is expected,” “I have the tools,” “I have opportunities/development,” “I am recognized,” “My colleagues care,” “My opinion counts,” “My work is important for the company,” “My co-workers are committed,” etc. ...

2 This survey measures customers satisfaction, likelihood to recommend and continue to use 3 U.S. financial services average

# 4 Insureco 'turnaround' transformation impact

## Context

### External context

- Previously privileged position unwinding because of deregulation
- A number of new multinational entrants, both banks and large insurers
- Mono-line attackers specializing in specific product types
- Customer buying patterns changing toward direct channels

### Company context

- More than 40,000 collaborators
- Decreasing profitability
- Unsatisfied employees
- Uncontrolled costs
- After a second year of losses, a new CEO was chosen by family owners with mandate to turnaround the company's performance

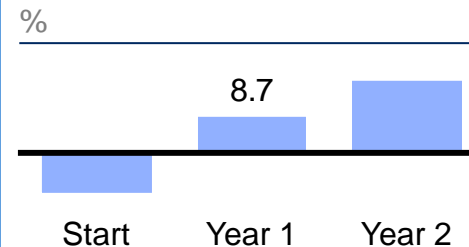
## Health impact<sup>1</sup>

		Year 0	Year 2
Direction alignment	Direction	55%	87%
	Leadership	69%	78%
	Environment and values	64%	81%
Conducting execution	Accountability	69%	82%
	Capabilities	80%	91%
	Motivation	52%	77%
	Coordination and control	56%	76%
Renewal	External orientation	71%	83%
	Innovation	59%	82%

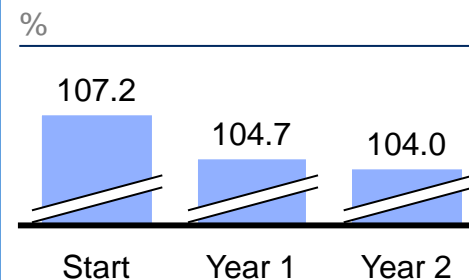
**Top 3% of all results in OHI database**

## Performance impact

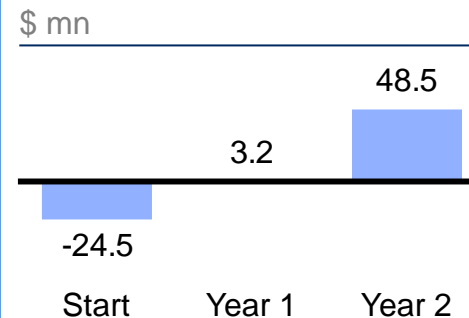
### ROIC



### Combined ratio



### Technical result



<sup>1</sup> About 90% response rate in each survey period with the survey conducted for the entire workforce

# The Five Frames of Transformational Change

June 2014

CONFIDENTIAL AND PROPRIETARY  
Any use of this material without specific permission of McKinsey & Company is strictly prohibited

