CHAPTER 1

The Big Idea

Performance and Health

In early 2004, the Coca-Cola Company was struggling. Since the death of CEO Roberto Goizueta in 1997, its fortunes had suffered a sharp decline. Over that seven-year period, Coke's total return to shareholders stood at minus 26 percent, while its great rival PepsiCo delivered a handsome 46 percent return. Two CEOs had come and gone. Both had overseen failed transformation attempts that left employees weary and cynical. A talent exodus was under way as leaders in key positions sought to join winning teams elsewhere.

At this less than auspicious moment, enter Neville Isdell. As vice chairman of Coca-Cola Hellenic Bottling Company, then the world's second-largest bottler, he had enjoyed a long and successful career in the industry. Since retiring from that role he had been living in Barbados, doing consultancy work and heading his own investment company. However, the opportunity to lead the transformation of one of the world's iconic companies was a powerful lure, and he was soon installed in the executive suite at headquarters in Atlanta.

Isdell had a clear sense of what needed to be done. The company had to capture the full potential of the trademark Coca-Cola brand, grow other core brands in the noncarbonated soft drinks market, develop wellness platforms, and create adjacent businesses. But how could he follow these paths to growth when his predecessors had failed?

Experience told him that focusing solely on improving performance wouldn't get Coke where it needed to be. There was another equally important dimension that wasn't about the performance of the organization, but its health. Morale was down, capabilities were lacking, partnerships with

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bottlers were strained, the company's vision was unclear, and its once-strong performance culture was flagging.

Just a hundred days into his new role, Isdell announced that Coke would fall short of its meager third- and fourth-quarter target of 3 percent earnings growth. "The last time I checked, there was no silver bullet. That's not the way this business works," Isdell told analysts.[1] Later that year, Coke announced that third-quarter earnings had fallen by 24 percent, one of the worst quarterly drops in its history.

Having acknowledged the shortfall in performance, Isdell ploughed onward, launching what he called Coke's "Manifesto for Growth." This outlined a path to growth showing not just where the company aimed to go, but what it would do to get there, and how people would work together along the way. Working teams were set up to tackle performance-related issues such as what the company's targets and objectives would be and what capabilities it would require to achieve them. Other teams tackled health-related issues: how to go back to "living our values," how to work better as a global team, and how to improve planning, metrics, rewards, and people development to enable peak performance. The whole effort was designed through a collaborative process. As Isdell explained, "The magic of the manifesto is that it was written in detail by the top 150 managers and had input from the top 400. Therefore, it was their program for implementation."[2]

It wasn't long before the benefit of addressing performance and health in an integrated way became apparent. Shareholder value jumped from a negative return to a 20 percent positive return in just two years. Volume growth in units sold increased from 19.8 billion in 2004 to 21.4 billion in 2006, roughly equivalent to sales of an extra 105 million bottles of Coke per day. By 2007, Coke had 13 billion-dollar brands, 30 percent more than Pepsi. Of the 16 market analysts following the company as of July 2007, 13 rated it as outperforming, and the other three as in line with expectations.

These impressive performance gains were matched by visible improvements on the health side. Staff turnover at U.S. operations fell by almost 25 percent. Employee engagement scores saw a jump that researchers at the external survey firm hailed as an "unprecedented improvement" compared with scores at similar organizations. Other measures showed equally compelling gains: employees' views of leadership improved by 10 percentage points to 64 percent, and communication and awareness of goals increased from 65 percent to 76 percent.

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But the biggest change could be felt in the company's halls. In a 2007 interview, Isdell noted that "When I first arrived, about 80 percent of the people would cast their eyes to the ground. Now, I would say it's about 10 percent. Employees are engaged."[3] When he returned to retirement in July 2008, he was able to hand over a healthy company that was performing well.

The Health of Organizations

Neville Isdell's actions at Coca-Cola revealed his intuitive grasp of a great paradox of management. When it comes to achieving and sustaining excellence in performance, what separates winners from losers is, paradoxically, the very focus on performance itself. Performance-focused leaders invest heavily in those things that enable targets to be met quarter by quarter, year by year. What they tend to neglect, however, are investments in company health—investments in the organization that need to be made today in order to survive and thrive tomorrow.

Perhaps surprisingly, we have found that leaders of successful and enduring companies make substantial investments not just in near-term performance-related initiatives, but in things that have no clear immediate benefit, nor any cast-iron guarantee that they will pay off at a later date. At IT and consultancy services company Infosys Technologies, for instance, chairman and chief mentor N. R. Narayana Murthy talks of the need to "make people confident about the future of the organization" and "create organizational DNA for long-term success."[4]

So why is it that focusing on performance is not enough—and can even be counterproductive? To find out, let's first look at what we mean by performance and health.

Performance is what an enterprise delivers to its stakeholders in financial and operational terms, evaluated through such measures as net operating profit, return on capital employed, total returns to shareholders, net operating costs, and stock turn.

Health is the ability of an organization to align, execute, and renew itself faster than the competition so that it can sustain exceptional performance over time.

For companies to achieve sustainable excellence they must be healthy; this means they must actively manage both their *performance* and their *health*. Our 2010 survey of companies undergoing transformations revealed

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that organizations that focused on performance and health simultaneously were nearly twice as successful as those that focused on health alone, and nearly three times as successful as those that focused on performance alone.[5]

High performance is undoubtedly a requirement for success. No business can thrive without profits. No public sector organization can retain its mandate to operate if it doesn't deliver the services that people need. But health is critical, too. No enterprise that lacks robust health can thrive for 10, 20, or 50 years and beyond.

In fact, we would argue that strong financial performance can have a perverse effect: it sometimes breeds a degree of complacency that leads to health issues before long. In the months before the 2008 economic crash, the financials of most banks were at record highs. Similarly, oil at record prices of more than US$200 per barrel led the oil majors to declare record profits. As it turned out, this didn't mean that the banks and the oil companies were in the best of organizational health.

The importance of organizational health is firmly supported by the evidence. When we tested for correlations between performance and health on a broad range of business measures, we found a strong positive correlation in every case. For example, companies in the top quartile of organizational health are 2.2 times more likely than lower-quartile companies to have an above-median EBITDA (earnings before interest, taxes, depreciation, and amortization) margin, 2.0 times more likely to have above-median growth in enterprise value to book value, and 1.5 times more likely to have above-median growth in net income to sales (Exhibit 1.1). Across the board, correlation coefficients indicate that roughly 50 percent of performance variation between companies is accounted for by differences in organizational health.

The results from our large sample of companies are mirrored by the results within individual organizations. At a large multinational oil company, we analyzed correlations between performance and organizational health across 16 refineries. We found that organizational health accounted for 54 percent of the variation in performance (Exhibit 1.2).

So strong is this relationship between performance and health that we're confident it can't have come about by chance. We'd be the first to admit that correlations need to be treated with caution. Take an example: education and income are highly correlated, but that doesn't mean that one causes the other. It's just as logical to argue that a higher income creates opportunities for higher education as it is to argue that higher education creates opportunities for a higher income (and even if it does, we can't infer that everyone who gains more education will have a higher income).

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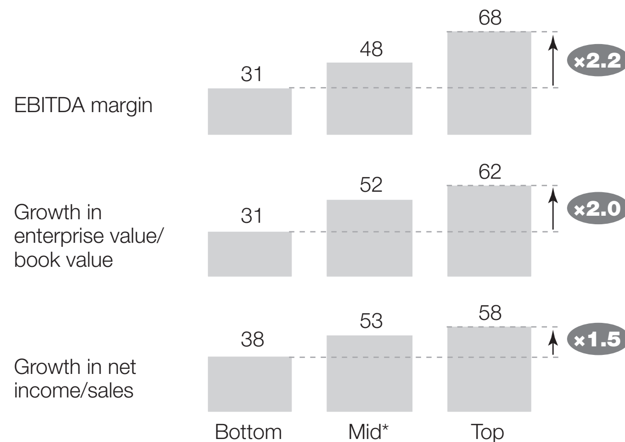
Exhibit 1.1
Healthy Companies Perform Better



* Comprised of second and third quartiles

But our argument doesn't rely solely on correlations. On the strength of our research and analysis, we assert that the link between health and performance is more than a correlation, and is in fact causal. We argue that the numbers show that at least 50 percent of your organization's success in the long term is driven by its health, as we see in Chapter 2. And that's good news. Unlike many of the key factors that influence performance—changes in customer behavior, competitive moves, government actions—your organization's health is something that *you* can control. It's a bit like our personal lives. We may not be able to avoid being hit by a car speeding round a bend, but by eating properly and exercising regularly we are far more likely to live a longer, fuller life.

To shed more light on this causal link, here's an anecdote from our own experience. At McKinsey, we hold an internal competition called the Practice Olympics to develop new knowledge. A "practice" is a group of consultants dedicated to a specific industry (such as financial services) or function (such as strategy). In the Practice Olympics, teams of consultants

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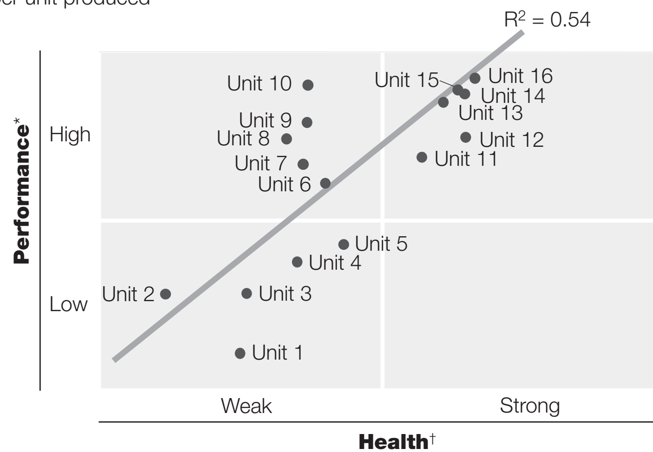
Exhibit 1.2
Impact of Health on Performance at Business-Unit Level

Example: Refineries at an oil company

US$ per unit produced



*Relative to industry average
†Relative to OHI database average

compete to develop new management ideas and present them to a panel of judges at local, regional, and organization-wide heats. In 2006, the topic of performance and health made it through to the last round.

A few days before their final presentation, the performance and health team decided to add in an extra ingredient. Rather than drawing conclusions from a retrospective view of performance and health at various organizations, they asked themselves, "If we look at the health of today's high-performing companies, what does it tell us about their prognosis for performance in the future?" After reviewing publicly available information about Toyota, the team concluded that it would face performance challenges within the next five years. What were the reasons for this seemingly unlikely verdict? The team noted that Toyota's strong focus on execution meant that its organizational health was partly driven by how well it developed talent in key positions—something that was likely to come under strain before long because of the way it was pursuing performance.

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In 2005, Toyota had set itself the aspiration to overtake General Motors as the world's largest carmaker. Renowned for its manufacturing expertise, the company had developed unusually close collaborations with suppliers during decades of shared experience. But this new aspiration would force it to expand so rapidly that it was hard to see how its supply-chain management capability could keep up. The company would have to become increasingly dependent on new relationships with suppliers outside Japan, yet it didn't have enough senior engineers in place to monitor how these suppliers were fitting into the Toyota system. And those engineers it did have wouldn't be able to give new suppliers a thorough grounding in how to do things the Toyota way in the limited time available.

In front of the judges at the finals of the 2006 Practice Olympics, the team put their stake into the ground. Toyota, with its proud reputation for building quality into its products at every step, was likely to have health issues that would affect its medium-term performance. Having sat through a day of novel ideas, the panel of judges reacted with outright disbelief. Toyota had just posted a 39 percent increase in net profit largely driven by U.S. sales, and appeared to be on a roll. One of the judges remarked that the team's prediction was "provocative, but completely ridiculous."

Fast forward to 2010, and Toyota was in the throes of recalling a number of models on safety grounds. So serious was the situation that its president Akio Toyoda was called before the U.S. Congress to offer an explanation and an apology for the defects. The general consensus on the reasons for the breakdown in quality was in line with the turn of events that the team had foreseen four years earlier.

That organizational health matters is repeatedly borne out by leaders' testimonies. Larry Bossidy, former chairman and CEO of Honeywell and Allied Signal, comments that, "The soft stuff—people's beliefs and behaviors—is at least as important as the hard stuff. Making changes in strategy or structure by itself takes a company only so far."[6] Don Argus, retired chairman of BHP Billiton, suggests the key to long-term success is to "mobilize and develop our people to unleash their competencies, creativity, and commitment to get things moving forward."[7] We could fill a chapter with similar quotes from virtually every successful leader we have spoken to.

The notion that organizational health matters as much as performance makes intuitive sense when we consider that ultimately it isn't organizations that change; it's people. Take people away and the life-blood of the organization is gone, leaving only the skeleton of infrastructure: buildings, systems, inventory.

Because getting and staying healthy involves tending to the people-oriented aspects of leading an organization, it may sound "fluffy" to hard-nosed executives raised on managing by the numbers. But make no mistake: cultivating health is far from a soft option. As the co-founder of *Fast Company*, William C. Taylor, observed in his book *Practically Radical*: "The truth is, the work of making deep-seated change in long-established organizations is the hardest work there is."[8] Nor should health be confused with other people-related management concepts such as employee satisfaction or employee engagement. Organizational health is much more profound and far-reaching. It is about the extent to which your organization is able to adapt to the present and shape the future faster and better than your competitors can. In that sense, health encompasses all the human elements required to achieve sustainable success.

The Perils of Performance

Ask almost any business leader about a company's goals and you are likely to hear some variation on the performance mantra: "We want to outperform our peers." "We aspire to lead the market in performance." A laser-sharp focus on performance—on doing better according to metrics such as profits and share price—pervades modern business. Of course, there's nothing wrong with focusing on performance, or profits, or a rising share price—unless, that is, a fixation on short-term results debilitates the organization and jeopardizes its future, leaving it incapable of achieving more than a brief moment of glory.

Here the history of Atari provides a cautionary tale. The company was founded in 1972 to exploit what was then no more than a figment of a designer's imagination: the electronic game. In 1973, Atari sold US$40 million worth of these games (remember Pong?) and earned US$3 million in profits. Not long after, it was bought by deep-pocketed owners who invested heavily in R&D. In 1980, it was on top of the world, posting record revenues of US$415 million and being hailed as the fastest-growing company in U.S. history. Two years later, it was saluted by Thomas Peters and Robert Waterman in their book *In Search of Excellence*.

But even as the book's readers were discovering how Atari excelled, the company was crumbling. Teamwork began to decline, communication broke down, a culture of risk avoidance set in, investment in R&D was cut, and product quality was sacrificed to the cause of faster time-to-market.

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The result was some of the biggest duds in video-gaming history. The shoddy visuals and poor playing characteristics of the games console versions of Pac-Man and ET alienated hitherto devoted customers. Fed-up engineers left in droves, many to set up or join rival companies whose innovative products would soon woo away Atari's fan base. By 1983, the rot had set in. The company lost US$536 million and resorted to massive layoffs.

Atari never recovered the glory of its heyday. The shell of the company, by then little more than a brand name, was sold in 1998 for a paltry US$5 million. Although Atari may have been consigned to history, the gaming market to which it belonged has gone from strength to strength. Worth US$25 billion globally, it is still growing at a tremendous pace.

Two questions arise from this sorry story. Where did Atari go wrong? And how did Peters and Waterman miss it?

A single answer will suffice. Both the company and its chroniclers were so intently focused on performance that they were oblivious to the symptoms of deteriorating organizational health: declining teamwork, reduced investment in R&D, and the other factors that we noted above.

By way of contrast, consider the case of Pixar. The CGI animation studio had earned 24 Academy Awards, six Golden Globes, and three Grammys at the last count—all the more impressive given that its president, Ed Catmull, had no business experience before he co-founded the company. In a talk about Pixar's creative process, he noted that the company's development process differs from that at most Hollywood studios: "Our development team doesn't look for stories. Their job is to create teams of people that work well together."[9]

While an average Hollywood studio produces between six and 12 films in a year, Pixar produces just one, a risky bet given that an animated film costs approximately US$180 million to make. "We have realized that having lower standards for something is bad for your soul," Catmull explained. Pixar's internal culture, known for its alternative, lifestyle-oriented feel, focuses on avoiding "no, but . . . " responses to other people's ideas and suggestions. "What you need to create," states Andrew Stanton, the writer and director of *Finding Nemo*, "is the most trusting environment possible where people can screw up."[10] Taking the right risks and accepting that bold, innovative ideas require a tolerance for uncertainty are central to the whole culture. As Catmull says, "Talent is rare. Management's job is not to prevent risk but to build the capability to recover when failures occur."[11]

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Another company from Peters and Waterman's research on excellence, General Motors, provides a further chastening example of the consequences of poor organizational health. In 2009, the company that once led America's "Big Three" automakers and dominated the world's car market filed for bankruptcy and received a government bailout of US$50 billion to resurrect itself. This was not a sudden fall from grace, but a calamity that had crept up on the company over time. In 2005, GM posted a loss of US$10.6 billion. By 2007, its losses for the year were US$38.7 billion. Sales for the following year dropped by a whopping 45 percent. By the fourth quarter of 2008, GM had reported it would run out of cash around the middle of the following year unless it was able to secure government funding, a merger, or a sale of assets.

Following an 18-month turnaround, GM made a return to the stock market in late 2010. Although the stock offering raised almost US$20 billion and helped to reduce the government's stake in the company from 61 percent to 33 percent, many would agree with an article that described GM as "a shadow of the company that once symbolized U.S. might" and saw it as still plagued by the repercussions of its short-term performance focus.[12] Mark Reuss, the head of North American operations, admitted that, "We have a lot of work to do. . . . There are a lot of people who do not understand who we are. We need to re-create the soul of the company."[13]

What had gone wrong? On the face of it, GM fell victim to its own strategic and operational choices. For instance, it had eight distinct brands while competitors such as Honda had just two. This drove up marketing spending, yet it still wasn't enough to saturate the target audiences, given that the investment had to be spread across such a broad portfolio. Innovation—or rather the lack of it—was another weak spot. As fuel prices soared and environmental concerns grew more urgent, competitors responded by investing in hybrid technologies, but GM stuck with its traditional focus on large vehicles with poor fuel efficiency. Product quality didn't keep pace with the competition either: for instance, in industry comparisons, every single Chrysler model was rated in the bottom quartile for quality.[14] At the same time, a fully funded pension plan negotiated with unions put GM at a strategic disadvantage in terms of its labor costs.

Scratch beneath the surface, though, and we can trace back the source of these strategic and operational failures to breakdowns in organizational health. GM had been aware of all these issues for 20 years. In the 1990s and early 2000s it had plenty of cash, but failed to use it. In discussing the company's downfall, the *New York Times* reported that "GM's core problem

is its corporate and workplace culture—the . . . essential attitudes, mindsets and relationships that are passed down, year after year."[15] The article quotes from a "brave and prophetic" memo written by former GM executive Elmer Johnson as early as 1988: "We have vastly underestimated how deeply ingrained are the organizational and cultural rigidities that hamper our ability to execute." In the end, the company's undoing came down to decisions that overemphasized short-term performance and neglected factors contributing to long-term success.

Perhaps the starkest example of the perils of pursuing performance at the expense of health is the story of Albert J. Dunlap, famous for taking over struggling companies, ruthlessly downsizing them, and selling them at a profit. Dunlap's mantra was "If you're in business, it's for one thing—to make money." In 1996, he took over U.S. appliance maker Sunbeam Products and, true to his "Chainsaw Al" nickname, sold two-thirds of its plants and fired half of its 12,000 employees. Ironically, at this point Sunbeam's stock price proceeded to rise so high that it wrecked his plans to sell the company. Having compromised Sunbeam's health, Dunlap now found he needed to sustain its performance for the coming years. But the damage was too great. By 1998, Sunbeam was facing quarterly losses as high as US$60 million, and Dunlap was fired.

Compare Dunlap's tactics to those of Lou Gerstner when he took the helm at IBM in 1993. Despite pressure from Wall Street to engineer a rapid turnaround at the ailing technology giant, Gerstner decided not to focus exclusively on improving its performance, but to put considerable effort and resources into improving its health as well. Under Gerstner's stewardship, the company worked on collaborating as "one IBM" across businesses. It became more externally oriented, reduced bureaucracy, and moved from an arrogant to a continuous learning mindset. By the time Gerstner retired nine years later, the stock had increased in value by 800 percent, and IBM had regained its leadership in multiple areas of the computer, technology, and IT consulting industry.

In retrospect, it's easy to see that the period of economic history between the collapse of Enron in 2001 and that of Lehman Brothers in 2008 was characterized by an obsessive focus on short-term business performance. During this time wealth creation as measured by shareholder value rose dramatically, only to crash leaving shareholders with huge losses. Although the crisis can be blamed on a multitude of factors, including strategic errors and ineffective regulatory regimes, the failure of large companies to tend to their organizational health is clearly implicated.

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Take Enron: part of the blame for its collapse has been attributed to dubious accounting practices that allowed the energy giant to keep its spiraling debt off its balance sheet. A bigger question, though, is why Enron had allowed itself to become so highly leveraged in the first place. The story goes that it had taken a number of hasty investment decisions in its desire to continue to show shareholders impressive growth in the face of mounting losses. At the time, a source close to top Enron executives neatly phrased this as "You make enough billion-dollar mistakes and they add up."[16]

In order to retain shareholder confidence, Enron's top management developed increasingly complex off-balance-sheet financing systems that were a mystery to most employees, outside observers, and even members of the company's own board. Enron's steadily rising stock price and investment grade shielded it from public scrutiny until the very end, when concerns about its accounting methods and complex financial arrangements came to the surface. Its subsequent declaration of losses in October 2001 led its stock price to tumble, triggering arrangements with investors that required loans to be paid back immediately. Unable to generate further leverage thanks to its nose-diving stock price, Enron eventually filed for Chapter 11 bankruptcy—another sobering example of the possible consequences of an excessive focus on performance.

The Enron collapse prompted a number of financial and accounting reforms designed to prevent similar situations from arising in the future. Yet these reforms did little to curb the appetite for quick returns and consequent performance focus that led to a number of equally spectacular collapses during the 2008 financial crisis. Lehman Brothers, a 158-year-old Wall Street bank that had financed corporate giants such as Macy's and 20th Century Fox, stands out as one of the sorriest cases.

At the beginning of the financial crisis in 2006, Lehman was no more or less entrenched in the housing market than other banks. However, it was one of the few that had made direct investments in commercial real-estate deals. In 2007, when even U.S. treasury secretary Henry Paulson was encouraging securities houses to scale back their balance sheets, Lehman continued to invest, doubling its real-estate commitments from US$20 billion to US$40 billion in the space of just one month.[17] Betting against the market had paid handsome dividends for the bank during previous crises such as the Russian ruble devaluation of 1998.

Ignoring warnings of an imminent collapse, Lehman continued on its downward path, bolstering its market position by overvaluing its deadly mortgage assets and announcing record profits in 2007. Once again, the desire to continue to deliver short-term performance overshadowed the need

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to conduct an honest assessment of the firm's position and take corrective measures. Eventually the bank had to revise its valuation of its mortgage assets, which led it to declare losses in late 2008. The market reacted almost immediately, sending Lehman's stock price into free fall. The bank made a number of internal changes in the hope of bolstering the market, but it was too little, too late. Lehman Brothers eventually filed for the largest corporate bankruptcy in U.S. history.

A more recent and equally sobering account is that of energy giant BP and its 2010 Deepwater Horizon disaster, the largest marine oil spill ever experienced in the petroleum industry. After an explosion in a drilling rig that killed 11 men and injured 17 others, a seafloor gusher proceeded to leak more than 200 million gallons of crude oil into the Gulf of Mexico. According to White House energy adviser Carol Browner, the spill was the worst environmental disaster the United States had ever faced.[18]

How did such a devastating turn of events come to happen at BP, once voted Europe's most admired company, and an organization with a long and impressive heritage? Press reports have pointed to cost pressures and tight deadlines as possible causes of the difficulty BP had in handling the disaster. Similar causes had been cited before for smaller-scale crises at the company. Inquiries into an incident at the Texas City refinery in 2005, for example, cited BP's "short-term focus" as a key factor. Bob Dudley, the recently appointed CEO, has conceded that BP must "look at risk management of safety in a different way."[19]

The tendency to emphasize performance at the expense of health is not confined to the private sector. The National Health Service in England harnesses the talents of 1.4 million people to pursue the noble purpose of providing universal health care that is free at the point of service. Yet even the best-intentioned institutions are not immune to unhealthy subcultures. A recent inquiry into "shocking" systematic failures of hospital care at the Mid Staffordshire NHS Foundation Trust revealed that patients were left, as one newspaper reports, "routinely neglected, humiliated and in pain as the trust focused on cutting costs and hitting government targets."[20]

The inquiry concluded that the failures of care, which led to between 400 and 1,200 more deaths than at other hospital trusts between 2005 and 2008 (after correction for patient numbers and pathology), was driven by a host of factors. These included short-term target-driven priorities, disengagement of clinicians from management, low staff morale, lack of openness, acceptance of poor standards of conduct, and denial of criticisms. In other words, the Mid Staffordshire NHS Foundation Trust was suffering from a breakdown in organizational health.

In a bid to maintain its Foundation Trust status,[21] the hospital had undertaken crippling cost-cutting measures that had left it with too few clinical staff and nurses, inadequate training, and problems with the availability and functioning of vital equipment. The accident and emergency (A&E) department, one of the hospital's worst offenders, would often rely on unqualified receptionists to triage patients, and then simply leave the patients in a nearby ward to ensure that the national four-hour target for A&E waiting time was met. Overburdened clinical staff raised concerns, but were mostly ignored. Things got so bad that the majority of staff didn't want to be treated by their own hospital if they became ill.[22]

The chairman of the independent inquiry into the case, Robert Francis QC, observed that "Such a culture does not develop overnight but is a symptom of a long-standing lack of positive and effective direction at all levels. This is not something that it is possible to change overnight either, but will require determined and inspirational leadership over a sustained period of time from within the Trust."[23]

The Genius of "And"

The Mid Staffordshire case is a sharp reminder that poor organizational health doesn't just hit shareholders, but also hurts employees, customers, and communities. A McKinsey survey of more than 2,000 senior executives carried out in 2010 reveals that transformations that ignore health and focus only on performance are 1.5 times more likely to fail in the long run.[24] Leaders could hardly have a stronger rallying call to give equal weight to health and performance. The good news here is that research and experience both tell us that performance and health are not in conflict, but are complementary. In fact, the most important word in "performance and health" is the "and."

To see why, consider a sports team that is focusing single-mindedly on its performance. If all it thinks about is winning games and titles this season, it will have a rude awakening in years to come. It will have failed to recruit new members, develop the bench, secure stakeholder support, obtain financial backing, build community relationships, and so on.

On the other hand, if the team takes steps to improve its health, it will improve its performance as well. Recruiting promising new members will help it perform better in the future. In turn, performing better will make it easier to recruit new members and secure financial backing. A team that

performs well this year is a product of superior financing, recruitment, and training in the past. In this way, paying attention to performance *and* health creates a virtuous cycle of sustained excellence over time. An important aspect of the "and" concept is that both performance and health require action *today*, even though returns on investments in health may not materialize for many years.

Let's take another analogy from the sporting world. For athletes, the route to future performance comes from tending to underlying health right now, long before any signs of deterioration or illness set in. World-class athletes don't just perform, they also monitor their body fat, diet, fitness regime, and lifestyle in general, and curb bad habits such as smoking, drinking, and staying up late. They also monitor leading indicators of health such as blood pressure, cholesterol level, and heart rate. If today's performance was their only concern, they wouldn't worry about most of these measures. And if they waited for their performance to decline before doing anything about their health, it could be a long road back to the top. Worse yet, if they waited for alarming symptoms such as chest pains before acting, it might be too late for any corrective measures to make a difference.

As with our bodies, so too with our organizations. The evidence, as we'll see in Chapter 2, supports the conclusion that sustainable organizational excellence requires a focus on both performance and health. But health is not a word that you'll often encounter in companies' annual reports or in the business press. Do capital markets understand organizational health? Or will a company that chooses to invest in its health be punished before its investments begin to pay off by markets that would prefer to see it focus on enhancing performance in the short term?

There is undoubtedly a noisy segment of analysts and traders fixated on the next quarter's earnings. Contrary to conventional wisdom, however, markets *do* recognize that health is essential for turning a company's growth prospects, capabilities, relationships, and assets into future cash flows (which are what most investors are looking for). As a former managing director of McKinsey, Ian Davis, observes, "An examination of share prices demonstrates that expectations of future performance are the main driver of shareholder returns. In almost all industry sectors and almost all stock exchanges, up to 80 percent of a share's market value can be explained only by cash flow expectations beyond the next three years. These longer-term expectations are in turn driven by judgments on growth and—a lesson relearned after the dot-com bust—on long-term profitability."[25]

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The Five Frames of Performance and Health

If achieving sustained excellence means paying close attention to performance *and* health, how can leaders bring about significant and mutually reinforcing improvements on both these fronts at the same time? The answer is to follow a structured process designed to transform performance and health in an integrated manner.

The mathematician and philosopher René Descartes advised us to "Divide each difficulty into as many parts as is feasible and necessary to resolve it." For a large corporation, achieving organizational excellence is an enormous undertaking that can involve tens if not hundreds of thousands of people. Various academics, commentators, and practitioners have recommended breaking down the change process in a multitude of different ways: you can identify, plan, adopt, maintain, evaluate; believe, decide, act, achieve, maintain; evaluate, vision, organize, link, vest, embed; prepare, connect, discover, activate, integrate; or define, discover, dream, design, destiny. However, the good news for leaders is that most of these people are saying much the same thing.

We've chosen to describe the process for achieving organizational excellence in terms of five basic questions that need to be answered in order to make change happen. Each question is summed up in a word beginning with the letter "A" to make it simple and memorable, and so the five stages in the process are collectively known as the "5As." Here they are:

- *Aspire:* Where do we want to go?
- *Assess:* How ready are we to go there?
- *Architect:* What do we need to do to get there?
- *Act:* How do we manage the journey?
- *Advance:* How do we keep moving forward?

In turn, each of the 5As translates into a specific challenge for performance and for health, and a particular approach for tackling it.

In performance, these challenges (and approaches) are:

- *Aspire:* How to develop a change vision and targets (the strategic objectives).
- *Assess:* How to identify and diagnose an organization's ability to achieve its vision and targets (the capability platform).
- *Architect:* How to develop a concrete, balanced set of initiatives to improve performance (the portfolio of initiatives).

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- *Act:* How to determine and execute the right scaling-up approach for each initiative in the portfolio (the delivery model).
- *Advance:* How to make the transition from a transformation focused on a one-time step change to an era of ongoing improvement efforts (the continuous improvement infrastructure).

And in health, the challenges (and approaches) are:

- *Aspire:* How to determine what "healthy" looks like for an organization (the health essentials).
- *Assess:* How to uncover the root-cause mindsets that drive organizational health (the discovery process).
- *Architect:* How to reshape the work environment to influence healthy mindsets (the influence model).
- *Act:* How to ensure that energy for change is continually infused and unleashed (the change engine).
- *Advance:* How to lead transformation and sustain high performance from a core of self-mastery (centered leadership).

In Part II of this book we show you how you can successfully navigate through the five stages in a transformation (the 5As) by adopting the approaches listed above, which are summarized visually in Exhibit 1.3. Taken together, these approaches are known as "the five frames of performance and health." We use the word "frames" to acknowledge that change doesn't happen in a linear way in real life, even if it may sometimes be portrayed that way on paper. When an organization undergoes a transformation, it experiences a process that is dynamic and iterative, rather than a one-way sequence of separate steps.

For example, when a company looks at where it is today during the "assess" stage, it often uncovers information and insights that send it back to refine the change vision and targets it developed earlier during the "aspire" stage. In much the same way, a company may need to go back and forth between the performance and health frames within a particular stage. When it is working on health essentials during the "aspire" stage, for instance, it may uncover health constraints that lead it to tone down the strategic objectives it had initially planned to set for its performance.

We should also stress that the approach we propose in this book is designed not only to support an organization through a one-time cycle of major change, but to help it increase its capacity to change and keep changing over time. In effect, our aim is not to help organizations "learn

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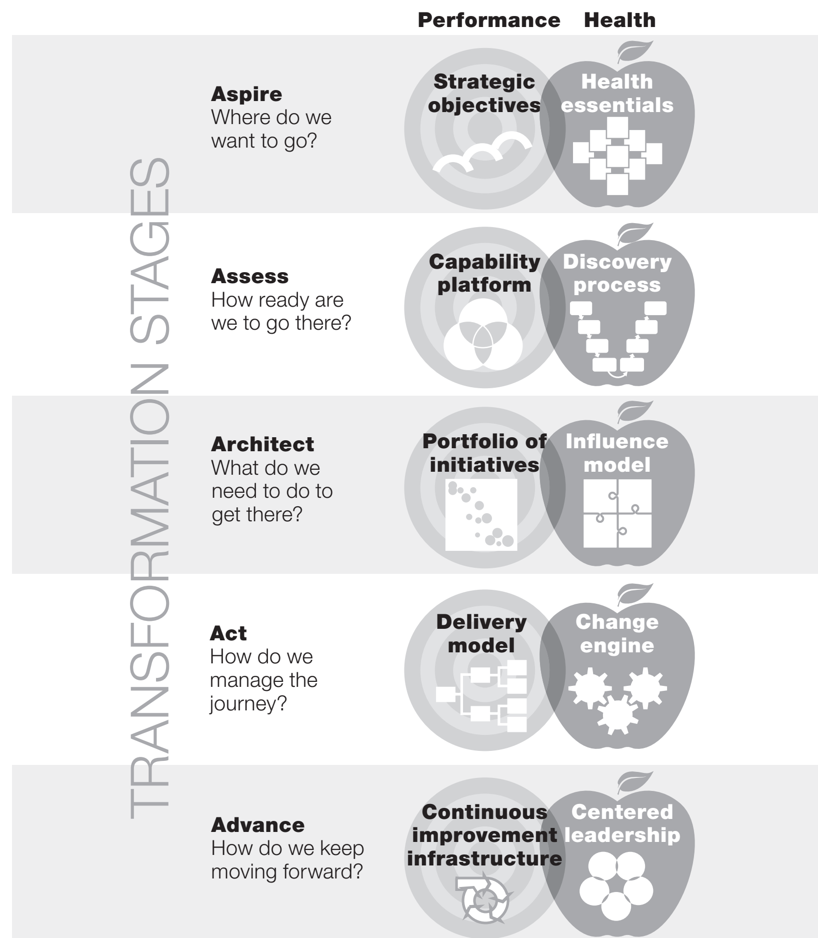
Exhibit 1.3
The Five Frames of Performance and Health



to adjust" to their current context, or to challenges that lie just ahead, but to help them "learn to learn" so that they will be able to respond flexibly to, and even shape, whatever the future may hold in store. The old adage applies: give a man a fish and he will eat today; teach a man to fish and he will eat every day. To extend the metaphor, teach a man to learn and he will be able to hunt and gather and farm as well as fish.

Organizations that learn are able to keep finding new sources of value and capturing them more quickly and effectively than their peers, creating the ultimate competitive advantage that we talked about in the Introduction.

To see how the five frames of performance and health work together, imagine that you *aspire* to become a marathon runner. You decide which marathon you'd like to compete in, find out when it takes place, work out how long you have to train for it, and set your performance targets accordingly. Perhaps you even have a finishing time in mind. Having decided on your performance aspiration, you can then work out your health aspiration: the level of fitness you'll need to run the marathon in your chosen time.

Next you need to *assess* your current capability as a runner. On the performance side of things, how fast can you run? How good is your technique? Do you have the right equipment? Can you get access to the facilities you need? On the health side, do you have the mental toughness to achieve your target fitness level? What dietary changes are you prepared to make to get into better shape? How much time are you willing to dedicate to training? If you have unhealthy habits like smoking or staying up too late, do you have the willpower to give them up?

Armed with this information, you can *architect* a training plan to improve your performance by alternating high- and low-intensity workouts and extending your range gradually over a few months. On the health side, you can plan a diet that will give you the energy you need. You may also want to make adjustments in other aspects of your life: letting go of commitments to free up time, telling your friends you won't be seeing them so often for a while, finding the money to pay for a trainer, and so on.

Then it's time to *act* on the plan. In terms of performance, you start out gradually and then ramp up your training. In terms of health, you change your diet and your life in general in the ways that you've planned, monitor and review your results, adjust your approaches as you go, and find ways to keep your energy levels and motivation high.

As you get closer to the date of the marathon, you consider how to make this more than a one-off event—how you can *advance* your running afterward. On the performance side, what will be your baseline training regime before you ramp up again for your next marathon? On the health side, how will you prepare yourself mentally to make marathon running a regular part of your life? What if you get injured? How will you keep a good balance between your training, your work, and your personal life?

It isn't hard to see how this way of thinking can be applied in a management context. We've found that the concept of tending to both the

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performance and the health of an organization makes intuitive sense to most experienced managers. Indeed, the case for promoting health is easy to make. The real challenge, however, is to adopt it as our "permanent residence," and not just a nice place to visit during episodes of discursive thinking. As Chris Argyris, a business theorist and expert on learning organizations, might say, it needs to become the "theory-in-use."

Apart from the next chapter, in which we describe our evidence base, research, and analytical methods, the rest of the book is devoted to exploring how leaders of organizations can approach the five frames of performance and health. Although both aspects are critical, we go into much more depth on health. Why? Because that's where the greatest need exists. Most companies already know how to keep a close eye on performance; it's their health that more often suffers from neglect. By way of example, when we asked more than 2,000 executives to nominate the areas where they wished they had better information to help them design and lead transformation programs, only 16 percent chose "determining what needs to be done to generate near-term performance." On the other hand, more than 65 percent chose "determining what needs to be done to strengthen the company's health for the longer term."[26]

This appetite for guidance on long-term health makes sense when we look at the data regarding why change programs fail. What we might think of as the usual suspects—inadequate resources, poor planning, bad ideas, unpredictable external events—turn out to account for less than a third of change program failures. In fact, more than 70 percent of failures are driven by what we would categorize as poor organizational health, as manifested in such symptoms as negative employee attitudes and unproductive management behavior (Exhibit 1.4).[27]

In the chapters that follow, we look at numerous examples of organizations that have grappled with such symptoms, traced their root causes, and brought themselves back to sound health—and have stayed that way. Their stories show that it can be done, but it is no easy task. As Roger Enrico, former chairman and CEO of PepsiCo, put it, "The soft stuff is always harder than the hard stuff."[28]

Of course, no two change programs are alike; any organization embarking on a transformation will need to devise its own journey in the light of its own internal and external context. Having said that, we believe that the five frames of performance and health contain all the key ingredients to deliver a successful organizationwide transformation in almost any circumstance. Is your performance under pressure from mounting shareholder expectations, rising consumer demands, increasing competition, a changing regulatory

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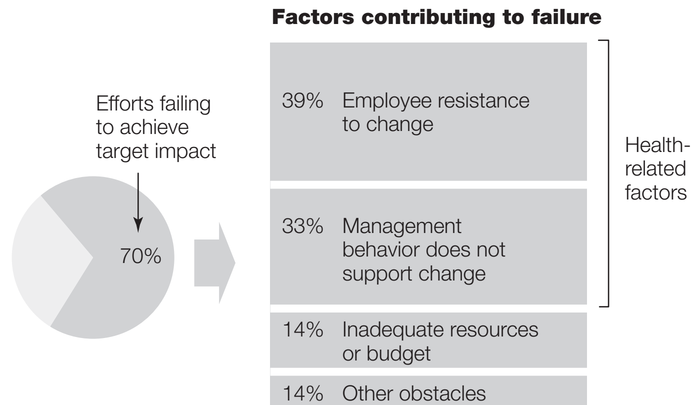
Exhibit 1.4
Barriers to Organizational Change



environment, or inefficient operations? The five frames can help you find better ways to tackle any and all of these.

The same goes for health concerns. Whether the issue is slow decision making, poor morale, a weak performance ethic, a lack of talent, or confusion over roles and responsibilities, the five frames can be used to tackle the causes and restore good organizational health.

Achieving sustained organizational excellence by understanding and applying the five frames of performance and health is undoubtedly more complex an answer than some readers will be looking for. After all, it involves working through 10 separate frames, each with several steps of its own. Where are the rules of thumb that typically reside in management literature, you may wonder? Not here—for the simple reason that such principles are all too often, paradoxically, both common sense and yet astoundingly difficult to put into practice.

Louis Lavelle, in a book review in *BusinessWeek,* puts this well: “To hear most authors of business books tell it, there is no management conundrum so great that it can’t be solved by the deft application of seven or eight basic

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principles. The authors are almost always wrong: Big public companies have too many moving parts to conform to any set of simple precepts."[29]

We agree. Our aim is not to offer a simplistic checklist, but to provide thoughtful insights and guidance to help leaders achieve excellence in anything from the smallest start-up to the largest and most complex multinational organization. At the same time, we've tried not to introduce any complexity that doesn't add value. We've done our best to abide by Einstein's edict that everything should be made as simple as possible, but no simpler.