Zero-based productivity—Organization: Using zero-based principles to forge a purpose-built organization

By redirecting resources and employees to higher-value areas, companies can ensure that organizational structure and spending align with business strategy.

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Single-minded pursuit of growth and scale can produce impressive top-line revenues. However, executives can discover that, along the way, organizational issues—including siloed functions, redundant capabilities across business units, and gradual mission creep as functions take on added responsibilities—have impeded greater profitability.

Achieving a successful organizational transformation is far from an easy feat. According to the McKinsey Transformation Change survey, just 26 percent of companies accomplish their performance objectives and can lay the groundwork for sustained results.[1] A range of barriers, from assuming the current organizational structure as a starting point to overlooking external spending, can hinder efforts to improve efficiency and reduce costs. Further, traditional approaches to operations can miss opportunities to harness technology to boost efficiency.

Zero-basing organizations, which use zero-based principles as a lens to reshape organizational structure and operations, can unleash greater productivity. The resulting purpose-built enterprise ensures that staff and resources are allocated to the highest-value areas of the business.

Applying zero-based principles to the organization

A zero-based approach to assessing and redesigning an organization shares many of the fundamentals of zero-based budgeting. However, their application is tailored in four ways to build the core elements of the new organization from scratch and capture new opportunities.

Establishing structural visibility and consistency. Business-unit leaders aren't typically monitoring the growth of other departments or the roles of employees to identify redundant positions. Companies should focus on gaining visibility into where resources are allocated throughout the organization, determining staffing levels, and assessing role definitions. And by establishing governance processes, companies can monitor variances in staffing over time.

Ensuring comprehensive benchmarking. By conducting a 360-degree review, companies can gain insights into multiple dimensions of productivity, including organizational size and structure, pay grades, spans and layers, automation, the mix of activities, and function-specific productivity factors (such as a shared-services center). Using both internal and external data sets for benchmarking enables intelligent target setting by comparing productivity levels within an organization across units on both efficiency (for example, cost per full-time equivalent) and effectiveness (such as error rates).

Understanding and exploring linkages to strategy and capabilities. A zero-based approach seeks to link organizational designs to strategic priorities (for example, areas for investment compared with efficiency optimization) instead of a "one-size-fits-all" solution across the business. By implementing organizational designs that, instead of simply evaluating existing talent, reflect the talent and capabilities required in the future, zero-based organizations create structures that can evolve as business priorities change.

Exploring the 'art of the possible.' A program featuring zero-based principles can catalyze transformative idea generation as to how the business is organized. In addition, companies should create a culture of innovative solutions that moves beyond boxes on the organizational chart to focus on changing the way work gets done (often through stretch targets). The result can be a more agile, responsive organization that is better positioned to pursue new opportunities.[2]

Zero-basing the organization addresses common transformation hurdles: it uses a clean-sheet approach to design, gathers a solid fact base, and takes a holistic view on costs. By drawing on a comprehensive set of design levers, companies can embrace an agile, iterative way of working to identify and address the needed shifts in both behavior and mind-sets.

Applying zero-based principles to your organization

Using zero-based principles as a lens to assess organizational spending and capabilities combines both effectiveness (What do we expect people to accomplish for the organization?) and efficiency (How do we create a lean, agile, and responsive organization?). With this approach, companies can capture significant efficiencies while upgrading capabilities and increasing value across functions. Moreover, these principles can ensure that the highest-value roles within the organization are clearly identified and staffed with the most qualified workers.

Zero-based organization goes far beyond the incremental improvements of typical performance improvement programs to create a fit-for-purpose organization (exhibit). This shift often produces a new operating model, empowers employees, and enables the reallocation of up to 20 to 40 percent of staff spending to other areas.

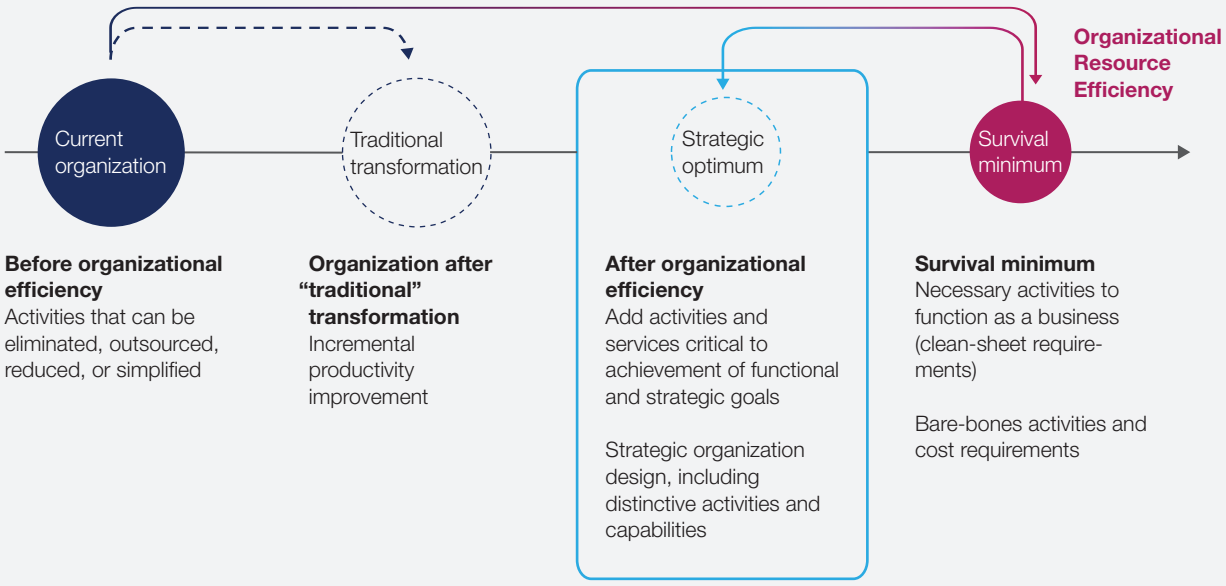
Zero-basing an organization can be accomplished through a five-step process.

1. Create transparency by taking an end-to-end perspective on both staff and nonstaff costs. Companies can use this transparency to understand overall budgets, compare their organization with peers', and highlight opportunities to apply approaches such as shared services, process redesign, and automation to reduce costs.

2. Determine a survival minimum, defined as the organizational capacity needed to keep the lights on for the business. Often, companies convene senior leaders to gain consensus on the activities vital to operations. Factors such as regulatory compliance and shareholder commitments should also be considered during this step.

3. Build a strategic optimum consisting of activities required to support function-level strategy. This step involves reinstating activities—for example,

Exhibit **Zero-basing creates a fit-for-purpose organization.**



Source: McKinsey & Company

investments in company culture or the creation of an analytics center of excellence—that are deemed critical to pursuing business objectives.

4. Align on design principles to guide organizational decisions—including structure (the number of spans and layers in management), governance, people, and technology (such as automation). Using a core set of design principles and architecture, companies should create templates for specific functions while allowing organizations to scale up or down based on their needs. A discussion of these factors often leads companies to redesign the organizational chart to reflect greater clarity on management and direct reports as well as add a shared-services function.

5. Stress-test the organization before going live and then develop a change-management plan. Companies must verify that the new organization structure can function properly and support business operations. Once these exercises are conducted, business leaders should be prepared to communicate to employees how the approach will improve operations—as well as how their actions tie to the organization's overarching goals.

One major retailer with more than 1,000 locations, 100,000 employees, and $15 billion in annual revenues sought to support its organizational transformation by starting from a clean sheet. It followed a zero-based organization approach in an effort to reduce costs and increase organizational agility. As a pilot, it sought to develop new operating models in its HR and marketing functions, with the goal of building the capabilities to support an enterprise-wide rollout. The retailer relied on frequent iteration to ensure it could adapt quickly to new information and analysis.

Initial results were impressive: the retailer identified opportunities to reduce costs by 30 to 50 percent across functions and developed practical blueprints to rebuild the HR and marketing functions. Further, a clean-sheet approach to indirect marketing spending uncovered cost savings of 20 to 30 percent—resources that were reallocated to higher-value areas within the functions and throughout the organization.

Over time, companies can find themselves saddled with an organization that is misaligned with its business strategy. Organic growth and the pursuit of new opportunities can result in a lack of visibility across departments that hides unnecessary spending. Using zero-based principles to assess organizational spending can bring much-needed clarity while directing resources to where they can have the greatest impact.

[1] Steven Aronowitz, Aaron De Smet, and Deirdre McGinty, "Getting organizational redesign right," *McKinsey Quarterly,* June 2015, McKinsey.com.

[2] Wouter Aghina, Aaron De Smet, Gerald Lackey, Michael Lurie, and Monica Murarka, "The five trademarks of agile organizations," January 2018, McKinsey.com.

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