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Reorganizing to capture maximum value quickly

Companies need an organizational design that's stable yet can respond quickly to threats and opportunities. Here's how to build one.

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FEBRUARY 2018 • ORGANIZATION

In Leading Organizations *(Bloomsbury Publishing, June 2017), McKinsey senior partners Scott Keller and Mary Meaney address the ten basic issues facing leaders: attracting and retaining talent, developing your current talent, managing performance, creating leadership teams, making decisions, reorganizing to capture value quickly, reducing long-term overhead costs, making culture a competitive advantage, leading transformational change, and transitioning to new leadership roles.*[1] *"Attracting and retaining the right talent" (McKinsey.com, November 2017) was the first in our series of articles based on the book.*[2] *A future article will discuss transitioning to new leadership roles.*

The history of organizations is the history of humankind. Each generation seeks better ways to organize itself—from tribes ruled by all-powerful leaders to hierarchical corporations with clear divisions of labor to matrixed, cross-functional structures promoting complex forms of work and value creation. We might now be on the verge of another major advance, toward self-organizing, decentralized, and adaptive organizations.

One of the most high-profile experiments along these lines involves the online retailer Zappos, which announced in 2013 that it would become a "holarchy." Instead of having job titles or permanent roles, Zappos rearranges them by agreement among peers, while GlassFrog, a web-based tracker of decisions and outcomes, makes information transparent. This approach is rooted in Frederic Laloux's book, *Reinventing Organizations* (Nelson Parker, February 2014), which calls it "the next stage of human consciousness ... taming our ego and searching for more authentic, more wholesome ways of being."[3]

Although early results from Zappos haven't been promising, the company insists that these growing pains are but a step toward the ultimate transformation.[4] Time will tell if holarchy succeeds.[5] But either way, it isn't the end—organizations will continue to evolve. No one organizational archetype permanently ensures the best performance; too many things change across too many variables. The right model for your organization today probably combines traditional and experimental structures, formal and informal operations, and a fluid yet stable design.

Why is organizational redesign important?

It is inevitable

A 2013 McKinsey survey found that up to 82 percent of executives had experienced an organizational redesign in their current companies.[6] Seventy percent reported that the most recent redesign had been implemented during the previous two years. A majority believed that they would experience another redesign in the next two. Companies apparently revamp their organizations more often than they overhaul their websites (on average, every three years) or upgrade their computer systems (every three to five years).

A typical reorganization takes ten months from plan to practice, and more than half of the executives responding to another survey said that productivity fell during this period.[7] Companies endure such problems because their strategies must change more frequently now, given the faster pace of technological disruptions, new market opportunities, evolving customer preferences, and competitors' moves. But redesigns are not only about changing external landscapes. Companies might become unhappy with their performance, and therefore their strategies and organizational designs, even in stable times. As David Ulrich, a business-school professor and thought leader in HR management, says, companies launch this kind of transformation increasingly often, so "every leader needs to know how to do it well."[8]

Redesigns can have a profound impact

Nearly two-thirds of executives in the 2013 McKinsey survey reported that the goal of the most recent redesign was to help companies execute their strategic priorities, and more than half reported that the changes aimed to improve the focus on growth.[9] Better decision making (40 percent), cost cutting (39 percent), and accountability (39 percent) round out the top five reasons for a redesign.

When redesigns are successful, they have a profoundly beneficial impact. Yet their merits are often hard to judge because an organizational transformation that creates significant value in one era might destroy it in the next. In 1990, for example, CEO Percy Barnevik decentralized the automation and power-technology giant ABB to unleash local entrepreneurship.[10] As profits soared, academics, journalists, management gurus, and shareholders praised the structure, which was a matrix of sectors and countries divided into 5,000 profit centers. By 1996, the *Financial Times* had anointed ABB as Europe's most respected company three years running.

A bit later, though, revenue growth slowed, and the share price plummeted. The redesign seemed to be part of the problem. As one reporter wrote, "The decentralized management structure Mr. Barnevik created for the company's far-flung units ended up causing conflicts and communications problems between departments." It also promoted duplication—ABB had 576 enterprise-resource-planning systems, for example.[11] Even Barnevik had to concede that his redesign had once been good "but it is not good today."[12] In 2002, a new CEO consolidated divisions and centralized profit-and-loss accountability. A more efficient, collaborative company now generated fast, competitive bids for multinational clients. Its fortunes improved, for the time being.

Only 23 percent get it right

An aphorism claims that "your organization is perfectly designed to give you today's business results, so if you want to improve them, you should redesign your organization." But this isn't always true. Charlton Ogburn Jr. captured what happens in most cases: "We tend to meet any new situation by reorganizing; and a wonderful method it can be for creating the illusion of progress while producing confusion, inefficiency, and demoralization."[13]

In McKinsey's most recent survey of executives, only 23 percent of them reported that the reorganization had met its objectives and improved performance.[14] Forty-four percent said that the redesign had bogged down during implementation and was never finished. In 1999, for example, P&G CEO Durk Jager inherited what he saw as a complacent, conservative, and hierarchical company. He reorganized it from a geographic-divisional structure into a more decentralized confederation of product groups, giving each group a mandate to encourage innovation. But although the design seemed to make sense, Jager couldn't mobilize the organization—particularly middle managers—and departed after 18 months as CEO.[15]

Another 23 percent of organizational redesigns are fully implemented but don't meet their objectives. Chrysler, for instance, restructured its organization three times in three years to negligible effect before going bankrupt. It then merged with Fiat in 2014. An additional 10 percent of reorganizations significantly impair the performance of the companies they were meant to revive. In one such case, Terry Semel, who was then CEO of Yahoo!, tried to encourage the sharing of resources by imposing a matrix structure that in practice confused accountability and stymied decision making.[16] His reign as CEO ended in 2007. Although the number of abject failures is relatively small, repeated cycles of ineffectual change might eventually create a culture of corporate failure.

What are the big ideas?

Think beyond lines and boxes

Nearly one in ten people around the world suffers from lower-back pain.[17] Up to 90 percent of these cases have no clear-cut diagnosis. The primary causes are structural (related to soft-tissue problems) or psychological.[18] Studies suggest that surgery to address structural issues succeeds for only 26 percent of all patients.[19] Physiotherapy and psychological interventions have far better results.[20]

This is an apt analogy for organizational redesign. The probability of success is low if companies address only structural elements, such as the lines and boxes of the org chart, roles and responsibilities, functions or businesses, insourcing or outsourcing, and governance. Process elements, such as standardization, decision rights, performance management, and information flows, are the second category to consider. The people elements of a redesign, including the size of the workforce, its skills, talent in general, and culture, must also be considered.

All three of these elements (structures, processes, and people) influence the way work gets done in companies. Yet many leaders fetishize lines and boxes, which seem important to people who care about their positions in the org chart. Other leaders veer in the opposite direction and focus on personnel issues, such as who reports to whom and how corporate politics plays out as a result. Yet our data suggest that leaders who address the dynamic interactions across all the elements are three times more likely to succeed than leaders who don't.

Agility requires stability

Rupert Murdoch is credited with saying, "Big will not beat small anymore. It will be the fast beating the slow." But speed doesn't help if you are heading in the wrong direction. The real source of advantage is agility, which involves not just speed but also balance, coordination, strength, stamina, and reflexes. Being first isn't solely about being fast.

To most leaders, the speed and flexibility that drive innovation lie at the opposite end of the spectrum from standardization and centralization, which promote efficiency and control risk. Not so. Rita Gunther McGrath's research sheds light on agile organizations.[21] Large companies that raise their income disproportionately, she found, have two main characteristics: they are innovative and experimental and can move quickly but also have consistent strategies and structures, and their "culture is strong and unchanging." Our research confirms that fast yet stable companies are upward of three times more likely to perform well than fast ones that lack stable operating disciplines (Exhibit 1).

Leaders who want to make their companies agile must therefore determine which parts of the organization should be stable and which should adapt to challenges and opportunities in a faster, looser, more dynamic way. They might choose a primary organizational axis like regions or functions (stability) but deploy temporary cells to address specific issues (speed); standardize work through signature processes (stability) but conduct fast, iterative experiments to develop new products or services (speed); or emphasize shared cultural values (stability) but radically empower the front line to make decisions that embody them (speed).

In short, by constantly reorganizing around a stable core, agile companies break the cycle of recurring—and mostly futile—large-scale organization redesigns.

Nine golden rules

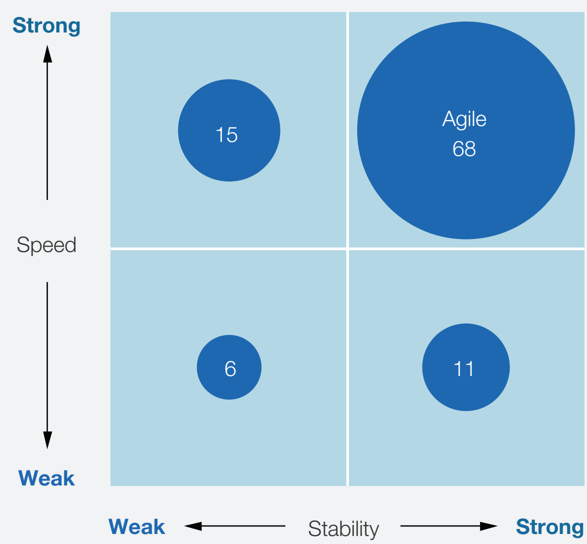
Although certain rules are made to be broken, you don't win at tennis by swatting balls off the court, to paraphrase the novelist Carlos Ruiz Zafón.[22] Research shows that when companies reorganize themselves, they should follow nine rules that make a redesign upward of seven times more likely to succeed than it would be if the company followed only a few.[23] The more of these rules they follow, the higher their chances of success (Exhibit 2) :

- Rule 1. Focus first on the longer-term strategic aspirations—dwelling only on pain points typically creates new ones.

- Rule 2. Take time to develop an accurate, verifiable picture of today's structures, processes, and people.

Exhibit 1 **Agile organizations combine stability and agility for superior performance.**

How performance relates to speed and stability in high-performing companies, %



Source: McKinsey analysis

- Rule 3. Select the right blueprint carefully by creating multiple options and testing them under scenarios.

- Rule 4. Go beyond lines and boxes; consider all three elements of organizational design.

- Rule 5. Fill well-defined roles in an orderly, transparent way. .

- Rule 6. Identify and actively change the necessary mind-sets. Do not assume that people will automatically fall in line.

- Rule 7. Use metrics to measure short- and long-term results.

- Rule 8. Make sure business leaders communicate, and create a powerful redesign narrative to inspire and mobilize the company.

- Rule 9. Monitor and mitigate transitional risks, such as interruptions to business continuity, loss of talent, and customer-care lapses.

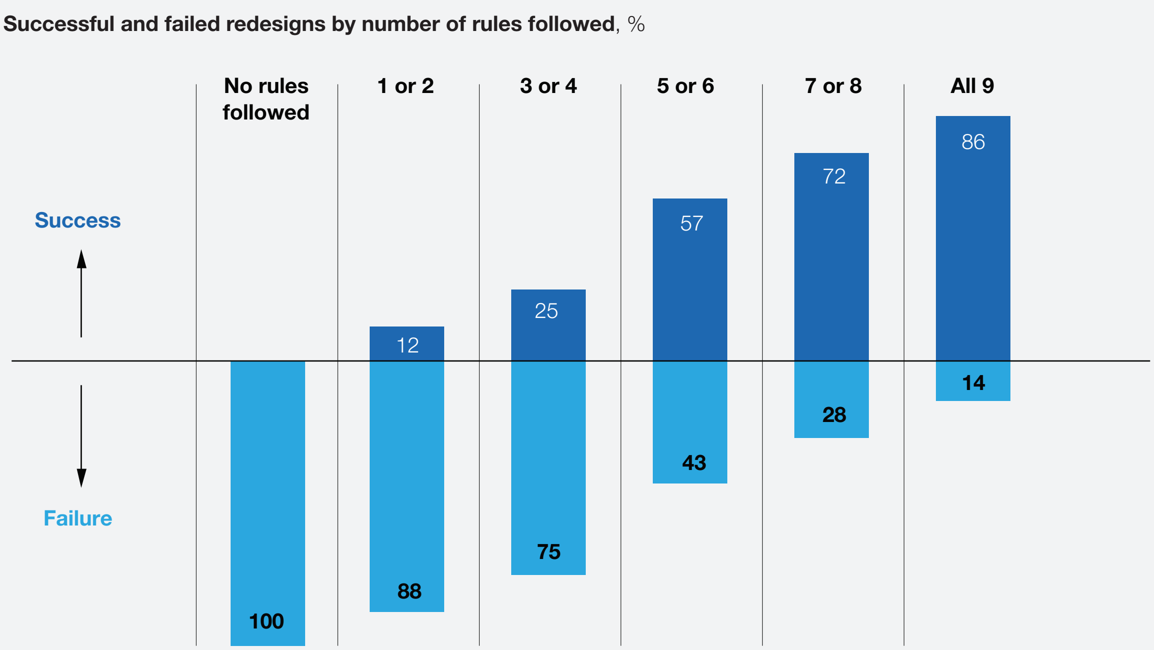
Making it happen

A large, US-based chemical company found itself outmaneuvered by smaller, more agile competitors. The company's CEO and top team decided on a new strategy to regain market share: more specialized products as well as better products and service. They understood that this strategy would require a new organizational design.

1. Aspire

The top team decided to strengthen the company's functional capabilities, particularly commercial ones, and its ability to innovate. Clarifying accountabilities would be necessary to help functional leaders understand how they could trade off competing demands and sales reps to know who

Exhibit 2 **The more a corporate redesign follows nine rules, the higher its chances of success.**



Note: Figures may not sum to 100%, because of rounding

could rule on specific customer requests. And the farrago of product lines, functions, and geographies needed simplifying; in one sales area, customers typically received uncoordinated calls from two or three sales reps, and key accounts spanning multiple geographies could be called on by ten.

The senior team had learned from failed redesigns that it needed to get the voice of the broader leadership into the mix early. Executives several levels down and high-potential talent from each area therefore participated in workshops to debate and refine the basic principles. These ideas ultimately included creating a single point of contact for priority customers, delegating decisions to the lowest possible level, clarifying accountabilities, developing explicit protocols for handovers in cross-functional processes, and creating agile project teams for ad hoc missions.

2. Assess

Before embodying the principles in a specific blueprint, the company developed a baseline picture of the current organization. Blank data fields and outdated information made this task surprisingly hard. Vague job categories obscured what people actually did, and overlapping structures double-counted certain roles, so the number of employees—in each area and overall—didn't add up.

A reorganization team then explored internal and external benchmarks. It found that staffing levels were at least 20 to 30 percent above the industry average. As the team examined R&D departments elsewhere, it realized how far the company's complex, rigid structure was from the "innovation engine" of its hopes. Yet the team also found a number of strengths: some of the industry's best technical talent in manufacturing and R&D, a sales force that understood customer needs, and a metrics-driven performance culture.

The next steps were to translate these basic principles into a set of options that took account of the organization's baseline and strengths and to pressure-test the options against plausible industry scenarios. In the resulting debates, one team argued the pros of each question, the other the cons. Ultimately, the reorganization team cut ten options down to three for presentation to the senior team, which then decided on its recommendations to the board.

3. Architect

After a robust debate, the senior team chose a top-level design based on a functional axis. All operations would report to a new COO. Salespeople across product groups and regions were to unite under a chief commercial officer, and a new R&D function would report directly to the CEO. This part of the design was the stable backbone.

Complementing it was an agile organizational overlay to help the company draw on pools of functional talent for teams to address customer and internal issues. To speed things up, each team was to be empowered and decommissioned within three months. The overall design was tested with key customers and regulators and then brought to the board, which supported it unanimously.

Next, the company held workshops for selected lower-level staff to determine how the new structure would work in each key function. These groups went through a process like the one that generated the top-level design, though shorter: understanding the principles and the current baseline and strengths, then developing and pressure-testing detailed options. Once the detailed work was complete in each area, the pieces were combined and adjustments made to ensure consistency. After top management approved this final design, it went to an HR team that compiled a list of critical job positions with specific requirements, including skills, behavior, and mind-sets. The final step was to create a rigorous talent-matching process guided by a playbook to ensure fairness and transparency.

4. Act

As the company determined who would fill key leadership roles, it developed a plan to roll out the new design. The CEO would announce it to the broader organization, and orchestrated workshops would help senior and middle managers understand the structure, process, and people implications for their areas and themselves. Conversations (including one-on-one meetings with the board, the CEO, and the top team) with the leaders most affected were to happen before the announcement. A program management office (PMO) would coordinate the process to ensure that the company met critical milestones and to monitor customer satisfaction as well as employee engagement and retention.

Mind-set and behavior changes were among the most important elements of the rollout. Leaders, for example, would have to become more comfortable being accountable for things they didn't control directly and would have to share knowledge—not protect it to get their next promotion. To encourage these shifts, the rollout plan included not only communications, skill building, and role modeling but also new processes, systems, and incentives.

5. Advance

Thanks to the leadership's involvement in the redesign, buy-in was high throughout the rollout. Transparent communication controlled anxiety and confusion. Feedback from customers and other key external stakeholders continued to be positive, in part because the company saw to it that the business functioned smoothly throughout implementation. This positive experience attracted high-quality external talent, which brought in needed capabilities and powerfully influenced desirable shifts in mind-sets and behavior. Not everything went according to plan, but the PMO quickly identified and addressed emerging issues.

After a year under the new structure, the company started to grow again. Talent in key positions worked well together. The empowered cross-functional teams of the newly agile organization seized key market opportunities. Bureaucracy no longer stalled ideas; now they were tested quickly—and then, if successful, scaled up. As the CEO said, "We didn't find a silver bullet … but we found a way to manufacture all the ammunition we need to win!"

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The authors wish to thank Aaron De Smet for his contributions to this article.