

The yin and yang of organizational health

Sustained performance over the long term and successful transformation in the near term require many of the same ingredients.

by Lili Duan, Rajesh Krishnan, and Brooke Weddle

Actions necessary to support longer-term corporate-performance objectives, on the one hand, and a rapid performance transformation, on the other, might seem at odds. But our research paints a different picture. When coupled with organizational health, long- and short-term performance can become interdependent and complementary—just as yin and yang in Chinese philosophy are inseparable, unable to exist without each other, despite their apparent opposition.

Simply put, healthy organizations are more likely to orient themselves toward the long term. And companies in the midst of a rapid performance transformation boost the odds of sustaining those efforts when they improve their health. The evidence for these propositions is substantial, and it underscores the fundamental link between organizational health and performance.

HEALTH AND THE LONG TERM

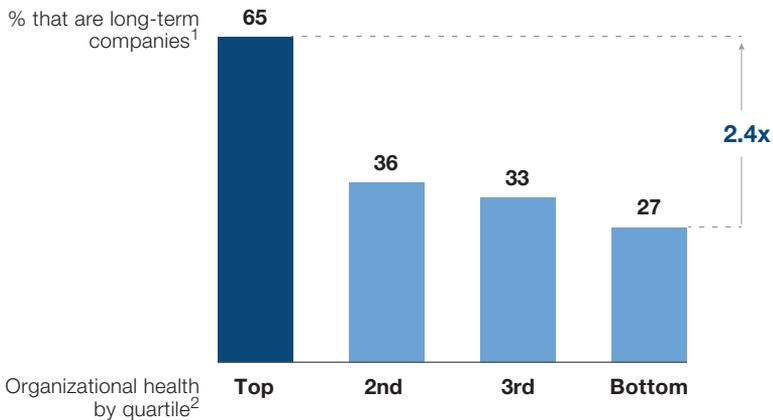
Renewal has always been central to our definition of organizational health, which emphasizes a company's ability to deliver superior financial and operating performance *over the long term*. Our conviction that there is a link between organizational health and a long-term orientation was reinforced recently when we analyzed a set of 51 companies for which we have rich proprietary data on both characteristics.

Our health data come from McKinsey’s Organizational Health Index (OHI), which aggregates the views of employees and managers on a set of nine key organizational dimensions that have proved critical to health. For long-termism, we drew on a metric created by the McKinsey Global Institute and McKinsey’s Strategy and Corporate Finance Practice that differentiates those companies with a long-term orientation from others. Known as the Corporate Horizon Index (CHI), it assesses five factors, including consistency of investment patterns, earnings quality, and the extent to which companies focus on value-creation fundamentals rather than the targets emphasized by Wall Street analysts.

When we compared the 51 companies for which we have both CHI and OHI data, we found a strong, two-way correlation between health and long-term performance (Exhibit 1). On the one hand, the healthiest organizations are the ones that focus more on long-term value creation. On the other hand, companies focusing on long-term performance tend to have higher organizational-health scores. What’s more, companies focusing on long-term value creation outperform their peers on all nine of the key organizational

Exhibit 1

Companies with a strong long-term orientation were predominantly the healthiest.



¹Businesses in McKinsey’s Corporate Horizon Index (CHI) categorized as long or short term by reference to patterns of investment, growth, earnings quality, and earnings management.

²McKinsey’s Organizational Health Index (OHI) measures an organization’s performance across 37 different management practices, looking at how behaviors, actions, and processes contribute to 9 dimensions of organizational health. The quartiles are based on the global OHI database with 750 organizations and 1,583,787 individual respondents.

Source: McKinsey analysis of 51 companies for which both CHI and OHI data are available

outcomes that contribute to organizational health. These are early findings; our next step is to identify specific management practices that simultaneously boost health and contribute to a long-term orientation.

HEALTH AND TRANSFORMATIONS

Transformations, as anyone who has lived through one well knows, are tough, emotional, and even searing experiences. Leaders of these efforts sometimes worry that the decisive, short-term actions needed to improve financial results will undermine their organization's health. However, our work suggests it's quite possible to *improve* organizational health during transformation efforts—helping to achieve and sustain the transformational gains, while further strengthening the fabric of the company.

What's more, by analyzing OHI data from a statistically significant sample of organizations that have worked with McKinsey's Recovery & Transformation Services unit, we have hit on a list of "power" practices, which increase a company's odds of sustaining top-quartile health (Exhibit 2). Companies prioritizing them during the first year of the transformation effort improve their health by twice as much as companies that don't. These practices are only one piece of the organizational-health puzzle (for more on the whole puzzle, see "Organizational health: A fast track to performance improvement," on McKinsey.com), but especially during the early stages of transformational change, they pack a particular punch, as we will describe in the remainder of this article.

Set a clear direction

Health in a transformation starts with strategic clarity and a shared vision that has been translated into crisp goals and milestones. The translation process helps the company decide what it will and will not do (including where it will and will not compete). And the broad communication of it to leaders and employees helps them avoid working on initiatives that are not germane to the strategy or that might even send mixed signals about what the strategy is.

One public utility drove strategic clarity by taking its "bankable plan" on a road show, visiting different sites and departments to state the case for change and to discuss ways to realize it. This company created simple communication devices, such as a vision "one-pager," which brought the strategy to life for employees by visually depicting how it would play out across the value chain, including where there would be new investments and what would change. In another example, a mining company produced banners and commitment cards with the performance and health goals of the transformation clearly stated as a visual reminder.

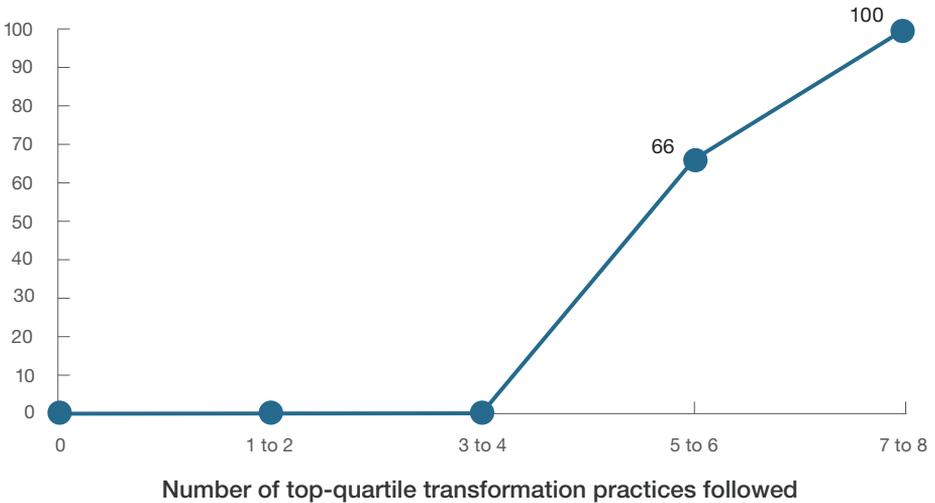
Exhibit 2

Management practices that jump-start health improvement during transformation efforts ...

Priority theme	Relevant OHI practice ¹
Setting the direction	<p>Strategic clarity—rallies business units, teams, and employees around goals</p> <p>Shared vision—enables leaders to align employees across all levels</p>
Providing clarity and meaning	<p>Employee involvement—engages people through a consistent and meaningful set of values</p> <p>Role clarity—holds employees accountable via clear roles and responsibilities</p>
Sparking ideas and innovation	<p>Capturing external ideas—invigorates company’s innovation efforts and best practices with ideas from outside</p> <p>Bottom-up innovation—encourages and rewards employees’ initiatives and new ideas</p>
Fostering strong operations	<p>Operationally disciplined—monitors adherence to clear behavioral and performance standards</p> <p>Supportive leadership—builds a positive environment characterized by care for employees’ welfare</p>

... also increase a company’s odds of sustaining top-quartile health.

Probability of top-quartile health, %



¹ OHI = Organizational Health Index; these practices had the greatest improvements in their OHI scores when resurveyed and the highest standardized correlation coefficients.

Make it meaningful to employees

The companies that made the biggest gains on health in a transformation took the extra, critical step of ensuring that their employees' day-to-day behavior was guided by the company's vision and strategy. This requires thinking through how to match the personal goals of employees with the company's goals—going beyond “cascading” the strategy into key performance indicators and targets to involving employees up front in setting the company's strategic objectives, ensuring that the right talent is in place to achieve those objectives, and making sure that each individual's “stake” in the strategy reflects his or her aspirations.

At an industrial company, the top team made a concerted effort to engage every employee so as to generate ideas that would improve the top and bottom lines. As a result, roughly 1,500 of the more than 5,000-strong workforce owned at least one of the more than 2,000 “transformation” initiatives, with many more owning important activities that were part of these initiatives.

Spark ideas and innovation

Organizational health improves during a transformation when companies embrace fresh ideas. Sometimes this means looking outside for best practices to help innovate and invigorate the business. Leaders should rightly be wary of the cookie-cutter approach, but there are proven ways to increase the flow of ideas and challenge incremental thinking. The industrial company mentioned above consciously set out to address the “not invented here” syndrome that had prevailed in the organization. Employees were encouraged to start working more closely with customers, for example, to enhance support services, and similarly with vendors to change product specifications to drive higher utilization in their processes. It even tapped recent hires to find out how competitors managed their supply chain, improving importing and exporting processes in emerging markets. These efforts sparked fresh ideas and created a deep sense of ownership among employees. Encouraging “bottom-up” innovation also generates such ownership—and it, too, showed up in our data as a transformation accelerant.

Build strong operational discipline, in a supportive way

Organizations seldom get fit without strong operational discipline. It's important to start at the top, with explicit targets for operating performance that are then replicated at other levels. Operational discipline requires the communication of clear standards of work so that employees understand how to achieve goals and metrics consistently. This also helps leaders ensure that the day-to-day work complies with those standards, and it allows leaders to

emphasize the core values of efficiency and productivity. Maintaining operational discipline puts a premium on another management practice: supportive leadership, which includes creating a sense of teamwork and mutual support throughout the organization and demonstrating concern for the welfare of employees.

Boosting operational discipline sometimes demands financial incentives or recognition that rewards new forms of behavior. A consumer-goods company in Asia-Pacific set aside a discretionary fund for employees who embodied the new way of working and who went above and beyond their routine jobs to help the company achieve the objectives of the transformation. Managers also formally recognized this extra effort, thanking fellow colleagues publicly on a near-daily basis and following up constructively with employees who were struggling. This approach helped to sustain momentum long after the initial impetus had begun to wane.

The common thread running through these findings and examples is sustainability. Healthy organizations are better at sustaining themselves over the long haul. And transformations are more sustainable when companies prioritize improving their organizational health—which, as our research suggests, isn't just desirable, it's quite feasible. By enhancing sustainability, stronger organizational health connects the yin of long-termism with the yang of aggressive performance improvement, making it a worthy goal for any leader worried about his or her legacy. 

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The authors would like to thank Oliver Bladek, Dominik Deja, Tim Koller, Randy Lim, and Jack McGinn for their contributions to this article.

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