

# Introduction

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## Excellence Found?

What is the greatest invention of all time? In our view, it isn't the wheel, it is organization: people working together toward a common goal. Organizations can achieve feats that go far beyond anything that individuals can accomplish alone. As each successive generation finds better and better ways of working together, it performs at levels that could barely have been imagined a few decades earlier. And when there are improvements in the effectiveness of our organizations—whether they be private enterprises, governments, public agencies, charities, community groups, political parties, or religious bodies—these gains translate into benefits for society as a whole. Innovations such as mass production, public transport, space travel, the internet, and the mapping of the human genome are all products of human organization.

Fittingly, the book you're now holding is itself the product of a collective feat of organization: many colleagues and friends have worked with us to advance the state of the art in management thinking. For Colin, this book marks the intellectual culmination of his leadership of McKinsey's global Organization Practice. For Scott, it represents a manifesto for an approach to management that he has long advocated and practiced, and at times staked his career on.

But *Beyond Performance* wasn't written for us; it was written for you. If you are a leader who wants to change things for the better, this book is for you. If you want to leave a profound and lasting legacy for your organization and its stakeholders, this book will help you do so. The concepts and approaches we describe apply broadly to anyone who leads people in an organization, whether you are the CEO of a company, the managing partner of a professional services firm, or the head of a public sector body, an activist group, a nongovernmental organization, or a social enterprise.

Much as we hope that every leader who reads the book will benefit from it, we would like its impact to ripple out still further. If we can help improve the way that people manage organizations, we hope that in some way we can also help advance the progress of society itself. It is our firm belief that the human race is capable of achieving far more by working together in the future than we are capable of achieving today.

## Ultimate Competitive Advantage

This book explains, both conceptually and practically, what it means to achieve excellence in leading and managing organizations. Although a multitude of volumes have already been written on this topic, we believe no other work offers what we are trying to provide. Our approach combines two views. The first view is of a “stable equilibrium” state of organizational excellence in which high performance can be sustained; the second is of the dynamics of the transition required to reach that state. This effort is, perhaps, a kind of management equivalent to the attempt by modern-day physicists to combine classical Newtonian physics with subatomic physics in order to advance the field and develop a deeper understanding of the fundamental nature of reality. In much the same way, by combining static and dynamic views of organizations, we aim to arrive at a fuller understanding of their fundamental nature.

To that end, we aim to shift the “installed base” of management thinking. In what follows, you’ll learn what management courses don’t teach, at least not yet. Our central message is that focusing on organizational health—which we define as the ability of your organization to align, execute, and renew itself faster than your competitors can—is just as important as focusing on the traditional drivers of business performance. That’s because, as Sir William Castell, chairman of the Wellcome Trust, puts it, “Healthy organizations get things done quicker, better, and with more impact than unhealthy ones.”<sup>1</sup>

In this book, you learn how to set aspirations for performance and health that are unique to your organization. You learn how to assess how ready your organization is to change so that it can achieve those aspirations. You learn how to develop a powerful plan to move your organization from where it is today to where you want it to be. You master what it takes to implement this plan successfully. And you discover how to help your organization make a gradual transition to a self-sustaining state of continuous improvement in performance and health. In short, this book is a field guide to harnessing the full potential of your organization.

Unlike many business books, this book does *not* suggest that you study what other organizations do to succeed and then apply their recipe to your own situation. How many companies have analyzed how General Electric replicates its business model across multiple industries, or how Southwest Airlines delivers low-cost air travel, or how the Ritz-Carlton sets standards in customer service, or how Procter & Gamble manages its brands, without ever being able to replicate the success these companies have achieved? The answer must be “too many.” Although there are always helpful things we can learn from others, the recipe for excellence in a particular organization is specific to its context: its history, the capabilities and passions of its people, its external environment, and its aspirations. Creating and sustaining your own recipe—one uniquely suited to these factors—delivers results in a way that your competitors simply can’t copy (or copy at their peril). This, we believe, is where ultimate competitive advantage lies.

The forces that shape today’s global economy have weakened or even wiped out our customary sources of competitive advantage. Consider the instant, often cost-free availability of information facilitated by the staggering growth (more than 20 percent per year) in the international use of internet bandwidth.<sup>2</sup> Such ready access to information undermines the advantage that companies have traditionally gained from smarter strategies and superior assets, which can now be copied with great speed and efficacy. The competitive advantage of the twenty-first century is increasingly derived from hard-to-copy intangible assets such as company culture and leadership effectiveness. Saad Al-Barrak, former CEO of Zain, a Kuwait-based telco, puts this well: “In the west, you can no longer create a competitive advantage with a new product or a new service, because everybody will follow suit. The level of development is so high and access to resources is so rich that cloning a product or a service takes no time. But to clone a community takes all the time in the world.”<sup>3</sup>

## Why It Matters for Business

The pace of change in business is increasing faster than ever. Consider how long an average company from the S&P 500 stays in the index. In 1955 it was estimated to be 45 years; in 1975, 26 years; and in 2009, 17 years.<sup>4</sup> At this rate, half of the companies that appeared in the 2010 S&P 500 Index are likely to have left it before 2020.

Moreover, in recent years many former household names have fallen not just out of a business index but out of existence: consider Enron, Digital Equipment Corporation, Lehman Brothers, Arthur Andersen, and

British Leyland. Which of today's household names will have ceased to exist in 10 or 20 years' time?

It's a question that's even harder to answer in times of rapid and far-reaching economic change. As we write, the world appears to be emerging from the most profound economic crisis since the Great Depression of the 1930s. No one knows how the situation will evolve, but there is broad consensus that the "new normal" will be characterized by increased volatility and unpredictability in capital markets, in consumer confidence, and in government policy. Charles Darwin's observation that "the fittest win out at the expense of their rivals because they succeed in adapting themselves best to their environment" may have become something of a cliché in the literature on change management, but it has never rung more true in the business world. The ability to manage an organization dynamically so that it can both shape its environment and rapidly adapt to it is becoming the most important source of competitive advantage in the twenty-first century.

Success is about winning not just in the marketplace for customers, but also in the marketplace for talented employees. The role of business in society is changing. As we work more and socialize less, the time we have left for traditional activities involving our family, our local community, and our religious institutions is declining. As a result, our sense of meaning and identity is increasingly derived from the workplace (our jobs) and the marketplace (the products and service we buy).

So work occupies a central place in our lives. But what do we expect from it? To answer this question, we surveyed more than 5,000 executives from the top 200 of their respective organizations, and asked what factors they saw as essential when deciding to join, stay with, or leave a company. Among the highest-rated factors were "freedom and autonomy" and "exciting challenges." These factors were chosen by more than half of the survey respondents, whereas less than a quarter chose "high total compensation." Among the lowest-rated factors were "high job security" (chosen by 8 percent) and "reasonable pace and low stress" (chosen by 1 percent).

The message is that talented employees are not content to be cogs in a machine geared to hitting quarterly performance numbers. They want to work in dynamic workplaces where they feel empowered to make meaningful, positive change happen. As Adam Crozier, former CEO of Royal Mail, notes, "People are looking for a sense of belonging, a sense of meaning. . . . Graduates are asking the questions, do I want to belong here? Do I see a future here? What kind of training do you give? What do you do for the community?"<sup>5</sup> Another CEO, Roberto Setubal of Brazil's Itaú Unibanco, concurs: "Talented people don't come here just to perform tasks. They want to

offer their ideas, discuss freely, grow professionally, and contribute to the future of the company.”<sup>6</sup>

So are we getting better at creating meaningful contexts for people to work in? Unfortunately not; in fact, we’re getting worse. Take job satisfaction in the United States as an example. In 1987, 61 percent of employees reported they were satisfied with their jobs. By 2000, satisfaction was down to 51 percent. Fast-forward to 2009 and the share had dropped to 45 percent.<sup>7</sup> This trend holds true for all ages and income brackets.

Less satisfied is one thing, but are we at least more productive? No: between 1995 and 2009, the output of U.S. businesses increased more slowly than in any 15-year period since 1950.<sup>8</sup> The vast majority of developed-market economies exhibit similar trends.

As our economies emerge from recession, the ability to lead and manage organizations in a way that motivates employees and helps them be productive is more important than ever. An Ipsos Mori poll of 100 board-level directors from the 500 biggest companies in the UK reported that “attracting, motivating, and retaining the best employees” was the number-one priority for business, ahead of improving efficiency or having the right strategy.<sup>9</sup>

## Why It Matters for Society

If we look beyond the marketplace for customers and talent to society at large, organizational excellence has never been more important. In the political process, for instance, leaders committed to change are attracting unprecedented levels of public engagement. This engagement is driven less by their personal charisma than by a growing acknowledgment that current approaches to health care, education, economic regulation, foreign relations, and other major issues simply aren’t working.

In the United States, President Obama was elected on a promise of large-scale change across the whole political system. In France, President Sarkozy is driving the largest transformation project ever undertaken in the country’s public sector. In the United Kingdom, leaders are pushing through a raft of reforms to change the way public institutions work, with new service agreements between ministries and central government, decentralized decision making, and broad-based efforts to improve skills.<sup>10</sup> In Malaysia, prime minister Dato’ Sri Najib Tun Razak has introduced a program to make the government more effective and more accountable as part of the country’s mission to become a fully developed nation by 2020. These are but a handful of many wholesale reforms happening at government level across the globe.

Outside politics, nongovernmental and not-for-profit organizations continue to tackle key cross-border challenges such as sustaining the environment and helping the developing world break the cycles of poverty, corruption, and inadequate education.

In the world as a whole, at least five factors are driving widespread change: the historic shift in economic growth from the developed to the developing world; the unprecedented imperative for mature economies to raise productivity to preserve living standards; the rise of new networks of hitherto unimaginable complexity for communication and trade; the increasingly urgent challenge to balance economic growth with environmental sustainability; and the expanding role of the state in regulating markets and influencing economic development. These factors are likely to continue to drive change for decades to come.

The way we respond to these challenges will have a profound effect on all our futures. Will our efforts be underpinned by organizational excellence? What are the odds of their being successful? And what will be the consequences if they aren't? What will be the social costs? And who will bear them?

## Excellence Lost

Almost three decades ago, McKinsey's Tom Peters and Robert Waterman published what was to become one of the best-selling and most influential business books of all time, *In Search of Excellence: Lessons from America's Best-Run Companies*. Perhaps the book's most powerful legacy is its famous "7S framework." Having examined 43 of the Fortune 500 list of top-performing companies in the United States, Peters and Waterman identified seven factors involved in organizing a company in an effective and holistic way: strategy, structure, systems, staff, skills, style, and shared values.

Since *In Search of Excellence*, there has been a torrent of business titles providing accounts of organizational excellence and theories about what drives it. One of the best-known examples is Jim Collins and Jerry Porras's 1994 book *Built to Last*, which analyzed patterns among 18 successful companies.

Unfortunately, it seems that the recipes for excellence offered by these landmark publications provide no guarantee of staying power. It's revealing to look at what has become of the "excellent" companies lauded in the pages of *In Search of Excellence* and *Built to Last*. By 2006—well before the recent financial crisis—20 percent no longer existed, 46 percent were struggling, and only 33 percent remained high performers.<sup>11</sup> Why was this?

Not all of these changes in fortune can be attributed to the companies themselves, of course. Performance is partly driven by macroeconomic forces, industry attractiveness, and sheer luck. But it's also driven by the decisions leaders make, what they do and don't do, and the way they lead, which are things under every leader's control.

Our research, as we show in Chapter 1, suggests that many companies fall from grace because of an excessive bias toward a static view of managing performance. They synchronize their "7S" dials to deliver against quarterly and annual targets instead of taking a more dynamic view that encompasses not only their company's performance but also its health: its ability to align, execute, and renew itself faster than the competition.

So if organizations need to take a more dynamic view of excellence, how can they achieve it? This takes us to the question of how leaders make rapid, large-scale change happen, and how they develop cultures of continuous improvement.

In 1996, when John Kotter published *Leading Change*—widely considered to be the seminal work on change management—he reported that only 30 percent of all change programs succeed. Fifteen years later, we can choose from more than 25,000 books on organizational change, and hundreds of business courses on how to lead and manage it. In spite of this abundance of advice, all available research suggests that—you guessed it—still only one in three programs succeeds. The field of change management, it would seem, hasn't really changed a thing.

Only a third of excellent companies remain excellent over the long term. Even fewer change programs succeed. Why is this?

We don't claim to have all the answers, but at this point in our research efforts, we're confident that we do have insightful (beyond common sense) and pragmatic (readily applicable) advice that will help leaders beat these odds and achieve sustained organizational excellence. In fact, we've observed so many successes in so many industries and from so many different starting points using the approaches we describe that we regard successful transformation and sustained excellence as a real possibility for almost any organization.

## The Science of Organization

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The world of management is rife with opinion and conjecture. In writing this book, we have endeavored not only to draw on our own experience as management consultants, but to ensure that our arguments are as objective and fact-based as possible. Whereas *In Search of Excellence* was based on

a study of 43 American companies and *Built to Last* on 18, this book draws on a much broader array of evidence. We have had the benefit of the results of surveys on the drivers of organizational performance and health from more than 600,000 respondents from more than 500 organizations across the globe, surveys on the experience of transformational change from more than 6,800 CEOs and senior executives, reviews of more than 900 books and articles from academic journals, one-on-one interviews with 30 CEOs and other senior executives who shared their personal experiences of leading change and driving performance, data and learning from more than 100 clients served by McKinsey on engagements specifically related to performance and health, and close working relationships with four eminent scholars who helped to challenge and augment our findings. In fact, we are confident that *Beyond Performance* represents the culmination of one of the most extensive research efforts ever undertaken in this area.

We realize that most of our readers will be more interested in the practical lessons we can draw from the research than in the research itself, so most of the book focuses on helping leaders get better results from their organizations. However, Chapter 2 provides details of our sources and methods for anyone who is interested in our fact base and technical approach. Other readers may want to skim through this section to understand the evidence base that underpins the assertions we make.



If this book helps more organizations to become and stay excellent, and more change programs to succeed, it will have done its job. If it also helps people make faster progress in tackling the major social and political issues of our time, it will have achieved everything we could have hoped for. But setting these grand aspirations aside, if you put this book down feeling that you are better equipped to make a positive difference in the world through the way you lead and manage your organization, we will feel that our work as authors has been accomplished.