

# TRANSFORMATION

## DELIVERING AND SUSTAINING BREAKTHROUGH PERFORMANCE

Edited by Lars Fæste and Jim Hemerling

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# Contents

<b>Foreword</b>	v
<b>Introduction: The Transformation Imperative</b>	1
<b>Part I: A Holistic Transformation Framework</b>	
1. Funding the Journey	17
2. Winning in the Medium Term	27
3. Organizing for Sustained Performance	43
<b>Part II: Taking the Transformation Journey</b>	
4. Leading Transformation	63
5. Managing Change	79
6. Building Capabilities	97
<b>Part III: Distinctive Types of Transformation</b>	
7. Digital Transformation	115
8. Turnaround and Restructuring	129
9. Transformation in Emerging Markets	139
<b>Note to the Reader</b>	152



# Foreword

**A**s the sources of disruption multiply and the pace of change accelerates, transformation has become an imperative for organizations. Whether the intent is to respond to disruption, create strong and sustainable value, or fulfill your organization's purpose, transformation—a large-scale change aimed at delivering and sustaining breakthrough performance—is now an essential *modus operandi*. For CEOs, leaders, and all those working in organizations who are called upon to adapt to change, transformation can feel daunting. But it need not be so. Done well, transformation can be energizing and empowering.

This publication is a synthesis of The Boston Consulting Group's latest thinking on transformation, based on our research and our experience working with our clients on hundreds of transformation programs:

- We start with a summary of key concepts and challenges.
- We then expand upon our holistic, three-part transformation framework: funding the journey, winning in the medium term, and organizing for sustained performance.
- Next, we share our experience in taking the transformation journey: leading transformation, managing change, and building capabilities.
- In the final section, we focus on three types of transformation that are important and unique: digitization, restructuring and turnarounds, and emerging markets.

*Transformation: Delivering and Sustaining Breakthrough Performance* offers many lessons throughout, and it traces three overarching themes: the value of a comprehensive approach, the need to think of transformation as a journey, and the power of putting people first. (For more, go to [bcg.com](http://bcg.com).)

On behalf of BCG's global partner group, we hope that this book will inspire you to be bold in your ambitions and enable you to succeed in your transformations.

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# Introduction

## The Transformation Imperative

**F**or CEOs and leaders of large enterprises, business today often feels like being on a steep treadmill whose speed control is set to max. Three months ago, the company may have finished a cost reduction transformation to remove management layers and streamline operations. Before it is even clear that the changes have taken root, a disruption in Asia requires implementing a new go-to-market model for several countries. And right around the corner is another large-scale transformation effort, using new digital technology to improve the delivery of services and tap new revenue streams.

Across industries and regions, the competitive environment today is far more unpredictable than it was even a decade ago, with disruption arising from all directions. Digitization and globalization are blurring the lines between sectors as well as between traditional competitor groups. Technology is changing consumer behavior, empowering startups, making pricing more transparent, and reducing product life cycles. Today's global economy, characterized by rapid growth in emerging markets and slower growth in developed countries, forces companies to develop unique strategies for each environment. Additionally, companies must rethink—and continually reassess—their operational footprint, owing to changing costs, evolving demand, and unfolding trade restrictions. (See Exhibit 1 for a list of common disruptors.)

As a result, the traditional sources of competitive advantage—market position, scale, and legacy—are diminishing, and established operating models are becoming obsolete. That leads to greater volatility within industries, creating a churn effect in which the dominant player is increasingly overtaken by more nimble companies with stronger business models.

### What Compels Transformation?

According to research conducted by The Boston Consulting Group, public companies traded in the US now have a 1-in-3 chance of failing

## EXHIBIT 1 | Businesses Face Growing Disruption from All Directions

### INCREASED VOLATILITY

More-intense competition and costly, extreme events (for example, natural disasters and financial crises) are driving more turbulence.

### DIGITAL DISRUPTION

Across industries, digital is fundamentally shifting how individuals interact, what customers expect, and how work is done.

### INCREASING REGULATION

As the number and complexity of regulations increase across markets, planning and operations become more difficult.

### GEOPOLITICS

Increasingly complex geopolitical situations are forcing global companies to shift how they think about risk.

### PUBLIC-SPENDING PRESSURE

Rising costs across most aspects of government create pressure to trim budgets, cut programs, or both.

### MANUFACTURING ECONOMICS

Advanced production methods, such as robotics and automation, change the formula for where to manufacture and what to outsource.

### ENERGY DYNAMICS

The global energy landscape is dramatically shifting owing to geopolitical issues, technology advances, and changing sources.

### VARIABLE RATES OF GROWTH

Companies must be able to shift gears between different approaches to compete in low-cost countries and developed economies.

**Sources:** “Half a Billion Clicks Can’t Be Wrong,” *Foreign Policy*, January 3, 2014; S&P Capital IQ; Thomson Reuters Accelus Regulatory Intelligence.

within the next five years—up from 1 in 20 just 50 years ago. (See “Die Another Day: What Leaders Can Do About the Shrinking Life Expectancy of Corporations,” BCG Perspectives, July 2015.) A leading company that misses one market shift loses three to five years in development time, which is enough to cede the leading position. Miss two turns, and your company is in real danger.

Disruptions, the loss of traditional sources of competitive advantage, and fear of failure, however, are not the only reasons why companies look to

improve performance. Across industries and geographies, leaders of successful companies aspire to go beyond merely hitting financial objectives. Many are driven by a strong sense of purpose: to change the world for the better for their customers, their employees, and society at large. Others see opportunities to capitalize on their advantaged positions and capabilities. These leaders are constantly pushing themselves to aim higher, grow faster, and develop new business models and new ways of working. Even when their companies are performing well, these leaders are setting their ambitions higher.

If companies are to respond effectively to these shifts and to realize the ambitions they have set for themselves, business as usual with incremental improvements alone will not get the job done; they need to transform. A transformation is a profound change in strategy, business model, organization, people, and processes—either enterprise-wide or within a specific business unit, function, or market. It is not an incremental change but a fundamental reboot of the business, enabling it to achieve a sustainable step-change improvement in performance and, ultimately, shareholder value. Unlike continuous improvement (which focuses on small-scale changes that start with employees and percolate up through the organization), transformation requires a series of much larger, interdependent initiatives that are initiated by top management.

BCG has helped leaders of companies—and other types of institutions—execute transformations that have led to significant financial impact. We have completed more than 400 transformations, generating a median annual impact of approximately \$340 million through cost cuts, revenue increases, the application of capital efficiency levers, and improvements in organization performance.

This book distills our experience and insight from those client engagements—along with proprietary research and several dozen reports on the topic—into a single publication. This book is dedicated to the CEOs, boards of directors, and leadership teams who are charged with the leadership required to launch, drive, and sustain transformation programs.

## **A Three-Part Transformation Framework**

Based on BCG's experience helping to execute transformations across industries and regions worldwide, we have developed a proven framework that consists of three critical components (see Exhibit 2):

- **Funding the Journey.** Funding the journey entails pulling short-term levers to establish momentum and free up capital to fuel new growth initiatives. Companies in transformation typically seek to quickly raise revenue, simplify the organization, use capital more efficiently, and reduce costs. Critically, these measures deliver rapid results to the bottom line; they also energize the organization and generate buy-in from managers and employees.
- **Winning in the Medium Term.** Once the company has taken steps to fund the journey, it must make a more profound change to its legacy operations and business model. Winning in the medium term requires dramatically rethinking the company's operating and business models to increase its competitive advantage. A critical component of this is rethinking the operating model—essentially rewiring the way the company delivers products and services to its customers. In many transformations, companies must even rethink their core business model and reevaluate the value proposition they offer: identifying the right target segments to serve, the products and services to offer, and the model that can maximize revenue and profit from those products and services. The new business model may include an innovative go-to-market approach, a new digital business to complement or compete with legacy operations, or the launch of new tech or digital ventures.
- **Organizing for Sustained Performance.** The third key element of a transformation is the people needed to sustain the transformation. Without a strong focus on the company's team, organization, and culture, the transformation will fail. Senior executives need to commit to the initiative and lead from the front. HR needs to serve as a partner in the transformation, in part by identifying critical roles needed and developing the talent to fill those roles. Change management tools can help implement specific changes and track progress on the overall effort. And the company needs to develop the right culture to support high performance.

A transformation should include all three elements, but the relative importance of these components changes at various points in the process. In the beginning, funding the journey is often the most critical aspect, not only to establish momentum but also to free up capital rapidly so as to fuel subsequent efforts in the overall transformation

## EXHIBIT 2 | BCG's Holistic Transformation Framework



STRONG AND SUSTAINABLE VALUE CREATION

Source: BCG analysis.

program. Over time, as the effort takes root, the priorities typically shift toward winning in the medium term. Throughout a transformation, a focus on organizing for sustained performance—with the right team, structure, operating systems, and culture—is vital to ensuring that a transformation is not short-lived but rather a long-term endeavor that delivers, and sustains, improved performance.

### Starting Points and Goals

In the past, transformations have often been perceived as radical solutions for companies with broad and systemic problems—that is, companies with no choice but to change.

That perception is increasingly outdated. A comprehensive survey revealed that fewer than half of the BCG clients that underwent a transformation over the past decade had been market laggards when they launched their change initiative. Indeed, more than half of them were market leaders. Leading companies in the sample chose to undergo preemptive transformations that further reinforced their competitive strengths. (See Exhibit 3.)

**The Hidden Value of Understanding Starting Points.** While starting points vary dramatically, they are helpful in setting the level of ambition and overall direction for a transformation. A company's starting point

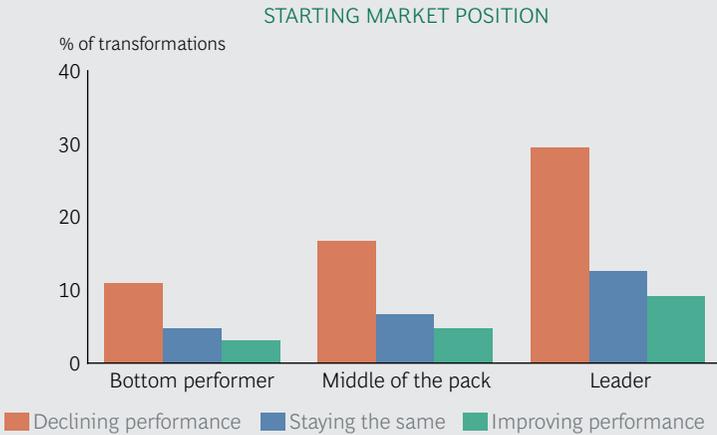
will also determine the relative emphasis to place on each element of the framework and the right levers to apply.

For example, a company with poor financial health in a strategically unstable industry may decide to focus on levers from the first component—funding the journey—such as cutting costs, generating short-term revenue gains, and improving net working capital. Once the immediate crisis has passed, the company can shift to establishing a new long-term operating model and putting the people, organization, and culture in place to sustain it.

In contrast, a company in good financial health and in a strategically sound industry may opt to focus more on determining the best strategy and business model for long-term revenue growth and reorienting the operating model and organization to support this new strategy.

BCG has developed a set of more formal screens that a company can use to assess its starting position. One such screen entails assessing the company’s overall performance in two dimensions: financial and strategic. The first dimension looks at the company’s recent financial performance relative to its peer group or industry average, along with its near-term financial prospects. The second dimension considers the

### EXHIBIT 3 | Transformations by Initial Position and Trajectory



Source: BCG analysis.

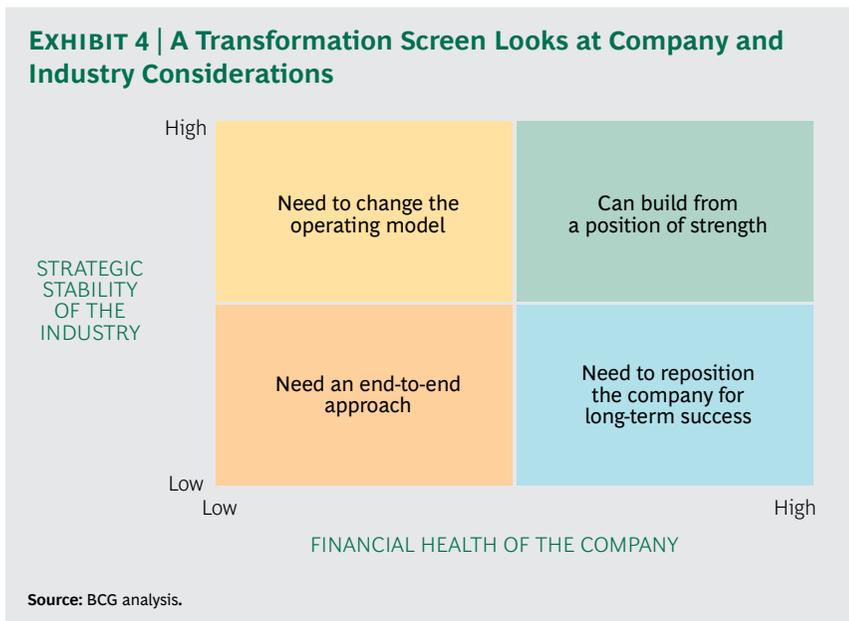
Note: Based on 123 companies that underwent a transformation or large-scale change effort at some point during the period from 2003 through 2013.

overall strategic stability of the industry in which the company plays, over the next five to ten years. As Exhibit 4 shows, plotting a company along these two dimensions puts it in one of four boxes.

Companies in any of the four boxes can benefit from transformation. The most obvious candidates are those with poor financial performance, which may need immediate steps to boost liquidity before taking longer-term measures such as rethinking their business and operating models or establishing the right processes, organization, and technology for sustaining improved performance.

However, even successful companies with excellent financial performance will often need to take heed of changing market conditions and reshape the strategy by which they create value for shareholders. And superior performers in stable industries will start to plan early where they want to be in the long term—in five or ten years, or even longer.

Preparing proactively allows these companies to transform gradually, building the capabilities and positioning that they will need for long-term success. In many industries, pressure from activist investors is pushing management teams to proactively transform. (See “Do-It-Yourself Activism,” BCG article, February 2014.)



In addition to financial and strategic performance, companies can determine their starting point by looking at organizational factors. Does the enterprise have the leadership, people, and capabilities in place to deliver and sustain performance? Far too many executives have invested heavily to launch and drive transformations only to find, two to three years down the road, that many of the hard-fought gains have been lost because the changes have not been ingrained deeply enough in the organization.

**Why Goals Should Go Beyond Merely Cutting Costs.** Regardless of where a company starts, it should have clear goals in mind. Many leaders still believe that transformations are primarily about cutting costs. While cost reduction is usually a critical component of transformation, given the wide range of starting points and goals, many types of transformation go well beyond cost reduction.

Exhibit 5 lists some of the more common transformation types and the initiatives that they comprise. These are not mutually exclusive, and companies may combine or alter them depending on their specific situation and objectives. The specific objectives will vary by company, but common to all transformations is the objective to establish a fundamentally different competitive position, leading to a step change in performance.

BCG research shows that 85% of companies that have undertaken transformations over the past decade have pursued more than one type, with the most common being organizational, operational, and rapid financial improvements. (See Exhibit 6.)

In addition, companies are increasingly transforming to meet the needs of other stakeholders, including their own employees (by creating a high-performance organization and culture where talent can thrive), society (offering products and services that help people), and the environment (through sustainability objectives and similar efforts).

## Welcome to the Era of “Always On” Transformation

Another outdated view of transformation is that companies can successfully launch them in a “one off” manner: putting up temporary scaffolding around one aspect of the enterprise, executing the transformation, and then returning to business as usual. Not so.

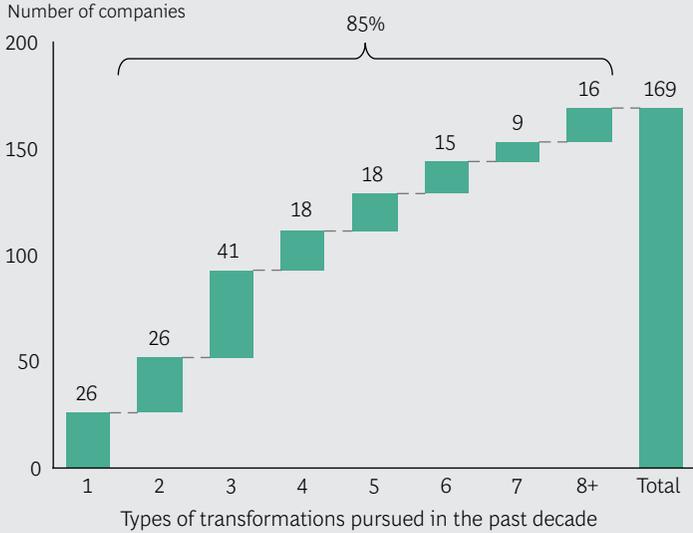
## EXHIBIT 5 | Companies Require Different Types of Transformation

ENTERPRISE-WIDE OR BUSINESS-UNIT-FOCUSED TRANSFORMATION	Turnaround/restructuring	Making the short-term moves necessary to save a company that is struggling or even failing (for example, facing a pending liquidity crisis)
	Rapid financial boost	Boosting the bottom line rapidly, through measures such as reducing costs, increasing revenue, simplifying the organization, or improving capital efficiency
	Growth	Developing the strategy and operating model to position the company for stronger growth
	Business model	Dramatically shifting the business model, including the markets served and the value proposition for customers
	Digital	Digitizing the entire value chain—and the company's competitive DNA—by adopting new technologies and rethinking the business strategy
	Global	Repositioning a company to take advantage of growth opportunities in emerging and developed markets
	Organization	Improving the efficiency and effectiveness of decision making and work processes throughout the organization
FUNCTION-SPECIFIC TRANSFORMATION	Innovation and R&D	Increasing the quality and quantity of innovation through more effective R&D
	Commercial	Reshaping sales and marketing functions by focusing on new markets and increasing the efficiency and effectiveness of spending
	Operational	Boosting a company's profitability and production across the manufacturing supply chain and service operations
	IT	Overhauling the core IT infrastructure to enable faster decision making, powerful analytics, efficient processes, and improved operations
	Support functions	Revamping vital support functions—such as finance, legal, and human resources—to reduce costs and improve performance

Source: BCG analysis.

## EXHIBIT 6 | Companies Are Pursuing Multiple Transformations

ROUGHLY 85% OF ORGANIZATIONS THAT HAVE TRANSFORMED PURSUED MORE THAN ONE TYPE OF TRANSFORMATION



### MOST COMMON TRANSFORMATION TYPES



**Source:** BCG internal survey conducted in October 2015; approximately 80 respondents provided information about 169 companies.

Unprecedented disruption and market turbulence, coupled with the aspirations of leaders to reach higher, require organizations to launch more-frequent transformations, often of different types, with several underway at any given time.

The increased frequency of such efforts, together with the wide range in types of transformation, heralds a new era: “always on” transformation, in which companies no longer launch individual transformations but are, in effect, always transforming. In practice, this means that a company will have several transformations of various types underway, at various stages, each building upon—and often interconnected with—the others. Executed well, these will combine to take the company to successively higher levels of performance. (See Exhibit 7.)

Always-on transformation has several implications for leaders and boards. These include:

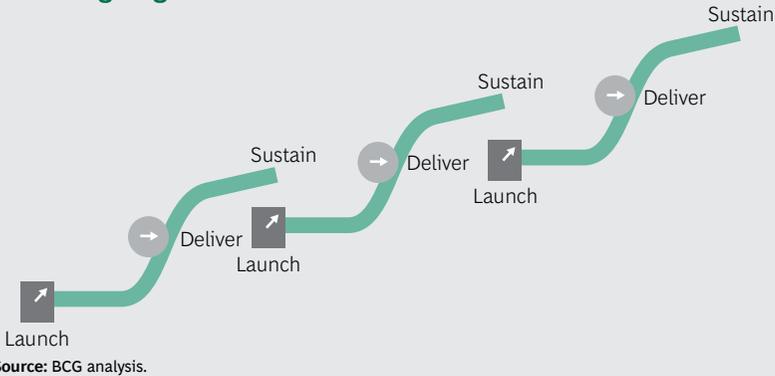
- Do everything required to launch, drive, and sustain the value of each transformation while anticipating what comes next.
- Continuously set the agenda for the transformation, giving thoughtful attention to the scope, pace, and timing of the transformation programs.
- Hardwire the transformation agenda and ambition into corporate planning alongside strategic planning.
- Develop the ability to transform across the organization, with an emphasis on transformational leadership, change management, and capability building.

Leading a company in the era of always-on transformation may seem daunting. Companies have little choice, however. They can cling to the old ways and become less relevant, or they can embrace this new way of transforming—one that will enable them not just to survive but to thrive.

## Common Transformation Traps

Transformation is not easy. In fact, up to 70% of all publicly announced transformations fail to achieve their full potential or deliver results on

## EXHIBIT 7 | In the Era of “Always On” Transformation, Change Is an Ongoing Process



time (or both). Problems can occur in each of the three areas of a transformation.

Common pitfalls during the first component of the transformation—funding the journey—include:

- **Setting the Ambition Too Low or Too High.** Management needs to understand the company’s financial, operational, and strategic position and to set the right transformation objectives.
- **Focusing Narrowly on Head Count Reduction Measures.** It’s easy to look only at head count reductions to reduce costs without adequately considering other cost reduction levers.
- **Failing to Measure and Monitor Progress.** Financial gains need to translate to the bottom line.

Common pitfalls for the second component of the transformation—winning in the medium term—include:

- **Declaring Victory Too Early.** Companies may succeed in the first set of efficiency and cost reduction measures, get distracted by other priorities, and fail to pursue necessary follow-on measures.
- **Focusing on Efficiency Ahead of Other Measures.** Other companies, encouraged by early success with funding-the-journey efforts,

continue to launch multiple rounds of cost-cutting and efficiency-improvement measures, devoting too many resources to eking out diminishing returns and neglecting to invest in the future.

- **Falling Prey to a Business-as-Usual Mindset.** Management may struggle to shed core assumptions and practices that have become self-limited or irrelevant.

Finally, whether the objective of the transformation is rapid improvement to the bottom line or more fundamental changes to business and operating models, company leaders need to ingrain the new ways of thinking and working within the organization. Common pitfalls in the third component of the transformation—organizing for sustained performance—include:

- **Trying to Compel Employees to Change Their Behaviors.** Leaders frequently seek to motivate people through carrots and sticks—mostly sticks. They would do better by changing the organizational context in which people work, such as restructuring incentives or giving employees greater responsibility; doing so can spur them to improve performance in a sustainable manner.
- **Failing to Build the Capabilities Required.** In many cases, companies focus too much on the finish line and not enough on capabilities, the “muscles” they must build and strengthen in order to sustainably transform. By “capability,” we mean an ingrained ability to do something well in a way that improves business performance.

## Taking the Transformation Journey

Given these challenges, how can a company approach transformation to avoid the traps and improve the odds of success?

Doing so requires paying attention to three key success factors, each of which is discussed in detail in subsequent chapters of the book:

- **Leading Transformation.** Many things are important to the success of a transformation, but nothing is more important than leadership. The role that leaders play evolves throughout the transformation, from defining the ambition and energizing the organization to preparing and launching the transformation, executing it, and sustain-

ing its results. Leaders also need to strike the right balance between directive and inclusive leadership styles.

- **Managing Change.** Transformations are fundamentally large-scale change efforts requiring the mobilization and motivation of large numbers of people, whose efforts need to be aligned with a common set of goals and milestones. So, several aspects of change management are critical: enabling leaders, creating executional certainty, engaging the broader organization, and putting the appropriate governance and program management tools in place.
- **Building Capabilities.** Transformations by definition require people to work in new ways, using new organizational “muscles.” As a result, companies must do the hard work of building the underlying capabilities needed to ensure sustainable results. This includes defining the capabilities in advance, prioritizing those that are most important, developing them through pilots and other measures, scaling them up, and ensuring that leaders devote adequate resources and attention to the capability-building effort.

In the following chapters, we discuss these concepts in more detail, drawing on the expertise we’ve developed helping companies develop and implement large-scale transformations over the years.

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Martin Reeves  
Diana Dosik  
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This chapter draws on the following BCG publications:

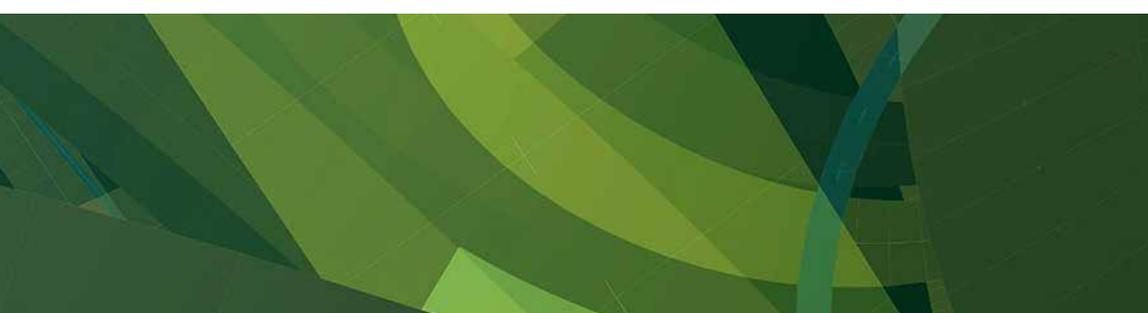
*A Leader’s Guide to “Always-On” Transformation*

*The New CEO’s Guide to Transformation: Turning Ambition into Sustainable Results*

*Transformation: The Imperative to Change*



**PART I:**  
**A HOLISTIC TRANSFORMATION**  
**FRAMEWORK**





# 1. Funding the Journey

Initiatives to generate funding are a critical element of virtually all transformations. Typically, completing a transformation takes several years, depending on the size of the enterprise and the scope of the changes required. During that time, senior leaders face constant pressure—from the board, employees, shareholders, and other stakeholders—to show momentum and deliver immediate results, often at a time when financial resources are scarce.

To succeed, they need to introduce a number of short-term initiatives that will achieve early, tangible wins to send cash to the bottom line, whether through cost cutting, revenue enhancement, or both. These “quick wins” will energize the organization, building momentum and freeing up capital for the larger transformation effort. They will generate buy-in, winning over internal skeptics who may doubt that change is actually happening. And they will build the confidence of managers and employees, establishing credibility for the new leadership team.

In addition, leaders must put in place a number of longer-term initiatives to continue the momentum over the life of the transformation. Both these and the organization’s short-term efforts will generate cash to sustain ongoing operations and to fund the larger transformation effort, which will require substantial investment over the length of the journey. Leaders should make sure that employees and stakeholders know that part of the savings realized will be used to fund the future; that understanding will further help to energize the transforming organization.

Four primary levers can be used for funding the journey (see Exhibit 1):

- Revenue
- Organizational simplicity
- Capital efficiency
- Cost reduction

## EXHIBIT 1 | Four Primary Levers Can Help Fund the Journey

PRIMARY LEVERS	CATEGORIES	COMMON TOOLS	TYPICAL IMPACT
REVENUE	Pricing	Revamp pricing model, reduce discounts, and develop new pricing capabilities.	Raises revenue by 2% to 8%
	Sales force effectiveness	Improve customer targeting and enable the sales team.	Increases revenue and profit by 10% to 15%
	Marketing	Optimize spending and implement data analytics.	Reduces marketing costs by 10% to 20%; boosts sales volume by 3% to 8%
ORGANIZATIONAL SIMPLICITY	Streamlining management structure	Trim the number of layers and increase the spans of control.	Shrinks indirect labor costs by 15% to 30%; improves accountability, decision making, and operational agility
CAPITAL EFFICIENCY	Net-working-capital improvement	Reduce inventory and handle payables and receivables more efficiently.	Decreases working capital by 20% to 40%
	Fixed-asset productivity	Sell assets, outsource functions, and increase overall equipment effectiveness.	Lowers capital expenses by 20% to 30%; increases EBITDA by 2% to 8%
	Project portfolio optimization	Analyze net present value, prioritize projects, and eliminate failed projects.	Improves relative TSR by 20% to 40%
COST REDUCTION	COGS and procurement	Decrease spending on promotions, better manage categories and suppliers, and improve procurement.	Cuts COGS by 2% to 3% and procurement costs by 5% to 20%
	Supply chain	Improve logistics, optimize the network, and streamline the product portfolio.	Reduces operating expenses by 10% to 30%
	Personnel cost	Increase offshoring or outsourcing and reduce head count.	Trims labor costs by 20% to 40%
	Nonpersonnel cost	Cut spending on travel, utilities, facilities, IT, and services.	Lowers overhead costs by 20%

Source: BCG analysis.

Note: COGS = cost of goods sold; EBITDA = earnings before interest, taxes, depreciation, and amortization; TSR = total shareholder return.

In choosing where to start, many companies understandably opt for the two obvious solutions: cost cutting and organizational simplicity. These approaches work, but revenue and capital efficiency can often generate a significant impact as well.

(For a case study of a company that launched strong early-stage initiatives, see the sidebar “A Consumer-Packaged-Goods Company Uses Several Levers to Fund Its Transformation Journey.”)

## Revenue

Three primary revenue levers—pricing effectively, deploying and incentivizing the sales force for the highest impact, and optimizing marketing and advertising spending—can generate as much as a 10% increase in top-line growth and a 5-percentage-point improvement in earnings before interest and taxes (EBIT).

**Pricing is the language of business.** Pricing drives brand perception, shapes customer behavior, and ultimately propels earnings. Pricing initiatives can typically drive revenue increases of 1% to 2% and gross margin increases of 5% to 10% in the short term and gross profit increases of 50% or more over two years and beyond.

Because pricing is so critical, companies need to develop it as a strategic capability, based on customer insights and an analytical approach. Typical quick wins include improving customer targeting, renegotiating accounts, managing discounts in a disciplined way, and optimizing promotions.

For example, an automotive manufacturer undergoing a large-scale transformation was facing a decrease in demand and an increase in competition. Aftermarket pricing was one of many levers the company used to boost revenue. By implementing a systemic pricing model for its service business, the company was able, within one year, to improve its competitiveness at the parts level, leading to an increase of 4% in the weighted-average price it could charge and a 10% increase in total EBIT.

### **Sales force effectiveness improves the top and bottom lines.**

Through improved customer targeting and engagement as well as better deployment and enablement of sales force field staff, a customer-centric sales process that is aligned with business objectives can help a compa-

## A CONSUMER-PACKAGED-GOODS COMPANY USES SEVERAL LEVERS TO FUND ITS TRANSFORMATION JOURNEY

A leading CPG player was struggling to respond to challenging market dynamics, particularly in the value-based segments and at the price points where it was strongest. The near- and medium-term forecasts looked even worse: sales volume and potentially even revenue seemed likely to contract. A comprehensive transformation effort was needed.

To fund that transformation journey, the company looked at several cost reduction initiatives, including logistics.

Previously, the company had worked with a large number of logistics providers, causing it to miss out on scale efficiencies. To improve, it bundled all transportation spending, across the network (both inbound to production facilities and outbound to its various distribution channels), and opened its logistics to bidding through a request-for-proposal process. The company was able to save 10% on logistics in the first 12 months—a very fast gain for what is essentially a commodity service.

Similarly, the company addressed its marketing-agency spending. A

benchmark analysis revealed that the company had been paying rates well above the market average and getting fewer hours per full-time equivalent each year than the market standard. By getting both rates and hours in line, the company saved more than 10% on its agency spending—and those savings were immediately reinvested to enable the launch of what became a highly successful brand.

Next, the company pivoted to growth mode to achieve additional wins in the medium term. The measure with the biggest impact was pricing. The company operates in a category that is highly segmented across product lines and highly localized. Products that sell well in one region often do poorly in adjacent markets. Accordingly, it sought to de-average its pricing approach across locations, brands, and pack sizes, driving a 2% increase in EBIT.

The company also analyzed trade promotion effectiveness by gathering and compiling data on the roughly 150,000 promotions that it had run across channels, locations, brands, and pack sizes.

The result was a 2-terabyte database tracking the historical performance of all promotions. Using that information, the company could make smarter decisions about which promotions should be scrapped, which should be tweaked, and which should merit a greater push. Another 2% increase in EBIT resulted. Critically, this was a clear capability that the company built up internally, with the objective of continually strengthening its trade promotion performance over time, and that effort has continued to pay annual dividends.

Finally, the company launched a significant initiative in targeted distribution. Before the transformation, the company's distributors made decisions regarding product stocking in independent retail locations; these decisions were largely intuitive. To improve its distribution, the company leveraged big data to analyze historical sales performance for segments, brands, and individual SKUs within a roughly ten-mile radius of a given retail location. That analysis enabled the company to identify the five SKUs likely to sell best that were currently not in a particular store. The company put this tool on a mobile platform and is in the

process of rolling it out to the distributor base. (Currently, approximately 60% of distributors, representing about 80% of sales volume, are rolling it out.) Without any changes to the product lineup, the measure has driven a 4% jump in gross sales.

Throughout the funding process, management had a strong change management effort in place. For example, senior leaders communicated the goals of the transformation to employees through town hall meetings. Cognizant of how stressful transformations can be for employees—particularly during the early efforts to fund the journey, which often emphasize cost reductions—the company talked about how those savings were being reinvested into the business to drive growth (for example, investments into the most effective trade promotions and the brands that showed the greatest sales-growth potential).

In sum, the transformation led to an improvement of EBIT margins by 300 basis points in just two years. Premium products now make up a much bigger part of the portfolio, and the organization is better positioned to compete in its core market.

ny achieve improvements of 10% to 15% in revenue and profit. (See “Jump-Start Growth by Sharpening Sales Force Focus,” BCG article, February 2014.) Activating the sales team is a practical, targeted approach to driving rapid, near-term results and making the sales force the engine of a broader transformation effort.

For example, one mobile telco facing increased competition was struggling because its sales force was not aligned with its distribution structure. By implementing a new incentive system and channel model and deploying its sales force more effectively, the company was able to capture a 10% increase in EBIT within a year of its transformation initiative.

**Marketing and advertising are critical revenue tools.** Many companies spend as much on marketing and advertising as they do on capital expenditures—but with far less analytical rigor. BCG’s proprietary research shows that the rules of thumb and shortcuts that many marketers use to make decisions don’t yield better results; in fact, they can destroy value: up to one-fourth of marketing spending is typically found to be ineffective.

By reallocating those resources, companies can achieve the same level of sales for 10% to 20% less marketing investment—or generate 3% to 8% higher volume with the same spending levels—within the first year.

Fortunately, more tools and models are available to help marketers improve their marketing performance than ever before. In our experience, however, no tool or model is sufficient on its own. Achieving substantial positive results requires pulling levers across the strategic, tactical, and operational levels to create a common currency of marketing performance and the capability to measure it consistently across brands, products, locations, and campaigns over time.

## Organizational Simplicity

Streamlining and simplifying both the company and the strategic agenda can dramatically increase the punch and implementation power of the organization and significantly reduce reporting layers and costs. Recent research has found that up to half of performance requirements are contradictory and that overall organizational complexity has risen 35-fold since 1955. It is no surprise that employees at the most compli-

cated organizations tend to be the most disengaged and unproductive. The layers of complexity lead them to focus on the wrong things and ultimately to miss their objectives.

For example, a leading global transportation provider facing a dramatic squeeze in margins streamlined the workforce at its headquarters facility. Within four months, it reduced its head count by 40% and shed ongoing projects from more than 100 to approximately a dozen. This simpler operating agenda significantly increased the focus and speed of its decision making and execution power, vaulting the company's performance from the median to the top quartile in its peer group within three quarters.

## Capital Efficiency

Utilizing capital efficiently is vital during a transformation and can help meet short-term cash needs and improve return on investment, positioning the company for growth. A strategic approach to capital allocation can help companies prioritize investment projects, improve financial discipline, and develop a strong governance structure to guide capital expenditure and growth projects.

In terms of financial metrics, optimizing net working capital—and managing the interfaces and tradeoffs between fixed assets and cost efficiency—can reduce working capital by 20% to 40%, often within the first year of implementation.

For example, a global industrial-engineering company had piled up inventory for years as a result of market volatility. It needed to reverse that trend, especially because financing costs had risen drastically. It tailored quick-win actions for each plant while a small team worked to strategically reduce inventory and optimize raw-material stocks across plants. After only one year, the company had realized a \$450 million cash release through a 35% reduction in total inventory.

A retail company that had an aggressive, six-month timeline to unlock cash provides a second example. Over three months, a small team focused on extending payment terms for the top 1,000 suppliers, representing a total of \$700 million in payables. After a detailed benchmarking analysis, the company established specific targets for each supplier. As a result, the company realized a \$180 million cash release in the first

quarter alone and a \$270 million increase in available cash after six months.

Moreover, a deeper analysis of fixed assets can also yield dramatic improvements in capital efficiency. In addition to asset reduction options—such as an outright sale or a defunding of future capital outlays—best-in-class companies manage both the need for assets and the way that assets are utilized. Asset needs can be lowered by reducing the complexity in both the product portfolio and the customer base. A complex portfolio of products often requires broad manufacturing assets, along with ramp-ups, ramp-downs, and changeovers. Streamlining the portfolio of products or customer accounts and rethinking outsourcing decisions can quickly improve productivity and allow for a reduction of assets.

Take the example of a large industrial-engineering company that was struggling to reach its ambitious targets for return on capital employed (ROCE) and needed to reduce the \$6 billion of capital employed in operations. A team thoroughly analyzed the amount of capital tied up in each of the value chain steps across all three of the company's business divisions. The company also conducted a strategic review of each plant and activity from a ROCE point of view. As a result, it developed a plan to divest select parts of operations by either optimizing remaining assets or outsourcing activities to third-party operators. After one year, the company had reduced capital employed by \$650 million—including \$200 million in the first three months—with a minimal impact on profitability.

## Cost Reduction

Targeted measures to cut costs are an essential component of a transformation, yielding reductions of 10% to 25% in the cost base. Short-term measures such as improving procurement, shuttering facilities, and reducing personnel and overhead costs can be very effective—and sometimes mission critical. Companies can also capture quick wins through more profound cost reduction activities, including changing the supply chain, implementing lean manufacturing, and improving operational processes.

The first cost reduction tool is better management of the cost of goods sold (COGS) and procurement; improved oversight of these areas can

boost profit margins by 2% to 5%. A leading European retailer, for example, had basic procurement practices and limited coordination across business units. To turn itself around, the company created a procurement center of excellence and began running coordinated, analytically backed negotiations with all of its main suppliers, an approach that unlocked annualized savings of 3% of the addressed COGS in the first year.

Personnel cost reductions are often necessary as well. As market conditions change, companies must adapt their workforce accordingly; personnel reductions can drive a 20% to 40% reduction in labor costs, in many cases within the first 12 to 18 months.

In one example, a leading European contractor was facing major margin pressure owing to a market contraction and several underperforming projects. A benchmarking analysis showed sales, general, and administrative (SG&A) costs that were 30% to 50% higher than those of the contractor's peers—something that previously had not been fully clear given varying and nontransparent accounting practices. A further review revealed overlapping roles and management layers across the organization. The company launched an effort to eliminate some positions, reduce management layers, and simplify the organization. Through these measures, the company closed the SG&A gap with its peer group in less than six months and restored its EBIT competitiveness.

Nonpersonnel cost (NPC) reductions also improve overhead. Roughly 50% of overhead costs do not come from labor but are fodder for NPC reductions of 10% to 30%. Primary cost levers include buildings and equipment, utilities, travel management, fleet management, IT, and business services.

A global cable group facing margin pressure after several years of sluggish demand growth and competition from low-cost countries took another approach to cutting costs. The group, which had been built on serial acquisitions, launched a quick-win, lean program across its plants, focusing on overall equipment effectiveness. It was soon on track to reduce personnel and materials waste costs by 30% in 18 months.

In another example, a European bank faced a sharp increase in operating expenses because of price hikes and its subsidiaries' inefficient and

ineffective use of shared services. By creating cost transparency, the bank was able to identify its highest-impact cost categories, thereby clearing the way to achieve a 20% NPC reduction within the first year.

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This chapter draws on the following BCG publications:

*The New CEO's Guide to Transformation: Turning Ambition into Sustainable Results*

*Transformation: The Imperative to Change*

## 2. Winning in the Medium Term

**F**unding the journey is necessary but not sufficient; although the levers applied for that purpose can be very powerful, they often don't have the scope to fundamentally change the business and create sustainable competitive advantage. Winning in the medium term requires delivering on transformation objectives that go beyond the short-term goals of fund-the-journey efforts. The specific objectives will vary by company, but common to all transformations is the need to establish a fundamentally different competitive position, leading to a medium-term step change in performance.

Winning in the medium term could entail a wide range of initiatives to transform, including spurring growth, launching a new digital business model, or identifying and scaling up technology solutions through joint ventures. But it can also involve revamping commercial processes or operations, building digital capabilities and ventures, and transforming internal support functions such as R&D, IT, and HR.

Compared with funding-the-journey measures, initiatives to win in the medium term are typically more difficult to conceptualize, because they require breakthrough thinking, usually in areas that are less familiar to the organization. It takes longer to deliver results from these initiatives, which are also harder to staff and implement. They call for managing interdependencies across functions and business units. (For an example of a CEO-led transformation that delivered sustainable gains, see the sidebar “A Global Insurer Implements a Value-Based Transformation.”)

In this chapter, we highlight several common medium-term initiatives:

- Rethinking the core business model
- Exploring options for top-line growth
- Repositioning the corporate portfolio
- Retooling go-to-market processes

- Expanding geographically
- Launching digital initiatives
- Revising the target operating model

## Rethinking the Core Business Model

In a transformation, companies must put all options on the table, including rethinking the core business model and addressing a fundamental question: What do we do? To answer this question, companies must zero in on their value proposition and how they deliver on it. This means a clear-eyed analysis of several aspects of the business:

- What segments are we serving? What segments should we target?
- What products and services do we offer? Are we focused on the right ones?
- What is our revenue model? Is it aligned with our long-term strategy and growth goals?

Answering these questions often prompts a fundamental shift in strategy, a reevaluation of the value proposition, and a focus on new products and services. Companies can emerge from this process to pursue new business models, such as an innovative go-to-market approach or one that emphasizes digital technology.

Even as a company moves toward a new business model, however, it cannot simply ignore its legacy business model. Leaders will have to think critically about how to juxtapose legacy business models that are still making money with newer and entrepreneurial bets that are aligned with the future strategy of the company. The longer-term objective is an ability to adapt and make progress with a flexible plan that can be refined over time. (See “Why Transformation Needs a Second Chapter: Lean, but Not Yet Mean,” BCG Perspectives, October 2013.)

## Exploring Options for Top-Line Growth

One common medium-term initiative is to explore options for top-line growth, which in turn requires a cohesive set of decisions about where to play and how to win. Deciding where to play means allocating bets

## A GLOBAL INSURER IMPLEMENTS A VALUE-BASED TRANSFORMATION

A new CEO was preparing to take over at a global insurance company that had multiple lines of business. The CEO conducted an outside-in analysis to assess the company's current situation, along with its capabilities, its competitive position (both globally and in individual markets), and industry analysts' perceptions. This process identified some clear challenges. The company's return on capital was low and its capital position was weak. The company also lacked a rigorous process for allocating capital and had unnecessarily high cost structures and an unfocused portfolio of business units whose performance varied widely.

Through this analysis, the CEO defined the ambition for a transformation and established explicit financial targets. Once he took over the top job, he built momentum for the effort in a series of meetings with the board of directors and the executive committee.

As part of the transformation, the CEO looked at specific insurance segments and restructured the company into 40 "cells." Each cell represented businesses and

markets with similar underlying characteristics (for example, vehicle insurance in the UK, pension insurance in Poland, and corporate insurance for large companies in the US). The CEO then assessed the performance of the individual cells across several dimensions through financial analyses and the evaluation of market prospects. On the basis of the results, the company grouped its businesses into three clusters: "grow" (the top 25%), "turn around" (the middle 50%), and "divest" (the bottom 25%).

Within the first 100 days, and backed by the senior management team, the CEO had begun communicating a new 18-month initiative to the entire organization. The transformation would include specific corrective actions to improve the cash flow performance of the turnaround units. In addition, the program would reduce costs throughout the company and strengthen the capital management process, with more-integrated planning and a better performance management cycle.

In all, the effort generated more than \$400 million in savings in its

## A GLOBAL INSURER IMPLEMENTS A VALUE-BASED TRANSFORMATION (CONTINUED)

first year—a savings that included a reduction of 25% in the head count of senior management. That success stemmed from several factors. First, the company took a strictly fact-based approach to analyzing business performance, in part by eliciting an outside-in assessment from the investor and analyst communities.

Second, the CEO ensured that all executive committee members had accountability for specific initiatives. And third, the implementation plan was clear from the start, thanks to strong communication and full buy-in from the management team.

and resources across the core business, adjacencies, and new frontiers. Core bets involve finding headroom in market share or customer demand within the current footprint of the business. Adjacency bets extend current advantage into nearby offerings, channels, or geographies. New-frontier bets are longer throws that more dramatically reimagine offerings or business models—or find new uses for old assets.

These choices determine the field of play, but, once made, they require additional decisions about where a business will invest to win on the field.

In our experience, companies that have achieved significant growth have been diverse in their starting positions and strategic choices, but they have all followed common disciplines. Among our clients, we have found these lessons on how to grow apply nearly universally:

- The nature, number, and risk profile of growth initiatives cannot be set without a clear view of the gap the company is trying to close. The start of any successful growth strategy requires an honest and rigorous assessment of the growth of all current initiatives, a clear objective for growth, and quantification of the gap between them over the target timeline.
- In addition to the effort spent looking outward at the marketplace, companies need to look inward at their unique advantages and

capabilities. It's possible to miss—or overstate—advantages. And today's advantages can be rendered obsolete or even become a liability as consumers, customers, and industries change.

- To best leverage their advantages, companies must stretch their thinking. New perspectives can upend long-standing beliefs about “stagnant cores” or “distant adjacencies.” Often, faint signals lost in the noise of today's core business suggest opportunities. And unattractive adjacencies can become attractive when they are paired with an acquired capability or when they can create value by reinforcing the core.
- For many companies, finding growth ideas is less difficult than focusing on the ones that matter. We like to ask three questions about all growth ideas: What is the size of the prize? What is our right to win? And what is the path to success? A strong business case is built on these three questions, and a strong strategy is built on a cohesive, qualified set of business cases.

Above and across all of these disciplines, one observation recurs: these companies pursue growth even as they take critical steps to fund the journey. They first earn the right to grow through operational efficiencies and the cultivation of advantage in the core business—whether that advantage comes from strong brands, cost control, or better customer insight. And as they pursue growth, they bring the same creativity and discipline to funding that growth through concurrent operational and cost initiatives.

## Repositioning the Corporate Portfolio

One of the most powerful tools available to CEOs to win in the medium term is repositioning the portfolio: assessing which business units and markets to expand, which to improve, and which to exit and then allocating capital accordingly. Unlike more operational levers, decisions about capital allocation are fundamentally strategic: they determine the long-term asset base upon which future value creation depends. Done correctly, capital allocation can be a highly effective means of delivering on the corporate growth ambition.

BCG's research and client experience suggest that the best-performing companies have a highly differentiated approach to funding business

units in the corporate portfolio. This approach has four steps:

- **Prioritizing Growth Among Business Units.** In this step, these companies identify the business units that can be growth engines—that is, those that are big enough and can grow fast enough.
- **Translating Roles into Actions.** The companies establish KPIs, performance targets, capital budgets, and, ultimately, detailed business and financial plans. (See *The Art of Planning*, BCG Focus, April 2011.) This is an area that clearly requires a customized approach.
- **Differentiating Among Types of Growth Investments.** Understand how technology platform decisions, product development, and product updates can all determine where to invest.
- **Actively Managing the Investment Portfolio.** The final step is to establish an interdisciplinary investment committee made up of representatives from key constituencies such as strategy, finance, operations, and R&D. This committee can continuously evaluate the overall investment portfolio to ensure that it aligns with the company's strategic growth priorities.

## Retooling Go-to-Market Processes

A go-to-market transformation retools a company's commercial functions—sales, marketing, pricing, branding, and customer insight—to exploit new possibilities while navigating a fast-moving landscape. It adapts processes to changing customer pathways and needs, prepares the company to face new global markets and competitors, and arms its go-to-market teams with the latest and most effective technology. (For an example of a company that significantly improved its commercial processes through a transformation, see the sidebar “A German Health Insurer Transforms Itself to Better Serve Customers.”)

Go-to-market transformation is a particularly potent lever for winning in the medium term because it exploits tactical, short-term victories to fund broader commercial transformation over the medium term. For example, one company started with a sales force effectiveness program that led to more than \$20 million in near-term value—an early success that energized the organization and created a financial foundation for a broader go-to-market transformation. From such beginnings, this ambitious

## A GERMAN HEALTH INSURER TRANSFORMS ITSELF TO BETTER SERVE CUSTOMERS

A large German public health insurer had a successful history spanning more than 100 years. When its new CEO took office, he quickly realized the need for action despite the company's relatively good financial health.

The company was still dealing with a postmerger integration, and it needed to adapt to a fast-changing, increasingly competitive market. It was losing ground to competitors in both market share and key financial benchmarks. The insurer was suffering from overhead structures that kept it from delivering market-leading customer service and being cost efficient, even as competitors were improving their service offerings in a market where prices are fixed. Facing this fundamental challenge, the company decided to launch a major transformation effort.

The goal of the transformation was to fundamentally improve the customer experience, with customer satisfaction as a benchmark of success. At the same time, the company needed to improve its cost position and make tough choices to align its operations to better meet

customer needs. As part of the first step in the transformation, the company launched an organizational simplification program that streamlined management layers, leading to significant savings and notable side benefits including enhanced accountability, better decision making, and an increased customer focus. Organizational simplification laid the path to win in the medium term through fundamental changes to the company's business and operating model in order to set up the company for long-term success.

The company launched ambitious efforts to change the way things were traditionally done:

- **A Better Client Service Model.** The company reduced the number of branches by 50%, while transitioning to larger and more attractive service centers throughout Germany. More than 90% of customers are still able to reach a service center within 20 minutes. To reach rural areas, the company created mobile branches that can visit homes.

## A GERMAN HEALTH INSURER TRANSFORMS ITSELF TO BETTER SERVE CUSTOMERS (CONTINUED)

- **Improved Customer**

**Access.** The insurer wanted to make it easier for customers to access it. So, it invested significantly in online services and full-service call centers. This led to a direct reduction in the number of customers who need to visit branches while maintaining high levels of customer satisfaction.

- **Organizational Simplification.**

A pillar of the company's transformation is the centralization and specialization of claim processing. By moving from 80 regional hubs to 40 specialized processing centers, the company is now using specialized administrators—who are more effective and efficient than was the case under the old staffing model—and increased sharing of best practices.

Although the company has strategically reduced its workforce in some areas—through proven concepts such as specialization and centralization of core processes—it has invested

heavily in areas that are aligned with delivering value to the customer, increasing the number of customer-facing employees across the board. These changes have made the company competitive on cost, with expected annual savings exceeding €300 million, as the company continues on its journey to deliver exceptional value to customers.

Beyond being described in the German press as a “bold move,” the transformation has laid the groundwork for the successful future of the company.

company funded a larger set of programs, which in turn produced a step change in both commercial capabilities and value delivery.

## Expanding Geographically

Growth in the developing world is slowing, yet companies that plan to look for the exits or scale back in emerging markets should reconsider. The fundamental trends remain promising, and emerging markets will remain an unmatched source of growth in most industries. In addition, hundreds of millions of households will continue to join the ranks of the middle class and affluent in the decade ahead.

To win in emerging markets, executives will need to rethink their approaches. As growth in many of these economies slows, tapping major new sources of revenue will become harder. Executives should adopt a more differentiated approach to emerging markets and market segments. Companies should build new capabilities, adjust their business models, and improve their execution. We believe that success requires overcoming the following challenges:

- **Refining the Emerging-Market Footprint.** Growth prospects, consumer behavior, and the local competitive environment differ widely from one emerging market to another, as well as among industries. Each company must define the most promising emerging-market priorities, taking into consideration its own unique context and starting point.
- **Winning Over More-Demanding Consumers.** Emerging-market consumers expect more from foreign brands than they used to. Even average consumers in the lower rungs of the middle class are quality conscious. They can no longer be consistently won over by Western or Japanese products with features and functions that have been stripped down to hit a certain price point.
- **Adapting to the Big Competitive Squeeze.** A decade ago, many multinationals regarded their global peers as their main competitors. This orientation has fundamentally changed. Foreign companies in emerging markets are now being squeezed by different kinds of players. One major source of competition is what BCG refers to as “global challengers”—fast-growing, globally minded companies that have roots in emerging markets and that are on track to establish

leadership positions and to fundamentally alter their industries. A second major challenge comes from companies that we call “local dynamos”: smaller emerging-market companies that focus only on their domestic markets. Such companies are catching up in terms of performance and distribution. They also have developed an intimate understanding of local consumers and strong relationships with local governments.

- **Meeting the Higher Expectations of Local Partnerships.** Multibillion-dollar, cross-border mergers and acquisitions in emerging markets tend to grab headlines. But making these deals pay off through long-term growth after the deal closes can be challenging. To succeed, companies will have to up their game both in M&A and in forming local partnerships. They will need to think through their partnership agenda and tailor it to their unique requirements and objectives in a given market.

(For more on improving profitability in emerging markets, see the chapter “Transformation in Emerging Markets.”)

## Launching Digital Initiatives

Digital technology is changing the way companies in all industries and geographies operate. Even as new technologies and evolving customer behavior are forcing companies to radically improve their products and services, these companies are finding enormous value in applying digital technology to improving internal processes, increasing transparency, and giving all levels of the organization the tools needed to make quicker and more effective decisions. More than any other type of transformation, digital transformation is pushing leadership teams into uncharted territory, often requiring new business models, operating models, organization structures, and capabilities. And dramatic shifts in competitive position can be won or lost if actions are too timid or the pace of change too slow.

Success in digital calls for an agile, four-step approach:

- **Educate.** Rapidly immerse the leadership team in the reality of digital disruption and set a path that is directionally correct, knowing full well that this will be only a starting point for a difficult journey.

- **Crystallize.** Develop a plan for how to move forward, along with a potential portfolio of digital initiatives that the company can quickly pursue.
- **Accelerate.** Avoid the trap of excessive deliberation by selecting a few digital initiatives, launching them, and adapting them as experience indicates.
- **Scale up and transform.** Riding the tailwind of the first few successes, look broadly at opportunities and take the actions necessary to scale them, even while expanding the transformation of the organization, placing a heavy emphasis on building digital capabilities and a digital culture.

(For a more detailed discussion, see the chapter “Digital Transformation.”)

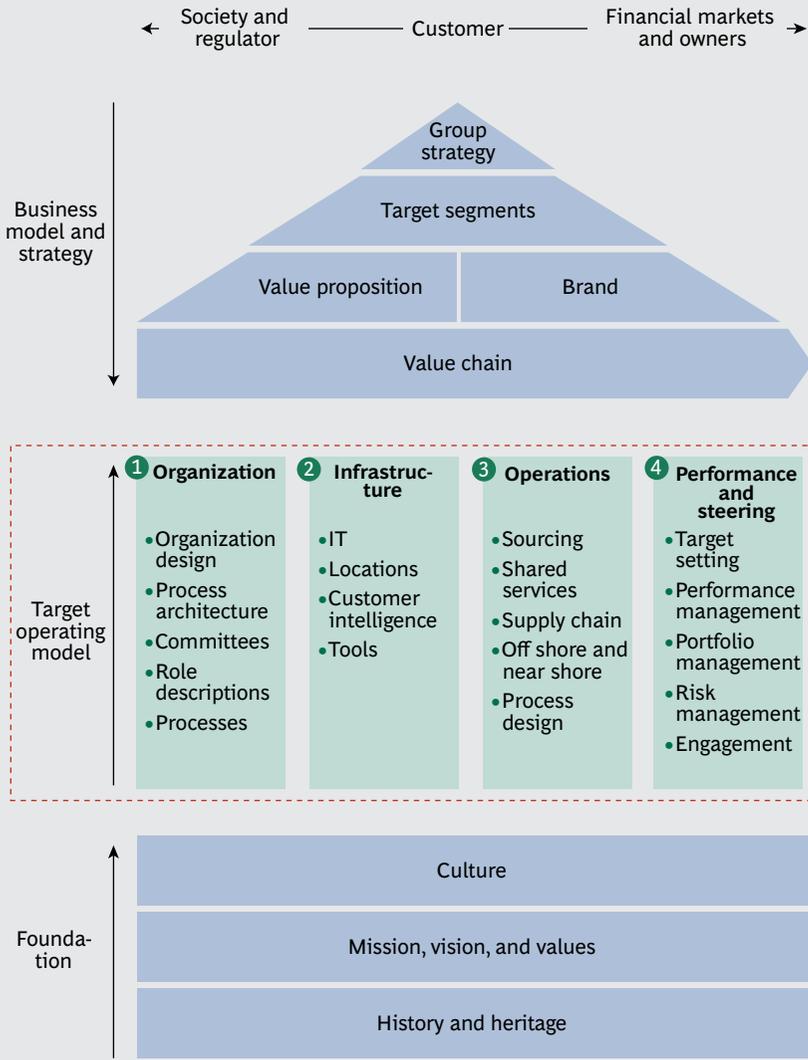
## Revising the Target Operating Model

To create a target operating model aligned with the goals of the transformation, a company must first make an honest analysis of its current operations. The process starts with assessments and benchmarking but also relies on a deep understanding of the complex interactions across the business and value streams, acquired through an evaluation of the organization, infrastructure, operations, and performance and steering. (See Exhibit 1.) By evaluating these four areas, companies will almost certainly uncover several core processes that they need to eliminate, replace, or improve.

One way to evaluate current operations is to utilize a lean approach. This approach has traditionally been used in manufacturing facilities and supply chains but is increasingly being applied to service industries and white-collar environments as well. An end-to-end lean approach starts with the value proposition, looks at it from the customer’s perspective (rather than an internal viewpoint), and breaks down processes into discrete steps. (For a case study, see the sidebar “A Leading Bank Uses a Lean Approach to Transform Its Target Operating Model.”)

But in some cases that’s not enough. Instead, companies must fundamentally reimagine core processes and rewire their approach to deliver-

## EXHIBIT 1 | The Target Operating Model Requires Addressing Four Core Elements



Source: BCG experience.

## A LEADING BANK USES A LEAN APPROACH TO TRANSFORM ITS TARGET OPERATING MODEL

A leading bank in Europe is in the midst of a multiyear transformation of its operating model.

Prior to this effort, a benchmarking analysis found that the bank was lagging behind its peers in several aspects. Branch employees handled fewer customers and sold fewer new products, and back-office processing times for new products were slow. Customer feedback was poor, and rework rates were high, especially at the interface between the front and back offices. Activities that could have been managed centrally were handled at local levels, increasing complexity and cost. Harmonization across borders—a challenge given that the bank operates in many countries—was limited.

However, the benchmark also highlighted many strengths that provided a basis for further improvement, such as common platforms and efficient product-administration processes.

To address the gaps, the company set the design principles for a target operating model and

launched a lean program to get there. Using an end-to-end process approach, all the bank's activities were broken down into roughly 250 processes, covering everything that a customer could potentially experience. Each process was then optimized from end to end using lean tools. This approach breaks down silos and increases collaboration and transparency across both functions and organization layers.

Employees from different functions took an active role in the process improvements, participating in employee workshops in which they analyzed processes from the perspective of the customer. For a mortgage, the process was broken down into discrete steps, from the moment the customer walks into a branch or goes to the company website until the house has changed owners. In the front office, the system was improved to strengthen management, including clear performance targets, preparation of branch managers for coaching roles, and training in root cause problem solving. This new way of working and approaching

## A LEADING BANK USES A LEAN APPROACH TO TRANSFORM ITS TARGET OPERATING MODEL (CONTINUED)

problems has directly boosted both productivity and morale.

The bank is making sizable gains in performance as the program rolls through the organization. For example, front-office processing time for a mortgage has decreased by 33% and the bank can get a final answer to customers 36% faster. The call centers have had a significant increase in first-call resolution. Even more important, customer satisfaction scores are increasing, and rework rates have been halved. For each process the bank revamps, it achieves a consistent 15% to 25% increase in productivity.

And the bank isn't done yet. It is focusing on permanently embedding a change mindset into the organization so that continuous improvement becomes the norm. This change capability will be essential as the bank continues on its transformation journey.

ing products and services to their customers (for example, through a full digital transformation).

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This chapter draws on the following BCG publications:

“Growth for Free: Embracing the Go-to-Market Revolution”

*The New CEO’s Guide to Transformation: Turning Ambition into Sustainable Results*

“Taking a Portfolio Approach to Growth Investments”

“Time to Reengage with, Not Retreat from, Emerging Markets”

*Transformation: The Imperative to Change*

“When the Growing Gets Tough, the Tough Get Growing”



# 3. Organizing for Sustained Performance

**A**fter funding the journey and winning in the medium term, the third key element of the transformation framework is organizing for sustained performance, which requires putting people first and addressing the context in which they work.

## Putting People First

We spend the majority of our waking hours working in organizations. Organizations enable us to contribute to society through the products and services we create. They help us learn, grow, realize our potential, develop relationships, and find sources of affiliation. The best organizations also enable us to find meaning in our work. As organizations transform, leaders need to ensure that they are truly enabling the people working within those organizations to contribute, to grow, to find meaning, and to be more productive.

Though organizations have a profound impact on people, and vice versa, companies launch far too many transformations with inadequate attention to the importance of people. Transformations are extraordinarily demanding efforts, in which people need to go above and beyond the call of duty to deliver and sustain improved performance. And in the era of always-on transformation, where organizations constantly need to adapt, the demands can be even greater. Rather than feeling inspired and energized, people involved in transformations instead feel exhausted. This need not be the case and surely will not yield the kind of sustainable results that leaders seek. The starting point is to stop treating people as a means to an end—or, worse, as collateral damage—and instead start putting people first.

## How Context Shapes Performance

Let's acknowledge that change is hard. People naturally resist change, especially when it is imposed upon them. But organizations do things that make it even harder—and more exhausting for people—than it

needs to be. Often, leaders try to motivate people through carrots and sticks (mostly sticks). Far too often, leaders expect people to perform at higher levels while working in an environment that does not foster and enable higher performance on a sustainable basis. Given these obstacles, how can leaders transform organizations so that their people feel empowered and energized?

Success requires understanding the company’s organizational context—the environment in which people work. For example, what meaning and direction have the company set with its mission and strategy, and how do its leaders and pivotal capabilities embody this? Is the organization’s design—its reporting structure, decision making, role definition, and processes—consistent with the direction the company has set forth? Has the company established the enablers to achieve this direction, with the right talent, effective use of people and organizational data, motivational performance management systems, and ability to handle change?

A thoughtful diagnostic at the start of the transformation journey to identify areas of strength and weakness among these contextual elements can help. With the insights thus generated, leaders can focus on the specific areas that require attention. It could be that the organization’s direction has not been effectively set, and the organization may lack purpose or clarity in its strategy or transformation agenda. Even if the direction is well established, there may be weaknesses in the leaders’ ability to convey and embody that direction. Alternatively, the organizational design may be inconsistent, with poorly defined roles or unclear decision rights. Or the organization may be weak on aligning its performance management systems to enable its strategy or not staffing the right talent in the right roles. Of course, many of the areas identified may also be strengths that can be further exploited. What matters is starting with a clear understanding of the organizational context and whether or not this context will enable the organizational outcomes that are critical to delivering and sustaining performance.

We have found that companies that truly put people first successfully achieve five core organizational outcomes (see Exhibit 1):

- **Agility.** The first outcome is agility, or the ability to act rapidly in an environment of change and uncertainty. Transformations, by

## EXHIBIT 1 | The Organizational Context Shapes Critical Outcomes

### ORGANIZATIONAL CONTEXT



### ORGANIZATIONAL OUTCOMES

AGILITY	Ability to <b>proactively act on signals of change</b> and uncertainty in nimble ways
SIMPLICITY	Utilization of integrated, <b>minimally sufficient solutions</b> that are easy to adopt
PEOPLE ORIENTATION	<b>People as a competitive force</b> for the company, enabled to contribute, learn, and grow
COOPERATION	Ability to create <b>additional value via collective problem solving</b>
ENGAGEMENT	<b>Long-term employee commitment</b> ; employees go above and beyond

Source: BCG experience.

definition, require organizations to anticipate and adapt quickly to changes. This ability is usually required for funding the journey, and always for winning in the medium term, as companies launch new business models, move into new markets and products, and embrace new ways of working, including the introduction of new digital technologies.

- **Simplicity.** The second critical outcome is simplicity, or the use of

minimally invasive solutions to enhance effectiveness and efficiency. With many initiatives happening across a transformation, it is critical to ensure that the company doesn't layer on new rules, processes, and other coordinating mechanisms that ultimately hinder its ability to execute.

- **People Orientation.** Third, companies that put people first enable them to learn, contribute, and grow. Transformations require people to adopt new behaviors and work with new tools and processes. It's critical to invest in developing them to learn new ways of working and contributing and to facilitate their personal growth.
- **Cooperation.** Fourth is cooperation, or working together across functions, locations, and businesses to increase the company's overall effectiveness. Transformation almost always requires across-the-board cooperation to deliver end-to-end solutions for customers, gain economies of scale, and enable companies to use resources efficiently.
- **Engagement.** Last, companies that put people first energize and inspire them to go above and beyond. Transformation requires a great deal of energy and commitment. More often than not, it is the very people who are already playing key roles with heavy commitments who are asked to contribute to key transformation initiatives. Leaders must focus on employee engagement if they want their people to have the energy and stamina needed to succeed over the long term.

These organizational traits may seem elusive, but they are, in fact, entirely achievable, provided that companies analyze and understand the context in which people work and then take deliberate steps to shape it accordingly.

## Organizational Imperatives

Building on the insights from the contextual diagnostics, organizations must then launch initiatives focused on improving their performance. Although each organization's transformation and starting position are unique, six organizational imperatives stand out in our experience as being the most important for delivering a successful, sustainable transformation while creating an environment in which people can thrive during—and well beyond—the transformation:

- Inspire through an authentic purpose, while ensuring clarity in the strategy and transformation agenda.
- Ensure that the best leaders and talent are in key roles, and develop the capabilities of the leadership team and critical talent.
- Develop the right structure and operating system.
- Build capabilities—organizational “muscles”—in areas critical for the transformation, including governance, skills, tools (including technology), and processes.
- Embed change management tools and processes (such as an activist program management office [PMO], roadmaps, and rigor testing) into the organization.
- Install an HR team that can act as a strategic transformation partner across the many elements required to create the right organizational context.

**Inspire through an authentic purpose.** Most transformations focus on financial or operational goals, like increasing revenue or improving operating efficiency. Such goals are extremely important—and motivating to the board, investors, and senior management—but they tend to be an underwhelming motivator for the majority of employees. For people to be energized and fully committed, the transformation must connect to something with a deeper sense of purpose. In the era of always-on transformation, purpose is able to provide a deeper sense of meaning and permanence that transcends any given transformation program. (See the sidebar “Key Lessons in Cultural Change During a Transformation.”)

BrightHouse, an independent division of BCG that helps companies develop a more purpose-driven culture, has found that when organizations can clearly define and communicate their purpose to employees, these employees feel that they are part of something bigger. And when employees believe in the company’s purpose, they are intrinsically motivated to go above and beyond. (See the sidebar “A Retailer Uses Purpose to Inspire Employees and Improve Business Results.”)

Once a company has formulated and articulated its clear overarching purpose, all subsequent transformations should link directly to that

purpose. Moreover, all employees should be able to see how their contributions help the company succeed in those transformations—and thereby fulfill the company’s broader purpose.

**Ensure that the best leaders and talent are in key roles.** In many industries undergoing significant market, competitive, and technological shifts, transformation is the new normal. Companies need to make sure that they have the right leaders with the right skills “on the bus” and that these leaders can work in effective teams, set the right priorities, and provide the leadership needed to make change happen.

## KEY LESSONS IN CULTURAL CHANGE DURING A TRANSFORMATION

Creating a high-performance culture is typically only one of several objectives in a transformation. Many of the other objectives, especially those involved in funding the journey, have a clear return on investment. The benefits of culture change, in contrast, can be harder to pin down and quantify—although in many ways, culture change is the most critical element for sustainable success.

As a result, leaders need to ensure that they are fully committed to protecting resources and actions to change the culture. Because transformation requires pulling levers from the first day of the process, this can be challenging. Compounding the problem, many work streams associated with the broader transformation are not under the

direct control of those responsible for the culture, such as HR.

Accordingly, it is urgent that leaders move fast in the early stages to generate a high-level view of the target culture and set a “north star” to guide the overall transformation. This means a clear description of the target culture—and target behaviors—that can be understood throughout the organization.

In addition, companies need to structure the program so that leaders buy into the cultural aspect, and they must ensure that there are appropriate resources to orchestrate the cultural change. Treating culture as an afterthought will erode the transformation—and the company’s performance overall—in a thousand small and large ways.

In fact, nothing contributes more to the success of a transformation than its leaders. Transformations are complicated initiatives that take place over time, with significant potential for miscommunication and misplaced priorities by the time they filter down the line. As a result, transformations must be led from the front, by committed leaders who consistently embody important behaviors and hold themselves accountable for results.

Senior leaders must be able to engage not just the senior team but also the extended leadership team—the next 100 to 200 managers in the

## A RETAILER USES PURPOSE TO INSPIRE EMPLOYEES AND IMPROVE BUSINESS RESULTS

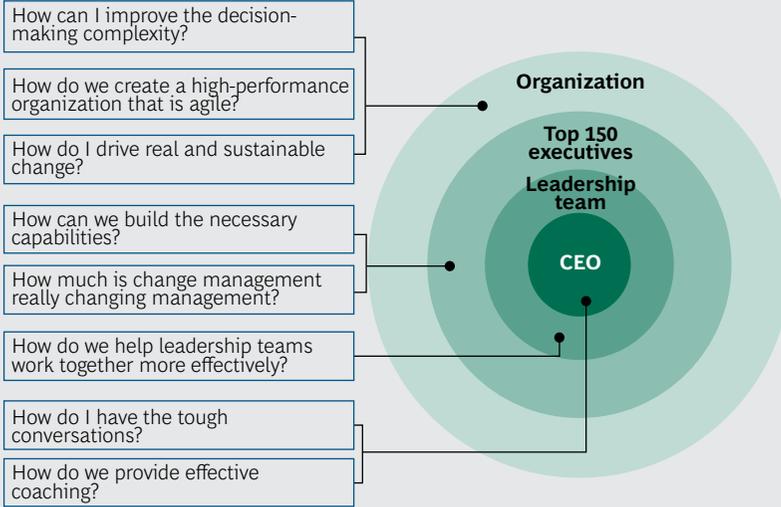
A North American retailer had a successful history of increasing sales through aggressive pricing and maintaining margins by keeping costs low. However, it faced increasing pressure from competitors, and it was struggling to motivate retail sales associates and engage with consumers in a meaningful way. In response, it launched a transformation with a strong emphasis on purpose.

The company's leaders conducted deep qualitative and quantitative research to determine the most salient ways to connect with consumers and in-store associates on an emotional level. They also explored the company's corporate history and organizational strengths to understand its values and heritage. As a result of this process, the management

team defined a new purpose and launched a comprehensive transformation of its stores—with that purpose as its foundation—aimed at improving everything from customer interactions to merchandising. It tested the new approach in several dozen pilot stores and then in a full division. On the basis of compelling test results, the company has begun rolling out the new approach to the rest of its locations.

With this purpose as a guiding principle, the transformation has been highly successful. Customer experience and associate engagement scores have improved significantly, as have key financial metrics such as same-store sales and market share.

## EXHIBIT 2 | Transformation Success Requires Engaging the Extended Leadership Team



Source: BCG experience.

organization chart—to ensure that all leaders have the right level of commitment to the transformation. (See Exhibit 2.) Typically, this requires convincing some skeptics who may question the need for change, doubt the urgency or validity of the transformation, or resist the transformation effort because it changes their span of control, responsibilities, or other aspects of their job.

Each leader should be assessed for past performance, current readiness, and future potential across four dimensions: knowledge, soft skills, experience, and motivation and personality traits. Leaders also must have a foundation in adaptability and change leadership. A shortcoming in any one of these can be a warning sign.

However, the right leaders will fill roles in varying ways throughout the journey, from champion of the venture (offering sponsorship and support), to resource (offering information and direction to employees, managers, and other leaders), to example (embodying the right actions and behaviors), to compassionate team member (acknowledging that change can be disruptive and stressful). (For a case study in how leadership can affect a transformation, see the sidebar “Nokia’s Leaders Reinvent the Company [Again].”)

## NOKIA'S LEADERS REINVENT THE COMPANY (AGAIN)

We all remember Nokia as the company that once dominated the mobile phone industry but then had to exit that business. What is easily forgotten is that Nokia has radically reinvented itself several times in its 150-year history, which is rooted in pulp mills and rubber boots.

In 2007, Nokia had close to a 40% share of the worldwide mobile phone market, thanks to a clearly superior operating system, features such as built-in cameras, and enormous scale benefits. In fact, managers were so obsessed with and proud of the advantage of Nokia that they forgot to be paranoid. As a result, in a few years Nokia went from being a dominant player to an almost-bankrupt enterprise burning cash at an unsustainable rate.

In 2013, Nokia orchestrated two deals that changed the company's trajectory: selling the mobile business to Microsoft and using part of the resulting funds to buy out Siemens from its joint venture in the networking business, giving Nokia full control of the unit and forming the core of the new company.

Since then, Nokia has transformed its entire business and restructured its organization and team. Virtually all of its current employees have joined the company over the past three years.

In 2016, the company conducted two additional deals:

- The acquisition of Alcatel-Lucent has helped Nokia become one of the world's leading telecom infrastructure players.
- Thanks to its acquisition of Withings, Nokia is also rolling out advanced products in digital health and wearable technology.

As a result of this repositioning, Nokia's enterprise value has grown more than tenfold since bottoming out in July 2012. And Nokia is again the pride of Finland, and its most valuable company.

Note that a transformation often brings significant turnover and, consequently, many leaders who are new to the organization. Beyond understanding their commitment to the change journey, it is vital to ensure that they have the right tools and capabilities to lead and manage change—a fundamentally different set of skills from managing day-to-day operations. (For examples of what can go wrong in a transformation, see the sidebar “Four Reasons Why Executive Teams Underdeliver.”)

Also, success over the longer term requires a strategy for identifying and developing talent at all levels and in all critical roles. All transformations require the development of new skills for leadership and functional expertise in disciplines such as pricing, sourcing, lean, and HR.

An industrial goods company was able to deliver on aggressive transformation goals through a fundamental shift in its talent strategy. Without a focus on talent, the company would have failed as it shifted from a local to a global focus: it started with 80% of its staff in its local country,

## FOUR REASONS WHY EXECUTIVE TEAMS UNDERDELIVER

Strong leadership can be a critical factor in executing a transformation, yet there are also many ways in which ineffective leaders can undermine the effort. The following are among the most common:

- **Lack of Clarity or Purpose.** Individual accountabilities among the executive team are not aligned with business requirements; the team is not clear on governance bodies and roles.
- **Individual Personalities.** Senior executives have been

promoted for individual achievement rather than team efforts; talent and leadership styles vary widely.

- **Internal Competition.** Multiple leaders are vying for the top job, which can erode the open and trusting climate needed for constructive group dynamics.
- **Team Structure.** Some structures foster a focus on personal accountability and individual business units instead of the overall organization.

but in five years had 50% of staff located in the emerging-market nations of Brazil, Russia, India, and China. The talent initiative also supported an effort to increase the revenue contribution of the company's service business to half of total revenue. Four pillars of this talent strategy helped the company deliver on its goals:

- Anticipating and constantly measuring the talent gaps with transformation and business leaders, and investing accordingly
- Opening talent pools to very diverse profiles to support a global strategy, and updating assessments to handle this diverse new pool of employees
- Marketing the company to potential employees who fit the new strategy, through a targeted employer value proposition and investment of time to standardize the talent experience globally by closely monitoring employees' engagement
- Helping the managers of the company succeed in their human capital performance objectives with cross-silo talent reviews and career-management and enterprise-development programs at different career levels that encompassed job rotations and training cycles

The time that the senior leaders of the industrial goods company invested in talent management was considerable—up to a month annually for each executive. But talent management has become a competitive advantage for the company, which is now a truly global leader in its sector.

**Develop the right structure and operating system.** Executing the new strategy and target operating model to achieve and sustain the transformation will likely require some adjustments to the organization's design. Any design includes multiple elements for success: companies cannot just contemplate classic reporting structures; for the transformation to become deeply rooted in the organization's foundation, they must also pay equal attention to how roles and collaboration are defined and clarified, as well as how decisions get made.

As they determine the organization's new structure, the CEO and his or her team need to link the company's new strategic direction to profit-and-loss accountability, and they must ensure that lines of reporting for

all functions reflect business priorities. For example, if the transformation requires a shift from product-driven innovation to client-driven development, the organization may operate more smoothly and sustain the shift longer if it moves from a focus on product P&Ls to an emphasis on customer segments. Whatever structure is chosen, it is essential that companies optimize individual managers' spans of control to limit redundancy, increase efficiency, and direct managers' focus to the right priorities—ever more crucial in a transformation environment in which resources and time are limited.

If an organization's structure can be thought of as its skeleton, then roles and collaboration make up its nervous system: Clarified roles and mechanisms for collaboration and effective decision making, in turn, support accountability, which is essential to avoid ambiguity about responsibilities and direction. Collaboration also provides the connections that allow different parts of an organization to work together effectively; forums, councils, and cross-functional teams are reliable mechanisms for fostering this collaboration. These connections are particularly important in transformational programs that require extensive collaboration to meet their goals.

Strong organization design also requires careful attention to how decisions get made. Effective and swift decision making can be a challenge, as there are no clear standards that apply equally across all business groups or in all circumstances.

Experience shows us, however, that effective decision making always has a few common elements: clear decision-making criteria, a sufficient number of people to make the decision with unambiguous decision rights, and an ongoing decision-making forum, coupled with a clearly defined mechanism for accelerating the most urgent decisions. Getting decision making right can unlock the power and necessary speed of a transformational effort.

**Build critical capabilities.** Companies are increasingly embarking on transformations that rewire the way they operate—including new business models, digitization, and fundamental changes to the roles of business units and functions. As a result, companies invariably need to build new capabilities. Knowing how to identify and develop these capabilities in any given transformation is pivotal to success.

To enable and sustain behaviors that support a transformation, the leadership team must address the four components of any capability:

- **Competencies**—the skills, knowledge, and beliefs held by employees
- **Tools**—IT, databases, apps, and related systems
- **Processes**—the activities, resources, and responsibilities that govern the way work is divided and done
- **Governance**—accountability, KPIs, incentives, and reporting structures

Collectively, these four elements reinforce each other and lead to sustainable changes in behaviors. For example, a company seeking to become better at innovation may need additional capabilities in conducting primary research, developing products, assessing the market potential of new ideas, building a business case, and getting new products to market quickly. To build these capabilities, the company may need to improve its understanding of changes in customer behavior. It may need to develop skills in rapid prototyping and design-to-value methodologies. At the employee level, required changes could well include revamping the company’s recruiting strategies and approaches to training, coaching, and development, along with redefining roles and upgrading performance management.

(For more on this topic, see the chapter “Building Capabilities.”)

**Embed change management tools and processes.** Depending on complexity, up to 70% of change efforts fail. However, a holistic approach to managing change—one that involves leaders at all levels, engages the broader organization, and ensures a high level of confidence in initiative delivery—can powerfully flip the odds in favor of success.

To begin, it is important to establish an initiative roadmap for each of the many high-impact initiatives required to fund the journey and win in the medium term. These roadmaps are made up of multiple milestones—typically, 15 to 25 are most effective—along with time frames, financial and operational metrics, and clear accountabilities. These roadmaps communicate the story of each change initiative in such a way that the transformation team, on the basis of monthly updates, can

easily understand what is happening and can make course corrections to ensure ultimate on-time value delivery.

To produce the greatest value, each initiative roadmap should be rigor tested. This entails a qualitative assessment of the robustness and consistency of each plan that ultimately addresses three important areas:

- Is the initiative roadmap clearly defined, logically structured, and readily implementable?
- Is the financial impact at each step clearly identified, along with the source, timing, and leading indicators?
- Are interdependencies and other risks identified and understood?

Analysis has shown that roadmaps whose rigor test earned “excellent” scores captured an average of 130% of their planned value. One company, which had more than 100 initiative roadmaps with 1,800 specific business milestones, performed rigor testing with every initiative team, leveraging the support of its PMO. By challenging each roadmap with key questions in these three areas, the company engendered confidence in its ability to deliver on its aggressive goals.

Next, an activist PMO, one that closely supports senior leaders and the transformation agenda, has time and time again proved critical in enabling and facilitating impact across the business—particularly for cross-business initiatives. The value of getting the PMO right cannot be understated. Only one-third of PMO leaders feel that their PMO has realized its full potential to enable change within the organization. (See *Strategic Initiative Management: The PMO Imperative*, BCG and Project Management Institute report, 2015.) When used correctly, the PMO helps the leadership team maintain an appropriate pace of change and acts as the steward of the aspiration for change, ensuring that there is a clear line of sight to senior executives regarding implementation progress and any emerging issues. At the same time, it must never usurp the authority of the business units or functions in delivering results.

We note that the PMO does not need to be liked, but it should have broad-based respect. “PMO used to be a dirty word around here. This

PMO has changed that,” remarked a senior leader at a global oil and gas company whose PMO is now recognized as a key part of a major transformation program. (See *Changing Change Management: A Blueprint That Takes Hold*, BCG report, December 2012.)

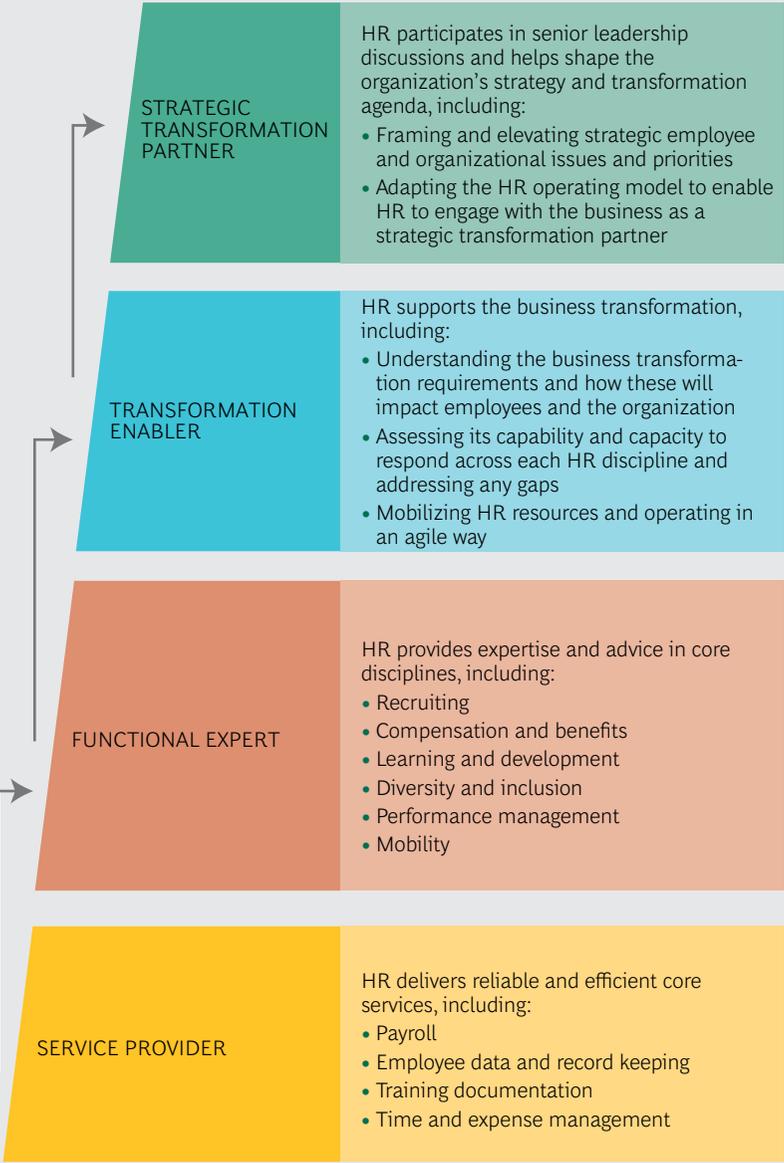
Finally, rather than rolling out each new transformation initiative from scratch—and moving temporary scaffolding around the organization for each—companies should consider setting up an internal transformation office to embed change management in the organization. Companies with a permanent transformation office have dedicated resources to, and institutional expertise in, all aspects of change management, which they can deploy as needed.

Properly structured, a transformation office can provide oversight of all transformation efforts, help prioritize and sequence transformations, design individual transformation initiatives, and track progress. The transformation office can also serve as a repository of change management capabilities in the company. (Some companies have also found it helpful to include related activities—such as lean initiatives and continuous improvement—under the overall mandate of the transformation office to ensure the coordination and alignment of all performance improvement programs.)

**Install an HR team as a strategic transformation partner.** All of the aforementioned imperatives have enormous implications for a company’s organization design, people practices, and HR policies. As such, HR must play a larger role in the transformation. Ultimately, HR needs to participate actively in senior leadership discussions, help develop the company’s strategy and transformation agenda, and support the alignment of specific functions with the company’s priorities. To embrace this role, HR needs to evolve beyond its traditional supporting function to become a true strategic transformation partner. (See Exhibit 3.) And, equally important, the company’s senior leadership needs to support HR’s expanded role.

Specifically, HR must understand the requirements of the transformation and how they impact the company’s employee-related processes and HR disciplines. It must work with company leaders to understand how employees and the organization will enable the company’s strategy. It must anticipate the implications of every change initiative on employees and the organization. And it must know whether the company has

### EXHIBIT 3 | HR Must Evolve into a Strategic Transformation Partner



Source: BCG analysis.

the capability and the capacity to meet its strategic goals. All the while, HR must keep pace with the organization and operate with agility as the transformation unfolds.

HR's expanded role will require a new set of capabilities. For example, frequent product and strategy shifts will call for regular upgrades to the organization structure. HR should work with line-of-business leaders to decide how the organization needs to adapt and then help orchestrate the process—with the expectation that the organization design will soon need to be upgraded again. Similarly, in the more volatile environment of a transformation, strategic workforce planning becomes more important—and more difficult. HR must take the lead in assessing and anticipating emerging skills gaps and in developing strategies to meet future needs for talent. (See “Transforming Technology Companies: Putting People First,” BCG article, November 2014.)

In this era of always-on transformation, organizations need to constantly launch large-scale change initiatives. But doing so does not have to be exhausting. Leaders owe it to themselves, their organizations, and society in general to boldly transform their approach to transformation. To do that, they need to commit to developing organizations that enable people to thrive. In turn, that requires putting people first.

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This chapter draws on the following BCG publications:

*A Leader's Guide to “Always-On” Transformation*

*The New CEO's Guide to Transformation: Turning Ambition into Sustainable Results*

*Transformation: The Imperative to Change*





**PART II:**  
**TAKING THE TRANSFORMATION**  
**JOURNEY**





# 4. Leading Transformation

**F**or most CEOs, the imperative to change is a given; how they respond to this imperative is not. Leaders who stand out are the ones who quickly define a bold transformation ambition and then move forward to energize the organization, prepare and launch the program, and drive and sustain the transformation. Through quick and decisive actions—while time, the board, and investors are still on their side—CEOs and their teams can seize the opportunity to lead a transformation and put their company on the right trajectory for success.

This chapter is a playbook for transformational leaders. It lays out how and where to start and then breaks the transformation process into four steps. It then discusses the need for leaders to be both directive and inclusive in how they oversee people. Finally, it offers guidance on avoiding the problems that many CEOs face when they fail to take action that is sufficiently quick or bold in the first few years of their tenure. Throughout, the chapter includes case studies of successful transformations in various industries—retail, technology, and manufacturing, among others—to show what the process looks like in the real world.

## A Four-Step Process

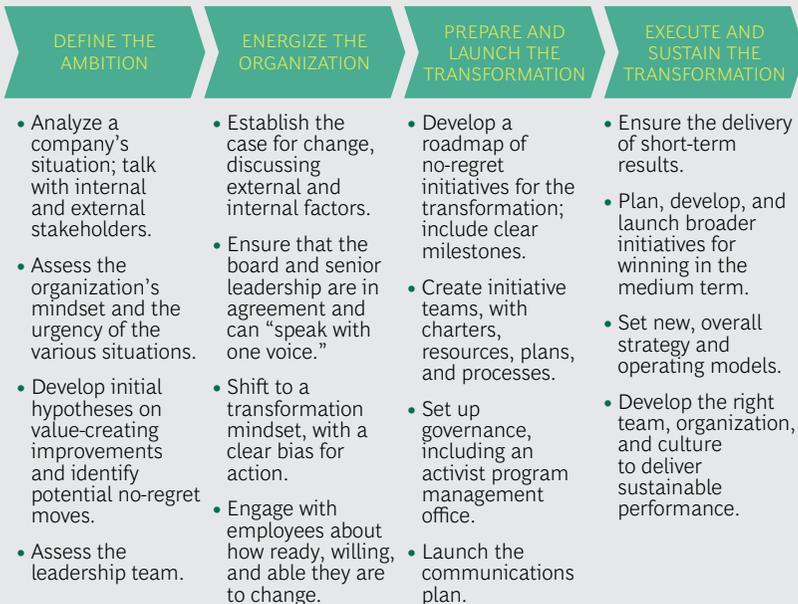
On the basis of our experience working with companies across a range of industries, we recommend that executives apply a four-step process in leading transformation initiatives. (See Exhibit 1.)

**Define the ambition.** Before starting the transformation, leaders have a critical window to take charge and define the organization’s collective ambition. When defining this ambition, it is essential that CEOs adopt an investigative and analytical mindset that says: “I need to learn more.” Leaders should talk with as many critical stakeholders as possible, both inside and outside the organization, to educate themselves about the company:

- Employees, to determine if there is a consensus regarding the changes that are needed; ideally, leaders should speak with 30 to 50 employees from across all units and at all levels
- Customers, to get unvarnished opinions of the company’s performance in addressing their needs
- Industry and functional experts, to understand the company and the complexities or disruptions in the market

During these conversations, a CEO should primarily listen, encourage open and honest discussion, and make sure that all possible dynamic factors and all possible solutions are being brought to the forefront. Throughout this process, the CEO must diagnose problems and create hypotheses regarding which aspects of the company require improvement. This means assessing the urgency of the various situations—in terms of both scope and timing—and determining whether the compa-

### EXHIBIT 1 | The Transformation Process for CEOs Has Four Stages



Source: BCG analysis.

ny should seek to transform a specific function, market, or division or instead undergo a more comprehensive effort that affects multiple areas of the company.

In both broad and narrow transformation efforts, CEOs need to start identifying rapid, no-regret moves during this time—initiatives that are relatively easy to implement and that can generate results in 3 to 12 months. These no-regret initiatives should close performance gaps in a few critical areas, reduce costs, improve top- and bottom-line performance, and free up cash to fuel longer-term initiatives. As CEOs establish momentum with these initiatives, they should also clearly define the company’s goals for improving long-term performance—and how the company will sustain those improvements. (For an example of an incoming leader who defined a bold transformation ambition, see the sidebar “A New Retail CEO Hits the Ground Running.”)

Starting at the very beginning, boards of directors play a critical role throughout the transformation journey, selecting and supporting the CEO, ensuring that the transformation is set up for success, monitoring progress, and “course correcting” along the way. (For more on the role of boards, see the sidebar “The Board’s Role in a Transformation.”)

**Energize the organization.** In the second step, communication becomes crucial. Transformations can be stressful periods for a company, yet success requires large numbers of people to go above and beyond to accelerate the pace of change. As a result, CEOs must carve out the time to energize the organization and build momentum for the collective transformation ambition.

Specifically, CEOs should start building a compelling case for change. Initially, they should make the case to the board of directors and to the senior management team to achieve consensus so that they all “speak with one voice” regarding the transformation. Then, CEOs should make the case to the entire organization.

The case for change should acknowledge the company’s heritage and the hard work of employees, but it should also discuss external factors (such as the customer base, competitors, and capital markets), internal metrics (for example, operational and organizational performance and employee engagement), and the necessary measures the company will

## A NEW RETAIL CEO HITS THE GROUND RUNNING

A new CEO was hired to run a retail organization that had been losing market share for several years and was starting to see profitability decline. Before taking over, the CEO visited stores, talked with customers, studied international best practices to build on his own experience abroad, and talked with experts in the retail sector. Through that process, he realized that the immediate priority was to identify rapid, no-regret moves that could increase top-line sales and reenergize the organization.

While conducting this due diligence, the new CEO also developed a strong presentation to introduce his plan to the organization as soon as he took over. He gave the presentation during the first executive committee meeting, supporting the plan with the customer feedback he'd generated firsthand, along with his international experience with retail peers. In this presentation, he used very direct language and simple terminology, which made the messages powerful, credible, and resonant.

During his first month, the CEO gave similar presentations to

larger groups of employees and managers, which provided clarity and reduced anxiety in the organization. He also traveled to meet the extended management team, visited crucial countries, and granted interviews to select media outlets—always with the same clear and consistent messages.

Within the first quarter, the company had begun to roll out several no-regret moves on the basis of the CEO's international retail experience and firsthand research, including a loyalty campaign, extended operating hours for a particular store format, and new promotions. The results jump-started top-line growth for the first time in years, leading to significant gains in market share. With those gains behind them, employees were more willing to accept the cost cuts and other measures necessary for the company to become leaner and more agile.

## THE BOARD'S ROLE IN A TRANSFORMATION

In our discussions with board chairs and other board members, the following six imperatives emerged for boards seeking either to spot trends that could signal the need for a transformation or to support a transformation once it has been initiated.

**Look “around the corner” to understand and react to key trends.** The board should identify the trends affecting the company and work with the CEO to adjust the company’s strategy before the trends alter the business landscape. As one chairman explained, “You need to be paranoid about how the world is changing” and then assess how the company should respond to the changes.

Keeping an ear to the ground within the organization and among customers is essential for staying on top of new developments. Early course adjustments in response to emerging trends can avert the need to transform under duress three to five years down the road.

The company can also identify opportunities to proactively transform before its competitors do. Spotting and reacting to

changes while in a position of strength confers a significant advantage compared with transforming when the company is in trouble.

**Find a CEO with the skills and motivation to lead the transformation.** If a transformation is needed, one of the board’s fundamental roles is to ensure that the right CEO is in place to lead the company. Finding the right CEO is especially important during a transformation; shepherding the company through the necessary changes requires particularly strong leadership and business skills.

More than 60% of the transformations that BCG supports are undertaken either shortly before or shortly after the appointment of a new CEO.

**Attack the transformation on three fronts.** First, as discussed in our chapter “Funding the Journey,” finance the transformation by launching short-term, no-regret initiatives that will significantly improve the bottom line as well as ensure that the organization has the capabilities to execute. Second, win in the medium term (two to four years)

## THE BOARD'S ROLE IN A TRANSFORMATION (CONTINUED)

by choosing a strategy, business model, and operating model that will enable a fundamentally different competitive position.

Third, build the right team, organization, and culture to position the organization for sustainable high performance.

**Ensure alignment between the board and the CEO.** The organization needs to know that the board fully supports the CEO and that both the board and the CEO support the company's new direction and execution plan. Additionally, it needs to be clear that the CEO—not the board—makes all the operational decisions.

When the board and the CEO are aligned on the direction, it is easier to form a relationship of trust in which the chair also acts as a “sparing partner” for the CEO outside of formal situations.

**Focus on the board's composition and use of time.** During transformations, boards meet as often as weekly and the chair might have to be involved several times per week. To effectively support the transformation, the board also needs a

small and dedicated team that can devote adequate time and be available on short notice to meet and to make decisions.

Further ways to enhance the support provided by the board include recruiting a chair or board member with transformation experience, involving experienced external advisors, and establishing a special task force within the board to focus on critical transformation topics.

**Closely monitor the transformation's implementation.** Understanding the status of the transformation program is critical to a board's efforts to support the management in making course corrections.

Many of the chairs we interviewed believe that boards need to devote greater time to discussing the progress of implementation during a transformation, and BCG's experience supports this view.

(For more information, see *How Nordic Boards Create Exceptional Value*, BCG Focus, June 2016.)

soon take in response. The case for change is typically made to internal stakeholders in various venues, such as workshops and town hall meetings, as well as through communication channels that allow the CEO to answer important questions on vision, approach, and tactical next steps.

Note that leaders should tailor the message and the communication style to the company's situation. Some companies have well-established ideas about their overall direction and sense of purpose; these companies can focus primarily on short-term performance and delay setting a more visionary agenda. Other companies are tired of short-term thinking and constant cuts and need a more compelling story about where the new CEO intends to lead the company. In all cases, however, it is critical for the CEO to speak with authenticity and a sense of urgency. (For a case study of a company that had to take rapid and dramatic steps during a transformation, see the sidebar "A Pharmaceutical Company Transforms Itself and Generates \$20 Billion in Value.")

**Prepare and launch the transformation.** As the transformation starts to take shape and the case for change becomes clear, leaders must put the foundation in place for the transformation, balancing the long-term vision with the day-to-day reality. It is time for the CEO to shift gears, from planning the transformation to actually leading it. This means immediately kicking off the rapid, no-regret moves that will deliver impact within 3 to 12 months, creating and enabling initiative teams, and setting up the overall governance and change management program for the transformation.

(For more on this phase of transformation, see the chapter "Funding the Journey.")

Once these measures are underway, there is a real risk of prematurely declaring victory and moving on to other priorities, which will all but ensure the failure of the transformation effort. Instead, it is critical to maintain focus and ensure that initiative teams are on track to achieve results. Assuming that some form of project tracking has been put in place, now is the time to ensure that leaders have full transparency into the progress of each initiative. Regular review sessions, facilitated by the PMO, should provide sufficient information for leaders to know whether—and how—they need to intervene.

In particular, CEOs should avoid a number of common pitfalls during this phase, including the following:

- Insufficient accountability among the owners and sponsors of the initiatives
- Failure to have in place clear plans and roadmaps, backed with specific actions and milestones that are linked to financial objectives
- A lack of resources and expertise on initiative teams
- Management incentives that do not support the objectives of the transformation
- Failure to engage stakeholders and overcome institutional resistance

**Execute and sustain the transformation.** As the broader transformation starts to gain momentum and initial fund-the-journey efforts begin to take hold, CEOs must launch broader initiatives to win in the medium term, set the new strategy and operating model, and build sustainable performance.

(For more on this phase, see the chapter “Winning in the Medium Term.”)

Compared with earlier, fund-the-journey measures, the initiatives to win in the medium term are usually more difficult to conceptualize, because they require breakthrough thinking, usually in areas that are less familiar to the organization. These initiatives are also harder to staff and implement, and they call for managing interdependencies across functions and business units.

As a result, companies often benefit from stepping back again to adjust their overall strategy and operating model. This does not need to be a broad strategy-planning exercise. In fact, we find that a targeted workshop-based approach with the senior leadership team—and the appropriate data and analysis—can lead to a strong outcome, and do so in a highly efficient manner that does not distract the leadership team from driving the overall transformation. This approach ensures that there is buy-in from the top team for these initiatives and that the

## A PHARMACEUTICAL COMPANY TRANSFORMS ITSELF AND GENERATES \$20 BILLION IN VALUE

A global pharmaceutical company had been extremely successful—consistently increasing earnings by 15% per year and reinvesting all remaining excess capital.

Nonetheless, management challenged itself to improve performance through a comprehensive transformation of the company. The investor community also indicated that the company could create more value by accelerating earnings growth. As the company began to consider a transformation, however, it faced an additional challenge: a hostile takeover attempt.

In response, the company launched an extremely rapid initiative to cut activities that generated a low return on investment, and it restructured to quickly increase earnings. The project team analyzed and redesigned the entire company in only three months and then implemented the new design. Despite the rapid launch, virtually

all functions and business units were included in the scope.

Notably, the company implemented the transformation through both senior leaders and managers who were several levels down in the organization hierarchy. This approach led to very specific, pragmatic solutions, and it built momentum for the initiative throughout the company's workforce.

Through this transformation, the company cut its annual costs by more than \$500 million and increased its earnings growth rate from 15% to more than 20%. These changes yielded an improvement in company value of approximately \$20 billion.

The transformation also represented a value-creating alternative to the hostile takeover and enabled management to strike a deal with a different acquirer on more favorable terms.

**strategy leads to immediate operational adjustments. (For an example of a company that implemented strategic changes as part of its transformation, see the sidebar “A Bank’s Transformation Boosts Customer Satisfaction and Financial Performance.”)**

## A BANK'S TRANSFORMATION BOOSTS CUSTOMER SATISFACTION AND FINANCIAL PERFORMANCE

In the wake of the financial crisis, a large bank was struggling to resume a growth trajectory. It suffered from poor profitability and process inefficiency compared with its peers. The bank also had severe liquidity issues and high write-downs on loans in both core and distant markets. More fundamentally, it had an unclear value proposition for customers and little organizational focus on performance or on collaboration among employees.

In response, the CEO and leadership team launched a three-step transformation aimed at improving customer satisfaction and financial results.

The first step was to reorganize the company around the customer experience, rather than around divisions and functions—which was the current, silo-based approach. That change clarified

the roles for specific functions, and it rewired processes to foster greater collaboration across departments. At the same time, the company revamped its leadership team, making some new hires and giving some current leaders new roles.

The second step was to develop a new strategy, and new business leaders were tasked with defining the strategy for their units. Those individual strategies were grouped into one major transformation effort that was owned by the CEO and had three specific objectives: better customer satisfaction, greater efficiency, and a performance-based culture.

In the third step, the CEO and leadership team put their full focus into executing the new strategy.

**Last, leaders need to make performance improvements sustainable. Many organizations that deliver good results during the transformation have a tough time sustaining their hard-won performance improvements after the transformation is over. The goal of every CEO should be to achieve success with the transformation program and then maintain it well beyond that point. This is what separates the most transformative CEOs from the rest of the pack. It is imperative for a CEO to own this**

phase and closely involve the chief HR officer and other influential leaders across the company.

(For more on this final phase, see the chapter “Organizing for Sustained Performance.”)

## Directive and Inclusive Leadership

As noted earlier, one of the inherent challenges of transformations is that they often take place under intense pressure to achieve rapid results. Under these conditions, leaders cannot afford to be hands-off after they set a broad vision; they cannot delegate the execution and stand back to wait for results. To deliver a fundamental change in performance at an accelerated pace, leaders need not only to define and articulate the vision but also to clearly articulate strategic priorities, set the transformation ambition and milestones, and hold employees accountable for results through regular checkpoints.

Still, while strong directive leadership is necessary, in the era of always-on transformation it is not sufficient: it fails to provide the motivation required for sustained performance and the new ways of thinking needed to develop fundamentally better ways of working. Instead, leaders need to develop a more balanced “transformational leadership” approach that is both directive and inclusive. (See Exhibit 2.)

Inclusive leaders involve employees early in the process—well before implementation—and make clear how employees’ contributions help fulfill the larger purpose and objectives of the transformation. By taking this step, the company’s leadership is able to secure a more authentic commitment from employees. Inclusive leaders also mobilize and empower teams by giving them some freedom, within a prescribed framework, to define and implement specific initiatives in the transformation. And they solicit honest feedback and take it into account when modifying the transformation in light of any issues that have come up during implementation.

Transformational leadership that is both directive and inclusive clearly raises the bar for senior executives. It requires an investment in time, energy, and management focus when demands on leaders are, typically, already very high. The bandwidth required to lead in this way is often one of the biggest constraints in a transformation. However, in our

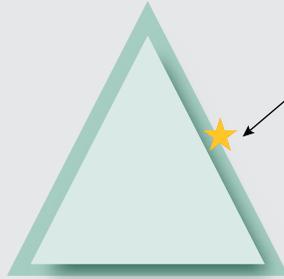
## EXHIBIT 2 | Transformation Leadership Must Be Directive and Inclusive

### Directive leadership

- Defines vision and strategic priorities
- Sets transformation ambition and milestones
- Holds employees accountable for outcomes

### Delegating leadership

- Defines vision and strategic priorities
- Delegates execution to organization



### TRANSFORMATIONAL LEADERSHIP (directive and inclusive)

### Inclusive leadership

- Involves employees early and emphasizes collaboration
- Mobilizes and empowers teams
- Actively seeks feedback

Source: BCG analysis.

experience, making the needed investment of time, energy, and management focus pays off through more efficient and effective execution and more sustainable results. Over time, as the transformation takes hold, leaders can shift to a style that relies more on delegation. (See the sidebar, “A Manufacturer Lays the Groundwork for an Ambitious Transformation.”)

## The Risks of Not Being Bold Enough

Leadership churn in large companies has intensified over the past decade, and CEOs are particularly vulnerable during the first few years of their tenure. To analyze this phenomenon, BCG and Spencer Stuart (an executive search and leadership consulting firm) conducted a joint study into the fortunes of almost 400 new S&P 500 CEOs based in the US during the past ten years. The aim was to establish the factors behind failing and excelling during a CEO’s first three years, and it defined some common parameters for CEOs who were thriving.

Notably, the state of the company at the time the CEO took over influenced his or her fate—but did not determine it. For new CEOs, the context is the hand of cards they have been dealt: it is not within their power to choose it, and they have to work within its constraints, but they can play the given cards well or badly. True enough, companies in a

## A MANUFACTURER LAYS THE GROUNDWORK FOR AN AMBITIOUS TRANSFORMATION

The US housing industry suffered a steep correction following the 2008 global financial crisis, and the CEO of a manufacturing company responded with a number of measures that did not improve its financial performance. Realizing that stronger measures were called for, the CEO decided to launch a more ambitious transformation program, with the goal of increasing earnings before interest and taxes (EBIT) in one year, independent of market growth or price changes.

To prepare for the transformation, seven teams—four composed of employees from business units and three made up of employees from major function areas—developed a roadmap of initiatives around growth, pricing, cost reductions, and operational productivity improvements. Each initiative specified the target EBIT improvement, required actions, milestones, and resources. The company enabled the teams to meet these aggressive goals by providing them with new analytical frameworks and problem-solving methodologies and tools.

To ensure that the overall program delivered on the EBIT ambition, the company set up a steering committee composed of senior executives and a PMO to provide governance and drive the pace of the transformation. The PMO provided rigorous program management, including the monthly tracking of improvements. Its reports highlighted any initiatives that were exceeding or falling short of their targets. This effort gave management a clear view of overall performance and flagged situations that required interventions.

As a result, the company was able to deliver on the ambitious EBIT target set by the CEO. In addition, the business units adopted a continuous-improvement approach so as to capture gains after the formal transformation program ended.

challenged state will give rise to a higher proportion of ousted CEOs, and companies in a favorable state—stable or growing—will produce more thriving CEOs. But there is no guarantee of failure in the former case, or of success in the latter.

Perhaps the most important finding was that thriving CEOs were quicker than ousted CEOs to make bold moves in their first year. They appeared more inclined than ousted CEOs to “go for it”—to launch initiatives that were innovative and ambitious yet still realistic in their timelines. In addition, thriving CEOs tended to strike a better balance between short-term and long-term returns. They also tended to commit more decisively to the financial value drivers that they intended to concentrate on first.

More specifically, our analysis identified a few types of strategic moves that thriving CEOs made far more often than ousted CEOs:

- Implementing operational improvements for a quick payback to fund future investments
- Developing new products to capture a distinctive market, paving the way for medium-term success
- Honing customer relationships in order to refine the service for existing customers and attract profitable new ones
- Adjusting HR practices to reinforce the new definition of success and increase accountability, thereby boosting employee performance
- Modifying aspects of corporate culture to support and sustain high performance

Last, thriving CEOs succeeded partly because of their more active and skillful way of presenting themselves and inspiring confidence in their abilities—not necessarily through deliberate self-promotion but through a few key behaviors. For one thing, they were generally far more adept at articulating a simple, compelling story line. For another, they demonstrated depth and foresight, communicated an inspiring plan, and showed an appetite and aptitude for executing that plan. In addition, they were clear about the financial value drivers they had targeted, and

they focused on them intently. And they visibly set the pace. Finally, when an initiative failed, they owned up to it and made no attempt to explain away the failure. With their cogent and transparent agendas, these CEOs instilled long-lasting confidence in all stakeholders.

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Many things are important to the success of a transformation, but nothing is more important than leadership. The role that leaders play evolves throughout the transformation—from defining the ambition to energizing the organization, preparing and launching the transformation, and then driving and sustaining it. Succeeding in this essential role means adopting the right approach to leadership and being directive and inclusive. It’s critically important that leaders—especially new CEOs—move quickly, ideally setting the organization’s collective ambition before the transformation even begins.

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This chapter draws on the following BCG publications:

*A Leader’s Guide to “Always-On” Transformation*

“Surviving the Sophomore Slump: The Moves That Matter Most”

*The New CEO’s Guide to Transformation: Turning Ambition into Sustainable Results*



# 5. Managing Change

**C**entral to the success of any transformation is the ability to manage change. What does it take to effectively manage change? What is the right mix of skills, attitudes and behaviors, approaches, and tools?

The good news is that there is growing recognition of the need for change done right. Many boards have appointed CEOs with that explicit charter, and almost all CEOs recognize the need to take even successful enterprises to new levels of performance. Most CEOs, especially those new to the position, must fundamentally transform their enterprises at some point during their tenure.

Christopher J. Nassetta, president and CEO of Hilton Worldwide, found that out during a tour of Hilton properties soon after he took the reins. “People were practically screaming it from the company’s rooftops from around the world, very consistently, that we need to transform this company,” he said in an interview with BCG. (See “Christopher J. Nassetta on the Four Ps of Transformation: An Interview with the President and CEO of Hilton Worldwide,” BCG article, October 2011.)

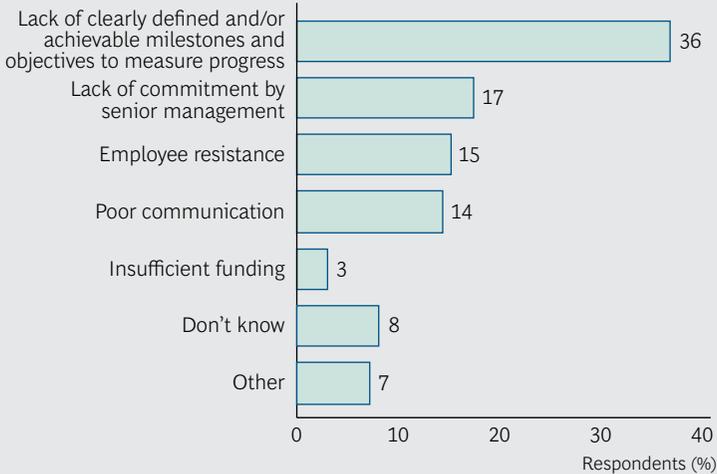
At the same time, senior executives are becoming much more aware of the factors that lead to failure, particularly the lack of clearly defined milestones and objectives and of sufficient commitment by senior management. (See Exhibit 1.)

## **Toward Very Practical Solutions: The Change Delta**

Working on change initiatives across several decades and in an array of industries, BCG has identified the distinct elements that come together to form what we call the Change Delta—a set of success factors proven to help organizations achieve sustainable change through an integrated approach. These elements consistently prove successful because they reduce the variability of results from a portfolio of change initiatives and allow for effective and early course correction. Indeed, companies that

## EXHIBIT 1 | The Lack of Well-Defined Milestones with Clear Impact Metrics Has Killed Many Change Initiatives

FOR THE CHANGE INITIATIVES THAT DID NOT SUCCEED IN THE PAST 12 MONTHS, WHAT WAS THE SINGLE MOST IMPORTANT FACTOR IN DETERMINING FAILURE?



Source: Economist Intelligence Unit.

Note: The January 2011 global survey included 288 executives, more than 75% of whom were from organizations with annual revenue exceeding \$1 billion.

have used the Change Delta approach have exceptionally high rates of meeting their targets while building organizational engagement and confidence in the future. (See Exhibit 2.)

**Enabled Leaders.** This element of the Change Delta starts with the top team's commitment to open, forthright, no-holds-barred discussion of the need for change and the objectives of a change effort. There can be no "undiscussable" topics among the management team members—no shrinking from debates about turf, power, or spans of control. There should be more than one or two or even three discrete discussions; the guts of change are that important. "Never assume that leaders get it," said the program sponsor at a global oil and gas company. "We need to take probably ten times as long in engaging, empowering, and educating our leaders as we actually think we do."

One thing that business leaders have certainly learned about change is that it cannot be mandated by the CEO alone. CEO support is necessary but not sufficient. What's needed is the enrollment of the extended leadership team. That's what happened at a European bank during a

## EXHIBIT 2 | The Change Delta Helps Organizations Achieve Sustainable Change Through an Integrated Approach

### THE CHANGE DELTA

#### Executorial certainty

- A portfolio approach to initiative management supports transparency across milestones and outcomes.
- Rigorous methodologies, tools, and testing of initiatives are required.
- A forward-looking view provides early awareness of emerging issues.



#### Enabled leaders

- Leaders are accountable for success.
- Leaders are able to sponsor and manage the change effectively.
- Alignment of leadership is palpable, visible, and maintained.

#### Governance and PMO

- A clear governance structure includes explicit roles, processes, and decision rights.
- The value-added PMO provides essential support structure to the organization.

#### Engaged organization

- Employees at every level understand the change and are equipped to manage it.
- Critical stakeholders are deeply engaged.
- Essential behaviors are reinforced.
- Accountability is hardwired in line management metrics, as well as in performance management and recognition systems.

Source: BCG industry experience.

Note: PMO = program management office.

major change initiative. The bank made serious commitments of time and effort to win over its extended leadership. To launch detailed discussions of the combined organization's brand values and the behaviors needed to support them, it held four sessions a year for the top 300 managers in its retail and IT operations. At the first session, the CEO himself explicitly laid out the expected behaviors. There was also a full day of interactive training for the top 1,000 managers, distributed among carefully orchestrated workshop groups of 60, to translate behaviors into practical realities. These sessions included development of an individual plan for each manager.

Over the next six months, repeated training sessions drove home the big change messages and engaged middle managers in determining what the organization should keep doing, start doing, and stop doing. In the sessions, managers were provided with information, training, and tools that would ensure that messages cascaded down to junior managers and employees.

To be candid, though, the enablement of an organization’s leaders must be a very practical catch-as-catch-can exercise. In many cases, senior executives lack the luxury of the time required to bring in lots of new blood or embark on long-term leadership development programs designed to spur change. And they likely have to work with the leaders they already have, regardless of how capable those leaders are. There is no time to wait until conditions are perfect: change has to happen in the next four to six months—not the year to three years it can take for major leadership development efforts to work. The key question is: How do we best support the personnel we have?

The answer to that question is rooted in the extent to which each leader truly “owns” the change agenda—and is seen to own it. Each leader should be continually aligned with his or her peers; the alignment must be palpable, visible, and evident to all in the way the entire management team communicates and embodies change, doing so in unison. And it should go without saying that all the leaders should have the skills and knowledge to manage change effectively and to pick lieutenants and key team members who can augment their efforts.

Throughout, leaders must continually, visibly, and authentically act as role models for the change. Furthermore, they must not tolerate the tendency to slip into old habits. The moment that senior managers are perceived as merely paying lip service to the change efforts, those efforts are doomed. An effective change champion models sponsorship of the effort, enables employees to achieve the declared goals, and drives accountability for the outcomes. (See Exhibit 3.)

**Executorial Certainty.** More often than not, executorial certainty is the preferred starting point for many conversations about change management—probably because it feels the most concrete and actionable. But the conversation almost always winds its way around and among the other Change Delta elements.

The insistence on executorial certainty diverges from traditional approaches to change management. Executorial certainty comprises several major activities, all of which are sharply focused on results. It is tied to another essential of change management: establishing a governance structure with clear accountabilities. The structure must provide the minimum level of orchestration to ensure progress without being burdened with bureaucracy.

## EXHIBIT 3 | Personal Checklist for Becoming an Effective Champion of Change

### MODELING EFFECTIVE COMMUNICATION

- Am I communicating openly and honestly, and addressing key issues directly?
- Am I reinforcing the purpose for change in alignment with the leadership team?
- Am I displaying positive support for the change?

### MODELING EFFECTIVE OUTREACH AND CONNECTION

- Am I establishing a personal connection broadly with my organization and deeply with key stakeholders?
- Am I actively listening to concerns and soliciting feedback? Am I leveraging that information to win support?
- Am I maintaining credibility and trust within the organization?

### MODELING DESIRED BEHAVIORS

- Am I leading by example, embodying the change I want to see?
- Am I coaching my team members on their own sponsorship and leadership behaviors?
- Am I demonstrating fact-based, decisive action, not letting issues drag on?

### PROVIDING CLARITY OF PURPOSE

- Have I clarified context, purpose, priorities, and expectations for my people? Am I reinforcing the messages regularly?
- Am I sharing clear and relevant information?

### PROVIDING RESOURCES, CAPABILITIES, TOOLS, AND SUPPORT

- Am I continually scanning for gaps in clarity, skills, and resources, and intervening to eliminate roadblocks?
- Have I equipped my people with the resources (for example, training, processes, and tools) required?
- Am I actively using change program reports to identify ways to support teams?

### PROVIDING CONSEQUENCES

- Am I rewarding rapid issue identification with fact-based support?
- Am I quickly addressing unacceptable behaviors?
- Am I driving an above-and-beyond culture with positive reinforcement and celebration of successes?
- Am I clearly seen to be valuing people beyond their work?

### PROVIDING EXPLICIT FEEDBACK

- Am I delivering pinpoint feedback to communicate reinforcing or constructive messages?
- Am I responding to problems with support and constructive messages—not shooting the messenger?

Source: BCG industry experience.

It's important to define the necessary initiatives precisely, figure out the risks and interdependencies, and prioritize those that drive the bulk of the value. The approach must expose any and all emerging risks to the impact of those initiatives. Senior leadership has to be able to see the inevitable gaps that open up between change targets and actual change progress; it has to be easy for leaders to get clear operational insights so that they can respond quickly—before targets are missed—and make the necessary course corrections across the range of change activities by

adjusting critical allocations of resources, time, and their own attention.

The underlying building block for this approach is an element that BCG terms the “initiative roadmap.” (A transformation program can have many initiatives, each of which can have several roadmaps.) The roadmap is categorically not a project plan covering a list of discrete tasks. Its purpose is to tell the story of the change initiative in such a way that executives can, on the basis of monthly updates, easily understand what is happening and make adjustments to ensure ultimate on-time value delivery.

Roadmaps are made up of a number of milestones—in most cases, 15 to 25 are most effective—along with time frames, financial and operational metrics, and clear accountabilities. The milestones set a cadence for the overall change program, breaking it into manageable pieces that seem much more attainable for everyone involved. Equally important: individuals and teams—and eventually the whole organization—steadily build confidence not only in the potential success of the transformation effort but also in their individual and collective ability to identify, launch, manage, and succeed at change at any time.

Most important, an initiative roadmap articulates the key risks of and lead indicators for delivering the financial and operational impacts; it ensures that these are tested at critical points, and it signals when and how financial and operational outcomes will be triggered. Conventional change efforts typically have overall financial and operational goals, but the roadmap approach of tying such goals to individual milestones proves to be a far more successful way to achieve the promised value.

Furthermore, linking measurable KPIs to milestones means that red flags will appear much earlier than in typical implementation exercises. (An example milestone might be the hiring of a designated number of sales personnel with a particular new skill set. Achievement of the milestone is a prerequisite for reaching a sales target in a new channel within a specified time frame.) Bad news becomes good news: as the roadmap owner updates the roadmap, which typically occurs monthly, flagging an item in red signals an opportunity to act in time to ensure delivery of desired results. Typically, red indicates failure, but that’s not necessarily so when effective early-warning indicators and financial goals are tied to milestones.

Of course, not every milestone can be defined in such quantitative terms. Typically, only 20% to 30% of milestones have impacts attached to them. To help gauge the robustness of each roadmap, truly change-capable companies use formal rigor-testing processes. (See the sidebar “Why It’s Smart to Rigor Test.”)

Senior leaders next think through the “how” of tracking and managing the initiatives that matter most. Typically, we find that the 80-20 rule

## WHY IT’S SMART TO RIGOR TEST

Just because there are plans for each initiative of the change program doesn’t mean that the overall program will be smoothly translated into action or will generate the intended value. Many unknowns, risks, and interdependencies can quickly scramble a plan.

That’s why BCG works with roadmap owners, sponsors, the PMO, finance, and HR representatives to apply a strict rigor test to each initiative’s roadmaps. The test includes a set of questions: Is the roadmap clear enough to be readily implemented? Are the benefits and timing clearly and correctly identified? Are the risks and issues explicit enough? (See the exhibit, “Rigor Testing Helps Gauge the Robustness and Consistency of Roadmaps Prior to Launch.”)

These questions seem obvious, but if they are not asked and

answered, more than half of the initiatives are likely to fail.

The rigor-testing discussion is often the most influential among the many conversations that PMO staff will have about each initiative in the program portfolio. While every discussion is slightly different—customized to the organization and its needs—the 16 or so core questions, in three groups, are much the same.

Essentially, the rigor test significantly strengthens both the local-level considerations of people-related issues (such as communication planning) and stakeholder discussions.

It also reinforces the delivery of the intended operational and financial impacts, addressing what the Economist Intelligence Unit has found to be the single biggest management challenge: a lack of clearly defined or achiev-

## WHY IT'S SMART TO RIGOR TEST (CONTINUED)

able milestones and objectives to measure progress.

The test, which typically takes up to one hour, exposes the roadmap to much higher levels of upfront discussion and scrutiny, making

sure that the milestones are clear, there is consensus about the impacts, and the assumptions driving intended impacts are articulated and validated. It also helps to ensure that the risk points are well understood, the

### Rigor Testing Helps Gauge the Robustness and Consistency of Roadmaps Prior to Launch

#### IS THE ROADMAP CLEARLY DEFINED, LOGICALLY STRUCTURED, AND READILY IMPLEMENTABLE?

- 1 Is ownership and accountability for the roadmap clearly established? Does the ownership structure tie logically to the content of the roadmap?
- 2 Is the roadmap logically disaggregated into regular milestones that are sufficient for review of main actions and progress against plan?
- 3 Are the milestones tangible enough to describe how the roadmap will really be achieved?
- 4 Is the timing and sequencing of milestones logical?
- 5 Do milestones incorporate an executable change plan, including communication, training, and stakeholder engagement?
- 6 Do those executing the initiative feel that they "want to" rather than "have to" be involved?

#### ARE IMPACTS, THEIR SOURCES, TIMING, AND LEADING INDICATORS CLEARLY IDENTIFIED?

- 7 Are the overall impacts disaggregated into financial and operational impacts and quantified along the timeline (for example, recurring cost reductions and downtime reductions)?
- 8 Do the operational KPIs act sufficiently as lead indicators of subsequent financial-impact delivery? Do they test appropriately for any critical business-case assumptions (for example, cost, yield, or market assumptions)?
- 9 Has the finance department identified all potential recurring and one-time cost implications and confirmed that they are measurable?
- 10 Is the timing of impacts (benefits and costs) consistent with the timing of the milestones with which they are associated?
- 11 Is revenue uplift thought through in a practical and measurable way?

#### ARE INTERDEPENDENCIES AND OTHER RISKS AND CONCERNS ADDRESSED CLEARLY?

- 12 Would someone from another part of the organization be able to read the roadmap and understand what to do and what is at risk?
- 13 Are key issues, risks, and interdependencies adequately exposed and addressed in the qualitative roadmap description?
- 14 Who are the key stakeholders for the initiative? Have their concerns and needs been factored in effectively?
- 15 Have key issues, risks, and interdependencies been made explicit in milestone descriptions? Have specific milestones been developed to trigger conversations that assess confidence in delivering against key issues, risks, and interdependencies?
- 16 Does a DICE assessment predict a favorable outcome for the roadmap?

**Source:** BCG industry experience.

**Note:** BCG's assessment of a change program's likelihood of success tracks the duration of the project, the capability of each initiative team, the overall leadership and local commitment to change, and the additional effort required of staff.

appropriate risk-testing and mitigation measures are in place, the key stakeholders have been identified and are being or will be effectively engaged, and every aspect of the endeavor that must be communicated has been or will be communicated.

Is rigor testing worth it?

It certainly is. BCG's analyses—mapping the outcomes of thousands of such tests over several years—indicate that high-quality rigor testing allows for the capture of more value. In fact, the roadmaps whose rigor tests earned “excellent” scores captured an average of 130% of their planned value compared with 100% of planned value for those with “marginal” rigor test scores.

Clearly, the incremental value derived from rigor testing is compelling. Even a marginal “pass” rate means that a roadmap is very likely to fully deliver against plan. Roadmaps with lower scores do not pass the rigor test and therefore are stopped or, more likely, reshaped and replanned.

A major railroad that was investing heavily to improve its on-time

record provides a good example. By applying a rigor test, the railroad was able to develop a clearer view of some of the risks associated with implementing its on-time initiative, enabling its leaders to actively manage the risks. The test helped ensure that leading indicators were built into the roadmap before it was launched.

For instance, the railroad developed a measure that correlates trains' on-time arrival with how quickly passengers move on and off the trains and across the platform. Building a milestone for passenger movement into the roadmap—and quantifying its impact—made it easy to see its importance and to ensure that it would be regularly tested against once the roadmap was launched.

In implementation, managers quickly diverted resources to ensure that employees who coordinated traffic on the platforms were able to take on new, more public roles, interacting with commuters and managing the flow of crowds at these stations. This response increased on-time performance substantially and kept it at the higher level.

applies: roughly 20% of initiatives drive 80% of the value. Few initiatives, typically those with large financial value or critical cross-functional enablers, require transparency up, down, and across the organization; they include only the information that the leaders need in order to be confident that progress is on track or to know when to intervene and make course corrections. By selecting a reporting mechanism that delivers exception-based reports on just these critical initiatives and by flagging early-warning indicators, business leaders remain engaged and can more easily and effectively resolve issues. (See the sidebar “Exception-Based Reporting in Action.”)

**Engaged Organization.** The organization has to be engaged down deep. If a critical mass of the workforce and middle management doesn’t buy into the change effort, then senior management should not

## EXCEPTION-BASED REPORTING IN ACTION

An exception-based reporting mechanism can make a big difference in the delivery of business value. Management at a large mining organization discovered this while trying to boost the output of the company’s extraction operations. The team leading one of the ten roadmaps for the company’s staff-planning initiative had identified the recruiting of miners formally certified in occupational safety, health, and environment (OSHE) skills as a critical leading indicator for the successful launch of a new shift.

Owing to an existing skills shortage, however, the team was hard-pressed to recruit the 120 miners needed to launch on schedule in October, three

months later. Top management rapidly recognized the challenge when the initiative team updated its roadmap and showed that the KPI for OSHE-certified miner recruitment was falling short of plan, a notification that in turn triggered an exception in the next executive report.

As a result, the organization’s HR chief jumped into action, setting up a temporary task force to bolster hiring for the remaining three months. The outcome: the company found its new recruits and started the new shift on time in October.

try to push it through, no matter how well the other elements of the Change Delta are handled. It is crucial that people at every level understand and be prepared and able to manage the change. The change program sponsor at a leading global health care company said, “People face constant uncertainty in their lives. Given the stress they are under these days, you must be empathetic and flexible, and you must address the uncertainty if your change effort is to be successful.” (For more information, see *The ABCs of Behavioral Change in Biopharma Manufacturing*, BCG Focus, November 2013.)

This element of the Change Delta defines and supports the necessary changes in ways of working at many levels, making sure that appropriate behaviors are reinforced and hardwired into systems and structures. The understanding and mandate for individuals’ behavior change should be cascaded down through the organization. Behavioral change will not show up organically everywhere at once. To successfully cascade the enrollment of the organization all the way down to grassroots employees, senior managers have to be able to help their people answer key questions such as the following: Why do we need to change? How will this change affect me and my colleagues? If I change, will my boss change too?

It is important to adhere to a clear, systematic process for clarifying roles, responsibilities, and leadership behaviors through the ranks; for assigning accountability; and for determining decision rights. This is one area in which leaders often fail for the simple reason that, in the absence of a structured process and candid debate, it is especially difficult to get it right. BCG has found that companies that use a structured role clarification process are more likely to experience superior economic performance than those that don’t. (See *Flipping the Odds for Successful Reorganization*, BCG Focus, April 2012.)

Overall, engagement is especially important when it comes to key supporters—and skeptics. The process of identifying and prioritizing stakeholders by their level of support for the change effort and their degree of influence in the organization promotes targeted engagement. We find that in many cases, influential supporters are underleveraged and skeptics are underengaged. Effective stakeholder engagement sees business leaders arming influential supporters as change agents, giving them the information and messages that they need in order to influence the organization.

At the same time, it requires real backbone to deliberately engage the skeptics. (See the sidebar “Never Shut Out the Naysayers.”) The upside, though, is enormous.

## NEVER SHUT OUT THE NAYSAYERS

It is not uncommon for business leaders to inadvertently ignore or shut down those who voice opposing opinions.

The naysayers often have good grounds for their skepticism, though. And when they feel that their points of view are disregarded or disrespected, bad situations quickly become worse.

A large commercial and retail bank had embarked on a major change program designed to offer a much better customer experience at far lower cost. The program meant extensive restructuring of back-office activities: a fundamental reorganization, greater use of technology, significant process redesign, site consolidation, and a workforce reduction of 30% to 40%.

Most senior executives had been with the bank for decades and were not particularly open to change. And many other employees had been with the bank for most of their working lives.

An initial assessment of the change program’s likelihood of

success (a review of the duration and phasing of the project, the capability of each initiative team, the overall leadership and local commitment to change, and the additional effort required of staff) helped reveal the extent of stakeholder resistance—and the degree to which it had to be actively managed. The assessment also shone a light on the need for a better-aligned message cascaded from the leadership team.

To identify employees whose enthusiasm would be critical to the success of the effort, the top team used an influencer matrix—a simple but powerful prioritization of stakeholders along the two most critical dimensions: the level of their support for the change effort and the degree of their influence in the organization.

The matrix helped the team determine whether and to what extent specific employees or groups were supportive or unsupportive. The matrix also guided the team’s hypotheses regarding why certain critical employees might not show support and helped the team

form constructive responses. The process of prioritizing and gaining a deep understanding of a select group of stakeholders—in this case, about 1% of the employee base—focused resources efficiently, producing real impact.

Regardless of how supportive the stakeholders are, respect is pivotal to success in change efforts. But respect does not imply overly inclusive or naively optimistic programs. Not everyone will be—

or needs to be—a direct agent of change. In the same vein, treating people with respect doesn't necessarily mean being "nice" to them or failing to make the tough decisions. But it does mean being honest with them. Some individuals may not have jobs when the change initiative is complete, but if they are addressed candidly and fully, and given every care and concern in terms of best-practice outplacement, they are much less likely to throw darts from afar.

Of course, engagement is very much about great communication—clear, candid, constant, consistent, and mutual. “Generally, people are not afraid of the unknown. They are afraid of the unexplained. A true leader shines a light on the road ahead to help others see where they are going,” one midlevel supervisor at a US bank said when asked about his greatest frustration in implementing change.

Such communication efforts start with active, effective listening to recognize and enlist the most critical stakeholders. These efforts involve much rehearsal of the key messages. The process cannot be rushed and must be repeated, because there is inevitable “signal fade” as the message is transmitted throughout the organization. BCG has found that it can take up to nine conversations to ensure that key change messages really do stick. (See Exhibit 4.) When senior leaders feel that they are communicating about three times as much as they ever thought they would need to, they are probably hitting it right. Moreover, it is really important to communicate in small, interactive group settings.

The hard facts of change—why, what, when, who, and, most important, what is in it for each individual—are the essential components of the conversation, to be sure. But leaders will have to communicate less tangible factors—pride of workmanship, job satisfaction, and self-worth—to win the teams' emotional buy-in for the changes ahead. After

## EXHIBIT 4 | Messages About Change Usually Do Not “Take” Until They Have Been Communicated Multiple Times

The progression of responses as change messages start to stick:

1. I barely know what they're saying.
2. I've heard this before.
3. Maybe they're serious this time.
4. They're sticking to this. I think they're serious. Maybe I should listen.
5. OK. This is probably going to happen. It's good for somebody else.
6. I think you mean me.
7. Here's why you're wrong.
8. Uh-oh. I think I have to change.
9. So now that I have to do things differently, explain my role in this again.

Source: BCG industry experience.

all, they will be asking busy people to use their time differently while ensuring that the incentives are in place to reinforce the new ways of working. They must not threaten with if-you-don't-do-this messages; there should be four times as much positive reinforcement as negative. Additionally, leaders need to be careful not to alienate people by sounding too critical or dismissive of earlier change efforts.

**Governance: Sponsorship and PMO.** If the three preceding elements—enabled leaders, executional certainty, and an engaged organization—are the arms and legs of a real change effort, then the governance, program management disciplines, and role of the PMO are its nervous system. The fundamental idea: to have a way to keep top executives engaged and updated on critical milestones, planned operational or financial impacts, and emerging risks and to provide them with the right information at the right time to take action.

Successful large-scale change requires engagement and support at the highest levels of the organization. In most cases, a steering committee comprising some or all of the senior team of leaders likely to be affected by the program is in place. The committee members act as sponsors of key initiatives, providing guidance, solving immediate problems, and removing roadblocks, and they energize the broader management team and celebrate success.

In general, it is critical that key governance bodies allocate time for regular reviews and resolution of key issues outside of meetings.

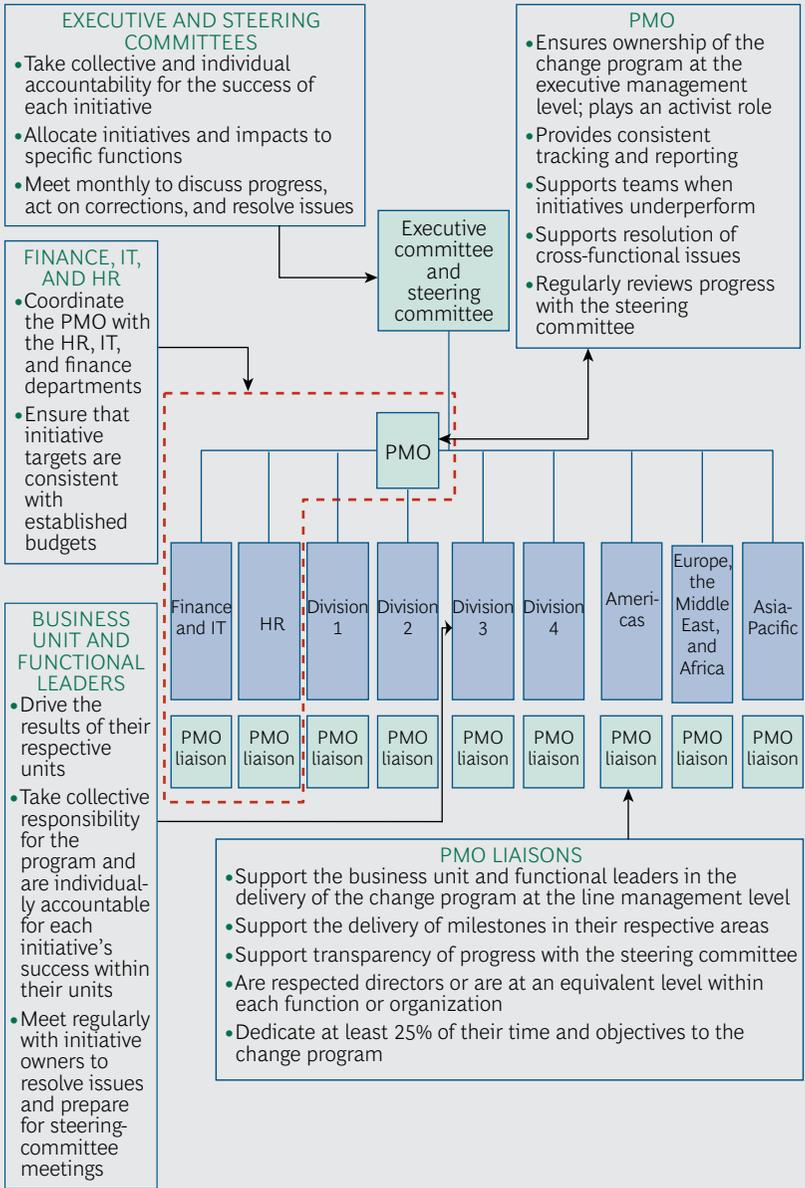
At ING, this was very much the case. The board of directors was heavily involved from the outset, committing significant time to getting the change journey right. During the critical early months of its effort, the steering group at another large organization—a global financial services provider tackling a particularly complex and challenging change program—invested a full three days per month in preparation, issue resolution, and review meetings. The group provided recommendations to the executive committee, which in turn invested a day each month to decide unresolved issues, review progress toward the targets, and track investments.

Change is created and delivered by line managers and their teams, but this happens effectively only when accountability is made explicit using robust governance structures and when the managers are armed with the information they need to facilitate timely decisions and actions. Given the challenges associated with information collection, data flow, and issue resolution in any complex program, a PMO is often the “glue” that binds the necessary data, conversations, and decision making among senior executives, initiative leaders, and the line organizations. This is crucial for complex cross-business initiatives. (See Exhibit 5.)

The PMO plays several important roles. It works with the leadership team to set an appropriate pace of change, supporting the creation of a detailed timetable and putting in place the mechanisms that make it possible to meet every deadline. It acts as the steward of the aspiration for change, elevating and highlighting inconsistencies in understanding, processes, and language across the enterprise. It is important—but often quite difficult—to have consistent ways of creating a baseline, developing the plans for the change initiative, tracking against those plans, and flagging the significance of any deviations.

To make sure that sufficient value is being delivered on time, the PMO supports executive sponsors in rigor testing the various roadmaps prior to the launch of the initiatives. As a result, the organization’s leaders have the forward-looking indicators they need to raise warning flags, giving themselves enough time to act effectively. When issues do arise, the PMO helps make sure that the right conversations are occurring and

## EXHIBIT 5 | The Components of a Governance Structure for a Significant Change Program



Source: BCG industry experience.

Note: PMO = program management office.

that rather than being blindsided, the line leaders are able to take action. The PMO does not need to be liked, but it should have broad-based respect as a key part of a Change Delta approach.

Overall, the governance structure gives leaders the enterprise-wide view they need to steer the program to a successful outcome. Without a breadth of view that encompasses both the change program and business as usual, costs can balloon in functional areas outside the scope of the change effort.

In almost any endeavor, clear roles and guidelines make things more efficient. Improvisation has no place in the unforgiving business of change. Governance and the organization structures to enable it are must-haves.

## In Unity Is Strength

So, how should the Change Delta elements be viewed?

Companies aiming for change management success should not consider the Change Delta elements to be an à la carte menu from which they can pick and choose. All the elements are important and interdependent. Each element augments and supports the others, propelling and proving the overall change journey. You cannot deliver executional certainty without getting the extended leadership team to really shape and own the change, and the change will not stick unless the organization is engaged right down to the grassroots level.

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This chapter draws on the following BCG publication:  
*Changing Change Management: A Blueprint That Takes Hold*



## 6. Building Capabilities

**T**he CEO of a large consumer goods company was near the end of his rope. He was one year into a large-scale transformation that was focused on growth through a shift into premium products. The company had invested millions of dollars to develop an innovative product that warranted higher prices. The early results had been promising: initial sales were strong. However, the transformation was wrapping up, and the CEO's attention was drawn to other challenges: the company had begun to revert to its old ways.

The engineering team did not seem to be on track to produce additional innovative designs. Recent prototypes were unimpressive. Discounting had crept back in, and the average price had fallen below the company's target. One successful product would not be enough to keep the business on track. Had the company invested millions to achieve only temporary results?

This predicament is all too familiar. Many transformations fail to deliver because companies focus too much on the finish line and not enough on the capabilities that they need to build and strengthen in order to get there and—most important—to stay there. By “capability,” we mean an ingrained ability to do something well in a way that improves business performance. For example, a company could launch a transformation to improve its R&D performance, develop a new digital service, or change business models from wholesale to retail. Each of these transformations requires new, specific capabilities that the company needs to build—or acquire—in order to execute the transformation and sustain its benefits.

BCG contends that, in fact, lasting transformations hinge on capabilities. Identifying and developing the requisite capabilities can mean the difference between a successful, sustained transformation and a short-term effort whose results quickly fade. In this chapter, we discuss the main reasons companies fall short in this regard, along with three imperatives for building capabilities effectively and generating lasting

gains. Companies must address all aspects of the target capability by applying a comprehensive definition. They must follow a systematic development approach and make sure that leaders are engaged and have committed their support.

## Where Do Companies Go Wrong?

In many organizations, the approach to capabilities falls short for several reasons.

First, as in the case of the CEO described earlier in this chapter, some leaders fail to recognize the importance of the target capabilities and, therefore, do not think about systematically incorporating them into the transformation itself.

Second, building capabilities generally requires coordination across functions and business units. For example, developing a robust digital capability might require new talent (supported by HR), new tools (IT), new processes (operations), and new governance (leadership). In many companies, it can be difficult to bring these groups together in a coordinated effort and even harder to get them to see the big picture. As a result, many companies hand the capability-building process to HR alone or seek to address it through a few days of training.

Third, acquiring the new capabilities might represent a huge leap into the unknown. A company in a process-heavy industry such as mining might find it reasonably easy to develop lean capabilities to make its production processes more efficient. But it might struggle to implement a new digital capability that requires upgrades to employee skills, technology, and other aspects of the organization.

The biggest obstacle, however, is that new capabilities call for fundamental changes in behaviors—the ways that employees, managers, and executives work on a daily basis. And behavioral change is hard. Without a systematic and explicit approach, companies can, at best, change these behaviors only superficially and temporarily. Once the transformation process is over and attention shifts to the next priority, employees can easily revert to their old ways of working, and the improvements of the transformation disappear.

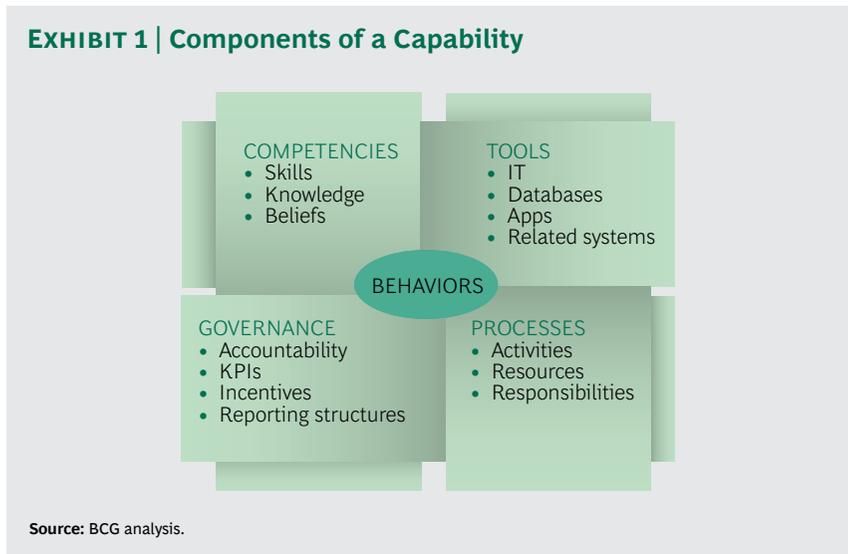
## A Comprehensive Definition

To address these challenges, companies need to start with a comprehensive definition. As stated previously, a capability is a deeply ingrained ability to do something well in a way that improves business performance. At the core are behaviors: the activities, interactions, and decisions made by a set of individuals in a company who exemplify that capability.

To enable and sustain such behaviors, we define four underlying components of a capability:

- **Competencies**—the skills, knowledge, and beliefs held by employees
- **Tools**—IT, databases, apps, and related systems
- **Processes**—the activities, resources, and responsibilities that govern the way work is divided and done
- **Governance**—accountability, KPIs, incentives, and reporting structures

Collectively, these four elements reinforce each other and lead to sustainable changes in behaviors, with the ultimate objective of helping the company create value. (See Exhibit 1.)



Consider a consumer goods company that wants to build a capability in marketing and promotion. The company could change behaviors by systematically incorporating all four elements:

- Competencies could include, for example, knowledge about which promotions are best suited to specific retail channels, the analytical skills required to build a promotion strategy, and the belief that promotion decisions should be driven by data.
- Tools could include an analytics system that collects more accurate point-of-sale data, customers’ mobile-browsing and purchasing history, and other information for generating insights for sales and marketing leaders.
- Processes could include the way the company plans for and rolls out events, how it allocates roles and resources across the team, and how field reps interact with store managers.
- Governance could include a new organizational function that reports to the CFO, new metrics to assess performance and improvement over time, and a new incentive structure for rewarding performance.

It’s important to note that these elements are not always weighted equally. Certain capabilities emphasize some elements more than others. Nevertheless, a strong capability does incorporate some piece of all four elements in order to fundamentally reshape behaviors. (See the sidebar “A Technology Company Builds a New Pricing Capability.”)

## Ten Key Practices for Systematically Building Capabilities

With a comprehensive definition in place, companies can turn their attention to identifying and developing the capabilities they will need in order to generate lasting change through transformation. On the basis of our experience, we have identified ten key practices for building capabilities. (See Exhibit 2.)

**Ruthlessly prioritize the critical few capabilities that will deliver the greatest value.** The first step is to determine what’s needed: the subset of capabilities that are critical for the transformation. This requires understanding the goals of the transformation and identifying the

## A TECHNOLOGY COMPANY BUILDS A NEW PRICING CAPABILITY

Revenue and profit at a large office-product manufacturer were declining as the overall market for its products shrank. In response, the company launched a transformation to convert its business model: instead of selling products, it would sell services and solutions. As part of that transformation, the company set about improving and reshaping its pricing capability.

Prior to that point, pricing had been a cumbersome process that was linked to cost rather than to what the market would bear. Sales reps offered discounts that were based on gut instinct. And even in today's increasingly digital environment, the company had no pricing-analytics function; little sales data made it back out to the field.

In response, the company took steps to systematically build a pricing capability that was part of its transformation journey and focused on all four components:

- **Competencies.** Because pricing was such a critical element of the transformation—and because the company had had no dedicated pricing team prior to that point—leaders opted first to hire outsiders who already had the required competencies. The company created a new pricing and analytics group around these experts. They trained company employees, rigorously developing their pricing knowledge, skills, and beliefs.
- **Tools.** The company developed an analytical tool that assessed product features and identified those with the biggest impact on pricing. In addition, the company rolled out a dashboard of sales data, which broke down pricing by region, product line, and sales rep. With these tools, the sales force gained a clearer indication of the pricing options for specific customers, and analysts were better able to identify trends and support field reps. Management also used the tools to track performance.
- **Processes.** Several processes were altered, particularly those associated with discounting. Once a list price

## A TECHNOLOGY COMPANY BUILDS A NEW PRICING CAPABILITY (CONTINUED)

was set, sales reps had clear guidelines—and guardrails—regarding the discounts they could offer. Steeper discounts required approvals from higher levels, up to the global head of sales.

- **Governance.** The company created a new role: vice president of pricing, who oversees the entire function and reports to the CFO. And the company refined its performance incentives for the sales force, introducing a bonus scheme that emphasizes pricing and is simple enough that a rep can easily do the necessary calculations in his or her head.

As a result of efforts associated with each of the four dimensions, the behaviors of pricing-team

members have fundamentally changed. No longer do sales reps offer discounts on the basis of their gut instincts. Instead, they have a standardized approach that is based on a quantitative analysis of the market. In addition, the company uses the pricing and analytics group to continually measure its performance and improve over time.

Within five months of rolling out the new capability, the company was able to raise prices by more than 2% on average, leading to approximately \$50 million in new revenue—and an 8% improvement in gross margin—each year. As the transformation journey continues, the new pricing capability is helping the company ensure that these gains are sustainable.

specific capabilities that will help the company achieve those aims. The company then needs to select the few capabilities that will generate the greatest value and prioritize ruthlessly. A company that tries to build too many capabilities at once can spread its resources too thin and accomplish nothing.

For example, a consumer goods company sought to expand its global presence and to use digital technology to improve its performance. In support of these strategic objectives, the company conducted internal and external interviews and a benchmarking analysis and came up with

## EXHIBIT 2 | Ten Practices for Systematically Building Capabilities

1		Ruthlessly <b>prioritize</b> the critical few capabilities that will deliver the greatest value.
2		Assess the <b>gaps</b> in all facets of the critical capabilities.
3		Align <b>leaders</b> on the overall process.
4		Design <b>each capability</b> , addressing all four components.
5		Assemble a <b>cross-functional team</b> with the necessary expertise and perspectives.
6		Use a <b>rigorous change management</b> approach.
7		Build <b>capabilities</b> in the context of employees' day-to-day work.
8		Measure <b>results</b> and make course corrections.
9		Address both the “ <b>hard</b> ” and “ <b>soft</b> ” aspects of the organization.
10		Stay the <b>course</b> until the change becomes permanent.

Source: BCG analysis.

a list of critical capabilities. To prioritize them, the company ranked the capabilities according to two dimensions: the relative importance of each capability to the company's strategy and the difficulty of implementation. Management decided that the capabilities that were important to the strategy and easy to implement would require relatively less direct oversight, which—later in the transformation—could be passed on to line managers. Conversely, capabilities that were important but hardest to implement would require a different approach. Those would require significant time, energy, resources, and commitment from leadership, so the company opted to create teams dedicated to building these as part of the transformation program.

**Assess the gaps in all facets of the critical capabilities.** Companies need to define the gaps between their current capabilities and their

target state relative to all four components: competencies, tools, processes, and governance. Many companies err at this stage, thinking of capabilities as single-dimensional attributes rather than considering all four dimensions of each capability. The gap analysis helps organizations start to map out the effort that will be required during the transformation.

**Align leaders on the overall process.** Senior leaders at the company need to understand not only the target capabilities but also the full scope of the process required to develop them. Executives must be prepared to invest time and energy to see that process through. And the process can extend over a long period during which the executives will likely face demands on their time and attention in overseeing the transformation itself. Clear alignment from the beginning offers a reality check for making sure that leaders are prepared to support the initiative.

**Design each capability, addressing all four components.** The next step is to design each of the required capabilities, addressing all four components of the definition. For example, a company seeking to build an R&D capability requires more than just technical expertise. It also needs, for example, tools to support research, processes to allocate resources among various projects, and metrics to evaluate performance. This requires recognizing that capabilities are not addressed only through training. (See the sidebar “An Auto Manufacturer Builds Digital Capabilities.”)

**Assemble a cross-functional team with the necessary expertise and perspectives.** During the design process, a cross-functional team can ensure that critical aspects don’t fall through the cracks. Such teams include representatives from, for instance, HR, IT, and finance. The team does not need to be large, but it should include the right experts and stakeholders.

The consumer goods company mentioned previously created a permanent corporate function that is directly responsible for identifying and developing new capabilities and designing ways to embed them in the company. This function comprised people from HR, IT, and operations, as well as other departments.

**Use a rigorous change management approach.** Creating lasting behavioral change is hard and requires the same rigorous approach to implementation as the transformation itself. A clear implementation

## AN AUTO MANUFACTURER BUILDS DIGITAL CAPABILITIES

While some capabilities are unique to a specific company and transformation, others—such as digital technology—are more widespread and more complex to develop. (See “The Digital Imperative,” BCG article, March 2015.)

Digital encompasses singular, tactical capabilities such as big data, analytics, and social media, yet it also may require the company to make broader changes to its business model. Moreover, in many industries, it requires an influx of new talent through direct hiring, a joint venture, or a partnership with another company. More fundamentally, building a digital capability requires a new mindset of rapid prototyping and learning through experience. (See *How to Jump-Start a Digital Transformation*, BCG Focus, September 2015.)

For example, the executives at a multinational automobile company recognized that it would need to incorporate digital technology more directly, both in its internal processes and in the vehicles it sold. The company launched a digital transformation, including a dedicated effort

to build the components of its capabilities:

- **Competencies.** The company needed to develop several competencies, including rapid prototyping and analytics, to support digital capabilities. Management hired experienced outsiders and paired some of the new hires with current employees in a reverse-mentoring process that would spread competencies quickly throughout the company.
- **Tools.** The company upgraded its IT tools and systems across the board, making changes to more than 2,000 applications. For example, a new-product data-management tool allowed designers at multiple sites around the world to collaborate on new products and accurately track all information related to their development and release.
- **Processes.** Rather than using the traditional product development approach, which is built on a linear series of steps, the company shifted to

## AN AUTO MANUFACTURER BUILDS DIGITAL CAPABILITIES (CONTINUED)

agile product development, which is faster, more iterative, and more focused on the customer experience. In an agile process, developers start by turning their ideas into a very stripped-down prototype, which they show to potential customers in order to capture their feedback. Using the agile approach, the company was able to deliver a full working version of a new product in just 13 weeks, during which users delivered several rounds of feedback and design changes were made. The process took far less time than would have been necessary using the old software development approach.

- **Governance.** After a few early-stage tests, it became clear that the company didn't have the right internal IT structure in place to support

the digital capabilities. It therefore split its IT function in two: one section would support the company's existing operations using traditional legacy systems, and the other would move faster to develop cloud-based mobile technology and other digital tools that could support the new initiatives.

Most important, employees, managers, and leaders all began to change their behaviors in lasting ways. For example, instead of interacting only occasionally, the IT teams made a habit of presenting the business teams with testable prototypes for feedback every two weeks. Procurement teams that had been spending three to six months recruiting vendors before offering long-term commitments started signing lower-risk trial commitment contracts within one week.

plan built on rigorous change management principles should include detailed milestones and KPIs, and it should establish the right team to execute the plan.

### **Build capabilities in the context of employees' day-to-day work.**

During a transformation, employees are under a great deal of pressure, and a seemingly theoretical capability-building project is bound to raise

skepticism. Rather than treating capabilities as an abstract exercise, companies need to make the capability-building experience as practical as possible, grounding it in employees' daily work and responsibilities. The goal of any transformation is to fundamentally change the behavior of employees and managers, leading to a new, permanent way of working. A capability-building program that is practical, based in the real work that employees perform daily, and executed in parallel with the business agenda of the change makes employees feel supported and leads to real changes in behavior.

**Measure results and make course corrections.** Success requires measuring and reviewing the impact of all changes and adjusting the course as needed. The abstract nature of capabilities makes them challenging to define and assess. Thus, companies need to establish quantitative goals and milestones, communicating openly and honestly with all involved.

To ensure the success of the overall program, implementation teams must use these metrics to continually evaluate impacts and make appropriate adjustments. (See the sidebar “An Industrial Company Pilots a Capability-Building Program for Managers.”)

**Address both the “hard” and “soft” aspects of the organization.** Once new capabilities are in place, companies need to take active steps to ensure that those capabilities become embedded in the company's DNA. Such steps include changes to the hard elements of the company, such as IT systems, as well as softer aspects, such as performance assessments, incentives, and the overall culture.

For example, a company that aims to have its sales force emphasize the quality of customer interactions rather than simply concentrate on upping the volume of sales calls would need to apply new metrics for evaluating customer interactions and to incorporate the new metrics into its performance management system, including the award system. Furthermore, sales managers would have to emphasize the importance of high-quality customer interactions on an ongoing basis.

**Stay the course until the change becomes permanent.** There is no finish line, and the capability-building process is never done. Companies need to stay the course, reinforcing a particular initiative until the new behavior—no longer unfamiliar—becomes second nature for employ-

## AN INDUSTRIAL COMPANY PILOTS A CAPABILITY-BUILDING PROGRAM FOR MANAGERS

One industrial company had a culture that was highly oriented toward processes and top-down directives. Rather than engaging in discussion and dialogue with their people, unit and department leaders acted like prescriptive taskmasters, and although the company posted decent returns, it had a poor track record for innovation.

The company hired a new CEO, who quickly realized that the culture was hindering the company's ability to solve complex problems. He initiated a transformation aimed at building up capabilities among frontline managers directly overseeing line employees. The goals were to reduce reliance on top-down tasks, increase dialogue between managers and their employees, and engage in value-based management that would ensure that all managers and employees knew the potential financial impact of their decisions.

To develop these new capabilities, the organization, rejecting theory-based training programs, opted to address the work of the

managers in practical and tangible ways. Managers were taught how to reframe daily conversations with their employees. The company restructured the morning meetings that line managers held with their units, allocating time to actively solicit employees' opinions and ideas, rather than simply issuing orders. Managers used simple tools such as checklists, feedback mechanisms, and learning guides to help them stick with the new target behaviors.

After an initial pilot test, the company made some refinements and rolled out the program on a larger scale, training 6,000 line managers across 18 countries, in three languages.

With these new management capabilities in place, employees are now far more empowered to make suggestions, and managers have a much clearer sense of how to evaluate those suggestions. The teams—well-integrated units—are adding significant value.

ees. (See the sidebar “A Software Company Builds a Capability to Support a New Business Model.”)

## Implications for Leaders

Even companies that get the first aspects (a clear definition and the ten imperatives) right can fail if they lack the right leadership. Leaders need to guide the overall process, set expectations, model the new target behaviors, and use positive reinforcement to reward progress. They also need to allocate resources among multiple priorities and take other steps to support the change. All of this requires significant time and energy during a period in which those leaders are likely to be running other aspects of the transformation, as well as the day-to-day operations of the company.

To help leaders prioritize, we provide the following guidelines.

**Know what you don’t know.** Capability building can be especially difficult when the target capability resides outside the leadership team’s expertise. Leaders are naturally drawn to areas they know well and to which they can quickly add value, but transformations don’t always offer that luxury.

For example, the leaders of a company that lacks first-hand digital experience but needs to become better at launching new digital initiatives might need to push themselves in ways that are unsettling. For this reason, it’s critical that they understand their own limits and become creative and resilient in building capabilities. One approach is to rely on experts, perhaps hiring from companies that already have the required capabilities. Mentorship and coaching can help. And leaders should strip away the stigma and blame associated with failure, treating setbacks as opportunities for learning.

**Balance medium-term capabilities with short-term business pressures.** Building capabilities takes time, resources, and energy. Moreover, the process can be thrown off track by the relentless pressure for short-term results and the competition for executive bandwidth and resources. Accordingly, it’s up to the leadership to prioritize capabilities, allocate resources, monitor the overall workload of key employees, and link progress on capabilities to short-term results.

**Prevent atrophy.** Organizational capabilities, like healthy muscles,

## A SOFTWARE COMPANY BUILDS A CAPABILITY TO SUPPORT A NEW BUSINESS MODEL

As customer preferences changed, a leading software and services company needed to transform its business model from on-premises licensed software to subscription-based, cloud-hosted software as a service (SaaS). That required developing several capabilities.

The company started in a few areas, analyzing customer expectations and benchmarking its performance against that of competitors to understand the biggest gaps. The most immediate priority was “customer success.” Rather than selling software systems to customers on a one-off basis, the company had to interact with customers more frequently and directly, and it needed to develop a culture focused on anticipating and addressing their needs.

To build the customer success capability, the company assembled a cross-functional team with representatives from sales, service, and engineering. The team drew heavily on external benchmarking and expert interviews. These proved critically important, given that the

company was expanding into an area in which it had little institutional expertise. Humility was key as well: even in designing the capability, leaders were leaping into unfamiliar territory.

On the competency front, the company built up its analytics and data management skills, enabling it to track customer usage accurately and to synthesize the data into insights for improving products. It also rolled out dashboards that allowed the company to anticipate problems, spotting usage patterns, and predicting and addressing customers’ needs rapidly.

With regard to processes, the company had to create value for its customers by building close, long-term relationships, thus improving retention rates. Finally, the company established a new role: a customer success manager serves as a single point of contact for handling all client needs. The company also altered its KPIs, focusing on adoption, retention, and customer success metrics.

To embed the capability, the company redefined its target

culture to emphasize customer service with specific behavioral changes. For example, it was no longer acceptable simply to pass customer problems from one department to another. Instead, because the company now aimed to resolve problems as soon as they arose, it authorized line employees to handle problems at the lowest possible

level and collaborate to solve problems across functions.

Through these measures, the company has succeeded with the new SaaS business model, reducing churn among its customers and increasing revenue from upselling and cross-selling.

atrophy if they are not tested, used, maintained, and improved. As we noted previously, leaders must deal with a steady stream of new initiatives and priorities that can pull the company in new directions. To avoid losing ground, leaders must deliver strong, consistent messages about the importance of core capabilities, linking them to employee objectives and rewards and regularly evaluating capabilities against continually changing strategic requirements. Finally, leaders must foster a mindset that treats capability building as an ongoing requirement rather than a one-time event.

Make the organization more agile. Perhaps the biggest challenge for leaders, beyond developing individual capabilities, is anticipating the need to transform the company repeatedly over time. Even a theoretically perfect set of capabilities today will have to be revamped in the near future, so company leaders need to make their organization more agile, capable of thriving amid continual change.

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The CEO we described in the introduction to this chapter eventually realized that focusing on the outcomes of the transformation wasn't enough. Members of the pricing team didn't simply need new products. They needed stronger pricing capabilities, including tools. Similarly, the R&D team needed new processes that were less cumbersome and more tightly linked to manufacturing. Broader scopes of responsibility would allow engineers to better integrate perspectives from developers,

designers, marketers, and customers. In sum, by doubling down on the capabilities needed to execute the transformation, the company was able to grow through stronger sales in the premium segment and to generate sustainable gains.

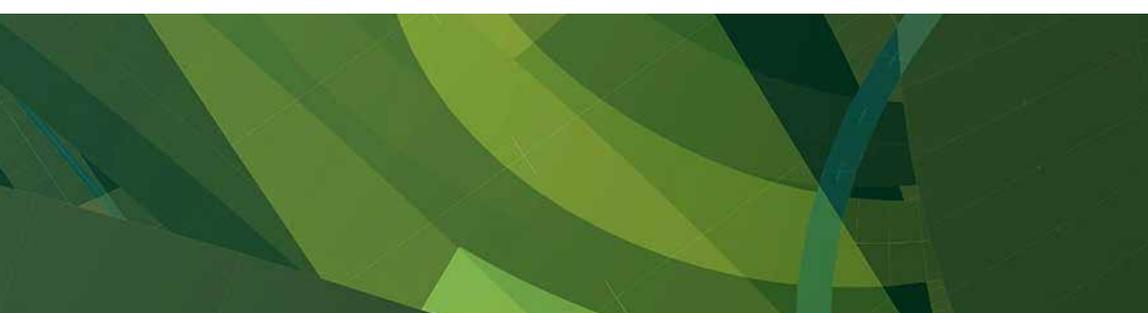
Many companies that launch transformations focus doggedly on demonstrating outcomes. That approach is understandable, but because it doesn't address the underlying capabilities needed to achieve and sustain the outcomes, it's shortsighted and will likely fail. Regardless of industry or type of transformation, capabilities are critical elements in improving performance and sustaining results, ultimately in the form of increased value creation. By focusing on the three elements discussed here—a clear and robust definition of capabilities, a structured approach for building those capabilities, and the right support from leaders—companies can successfully transform themselves to meet whatever challenges they might face.

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This chapter draws on the following BCG publication:  
*Building Capabilities for Transformation That Lasts*



**PART III:  
DISTINCTIVE TYPES OF  
TRANSFORMATION**





## 7. Digital Transformation

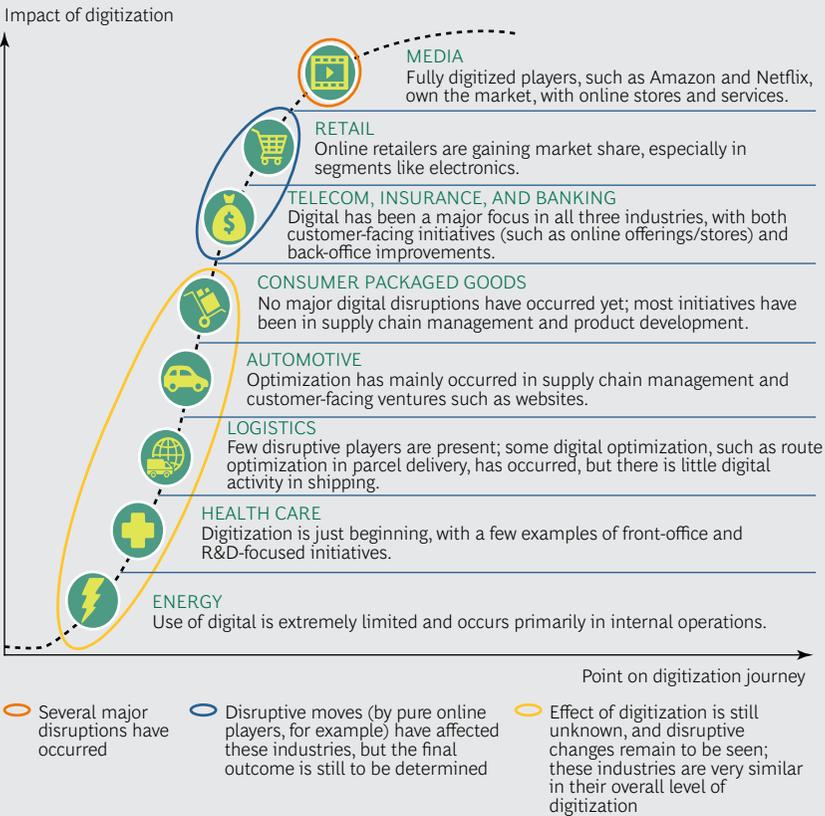
**D**igital technologies and approaches are infusing all aspects of the business world. The Internet of Things, ubiquitous connectivity, big data and advanced analytics, the cloud, cognitive computing and artificial intelligence, robotics, and 3D printing are significantly altering nearly all industries. Mobile-first and social media strategies are essential for success in consumer industries. “Digital twins”—virtual models of physical things that are used to simulate production and maintenance and to provide training—and augmented reality are reshaping the industrial environment.

Despite the pervasiveness of digital disruption, not all industries are responding to the threats and opportunities. In contrast to industries like media and retail, where digital technology has been a significant disruptive force, process-oriented industries such as energy, transportation, industrial goods, and health care have not yet seen its full effects. (See Exhibit 1.) For management teams in these industries, it can be difficult to know how to start implementing digital technology—or even to see the need.

As a result, many companies have yet to take action to capitalize on digital. Some of these late adopters say they are hindered by legacy IT systems or don’t have the necessary capabilities in place. Others spend months studying the market and getting bogged down in large-scale strategic and conceptual considerations, believing—incorrectly—that they need to understand how and where the journey will end before they can take the first step. The development cycles of digital technology are extremely rapid—far faster than for most traditional products and services—and an overly deliberative (and outdated) approach means that these companies are essentially fighting yesterday’s battles.

Given the pervasiveness, low cost of entry, and potential impact of digital technology, it’s imperative that late adopters act today to launch new digital products and services and digitize internal processes. This means that they must implement far more nimble develop-

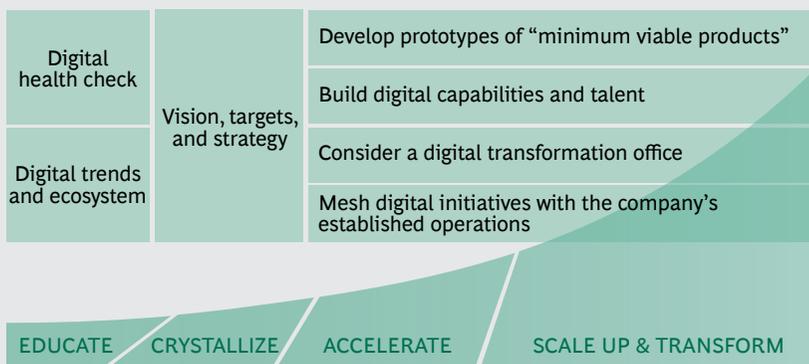
## EXHIBIT 1 | Industries Are at Different Stages in the Adoption of Digital Technology



Source: BCG analysis.

ment processes and become far more comfortable making decisions amid uncertainty. Rather than using a top-down, strategy-driven approach (which worked in the past), these companies need to innovate using build-assess-learn cycles, even when not entirely sure of the outcome. They need to focus on pilot tests and prototypes that can be developed and rolled out quickly, assessed for performance, and scaled up (or shut down) accordingly. They need to embrace the concept of “fail fast and fail cheap,” and build up their digital capabilities through direct experience. And rather than making a single big, strategic bet, they need to manage multiple initiatives, trying out new business models with low sunken costs, killing off the losers, and scaling up the winners.

## EXHIBIT 2 | Digital Transformation Is a Journey



Our experience with companies in virtually all industries shows that success with this kind of trial-and-error approach requires four critical steps: educate yourself on the landscape, crystallize a plan for how to move forward, accelerate successful initiatives, and scale up and transform the entire organization. (See Exhibit 2.) Together, these steps can help management teams determine where to start, how to manage the process, and how to generate sustainable progress with their digital transformations.

### Educate

Companies seeking to pursue digital often proceed from very different starting points, with different capabilities, circumstances, and degrees of ambition. Some will be able to leverage digital technology to fully transform their operations, processes, and business model. Others may need only to increase efficiency by reengineering certain business processes.

The first step for a leader considering a digital transformation is to educate himself or herself on the company’s current use of digital. This need not be a comprehensive, exhaustive process. As with all digital endeavors, speed and initiative are critical. Moving forward on the basis of partial information is far better than trying to complete a precise assessment before taking a first step. There are several objectives at this stage:

- Expose the leadership team and the organization more broadly to the opportunities and threats posed by digital technologies and digital attackers.
- Elevate the sense of urgency and clarify the call to action required given the opportunities and threats.
- Enable leaders with the knowledge and, even more important, the confidence needed to lead the digital transformation.

At this point, it is helpful to focus on digital use cases where simple prototypes can clearly demonstrate the power of digital. These opportunities may not be the biggest or the most urgent, but they should serve to make digital's potential more tangible.

In addition to charting the current and potential use of digital, a company planning a digital transformation needs to assess its current readiness across a variety of dimensions—for example, by undergoing a digital health check. This includes assessing the availability and quality of a company's data, as well as the company's IT architecture (including the degree to which it is digital ready), capabilities in innovation, and overall culture and readiness for change. Talent is a critical element—management teams should work with HR to evaluate the company's pool of digitally skilled employees, including those in areas such as programming, mobile, IT implementation, digital marketing, social media, and data analytics.

## Crystallize

The second step is to crystallize a plan for how to move forward, along with a potential portfolio of digital initiatives. In the agile spirit of digital, this should not be a drawn-out effort. Big organizations are accustomed to managing large-scale, multiyear projects with fixed timelines and set budgets. It's not uncommon for an enterprise-resource-planning migration project to take five to ten years from start to finish. But in today's fast-paced digital economy, such a model is not just outdated—it's potentially fatal to the organization. To survive, companies need to work and make decisions more rapidly than ever before.

The portfolio of potential digital efforts should include initiatives for reshaping the customer experience; reimagining products, services, and

business models; and reengineering business processes. Each of these warrants a more detailed discussion.

**Reshaping the Customer Experience.** The first initiative builds on the analysis of the customer journey in the first phase to determine how to eliminate pain points and how to surprise customers with new levels and forms of service.

For example, some energy companies are starting to offer mobile apps that allow customers to check bills and obtain meter data. Some retail chains have advanced offerings that allow customers to keep track of shopping lists and order out-of-stock items through an e-commerce portal on their smartphone. (See the sidebar “A Retail Player Quickly Rolls Out a Mobile App.”) Similarly, some travel sites send flight status updates, departure gate numbers, seat assignments, rental-car confirmations, hotel directions, and other trip-related information to customers’ phones—all sequenced to arrive at precisely the right time. And automakers are improving sales by using digital channels to send vehicle information and specs to potential customers at critical junctures in the purchasing and maintenance processes.

A key challenge in this area is to avoid letting perfection stand in the way of progress. It is more important to launch minimally viable offerings and then to upgrade them quickly in response to customer feedback than to let time and opportunity slip away. Customers have proven to be highly collaborative—accepting initial imperfection and suggesting practical product improvements—when their feedback is acted upon.

**Reimagining Products, Services, and Business Models.** This reimagining prepares companies to better meet their customers’ needs, often by exploiting new data and powerful analytics. These offerings don’t merely improve the value proposition for customers; they transcend it and help the company expand into new areas of the value chain. For example, many banks are moving beyond the processing of payment transactions into services such as shopping, product comparisons, discounts, and post-transaction ratings. Similarly, telecom companies are starting to provide streaming-video and e-commerce services for their customers, in addition to basic voice and data. In the industrial goods industry, many companies are now using embedded sensors in capital equipment to warn users of maintenance issues, allowing them to make less expensive repairs early on and prevent larger problems.

## A RETAIL PLAYER QUICKLY ROLLS OUT A MOBILE APP

A multinational big-box retailer operating in an emerging market launched a quick-win initiative with a mobile app to boost declining sales at its physical stores. Rather than develop a grand digital strategy or conduct detailed market research to determine the scope of the opportunity, the retailer outsourced the entire app development process so that it could get something to market quickly.

The app included customer-friendly features like personalized coupons and offers, tools to plan shopping trips, automatic replenishment of regular purchases (though a subscription model), and in-store navigation. It resonated strongly with customers and led to increased sales at the retailer's stores, especially once manage-

ment learned what worked well and continued to add new features, such as in-store WiFi and home delivery of goods purchased online.

The overall initiative was so successful that the retailer extended the outsourcing arrangement for a second year, meanwhile hiring digital talent and building up its own internal capabilities in critical areas, such as customer analytics, mobile payment processing, app development, and coding. Eventually, it rebuilt the main app using internal resources and continued to refine and improve it. By outsourcing much of the process initially, the company was able to get an app in consumers' hands quickly, build its digital capabilities over time, and learn from direct experience.

A common pitfall in this aspect of digital transformation is an unwillingness to cannibalize the existing business. Companies that fall into this trap limit their powers of imagination and forfeit growth opportunities.

**Reengineering Business Processes.** This initiative entails adopting flexible and intuitive digital technologies to simplify processes and increase efficiency. This approach is particularly relevant for B2B companies, which place less emphasis on the customer experience. The use of

digital can improve the efficiency and accuracy of internal processes, reduce costs, and allow the company to use data-driven analytics to improve performance.

Radical process reengineering demands careful strategic workforce planning. In the digital age, such transformation can increase a company's productivity—but only if the company quickly finds or trains candidates to fill new job profiles that may affect a substantial part of its total workforce. (See *Man and Machine in Industry 4.0: How Will Technology Transform the Industrial Workforce Through 2025?*, BCG Focus, September 2015.) Without active management of workforce issues, fundamental reengineering will almost certainly stall or even fail.

A leading North American bank offers a good example of the reengineering of business processes. Prior to its transformation, the bank took 18 months, on average, to release new digital products into the market. With startup attackers moving quickly on the digital front, the bank needed to shorten its development period without compromising quality or regulatory compliance. The bank changed three things: the way it organized teams, the way it made decisions, and the way its teams worked. First, the company created cross-functional teams, bringing together people from the business side and the technology side, to follow a product from inception to release. These teams rallied around a business objective, such as increasing incoming applications for mortgages by 10% or increasing conversion rates on credit card applications by 5%.

Unlike in the typical development model, in which IT teams deliver specific functionality (creating a button here or a search box there), the bank's cross-functional teams had the freedom to design a product as they saw fit—and supervisors evaluated them on their ability to meet their stated business objective. Teams also embraced a new way of working, through agile principles. Rather than engaging in extended philosophical debates on the merits of various offerings, they created prototypes and put them in front of users. They analyzed the customer feedback and learned what customers wanted—thus clarifying what they should build. By implementing these new processes, the bank released products in approximately half the time that the process used to take (roughly 8 months instead of 18 months), while maintaining compliance and improving quality.

## Accelerate

Once a company has crystallized a plan and a clear set of priorities, the next step is to accelerate the digital transformation. The goal of this phase is to use an agile approach to launch pilots for the initiatives identified during the “educate” and “crystallize” phases. At this point, speed and agility are crucial. The digital transformation, when done right, is not a monolithic endeavor. Rather, multiple projects run simultaneously on parallel tracks. Rather than clinging to the traditional, linear approach to rolling out new initiatives, companies should quickly bring new ideas to market, gather customer feedback, and refine the concept iteratively. Many accomplish this by means of the minimum viable product (MVP) process of prototyping.

The MVP process is based on the idea of the “good enough” product. Rather than trying to perfect new products or services internally during the development stage, the company instead aims to get them to market with just enough features included to make them functional (typically relying on inexpensive, easily accessible technology). That allows the company to minimize its investment, test the new products and services in the real world (instead of in artificial settings such as focus groups), and refine them using customer feedback. For example, the initial versions of apps and online stores are often quite basic, with new features and functions added over time, depending on how customers use the products.

A North American pharmaceutical company, for example, adopted a prototyping approach to accelerate digital change. It started by testing initiatives such as search engine optimization and targeted training in the sales and marketing organization. When these improvements led to a 10% to 20% reduction in spending for marketing, with no falloff in sales, executives moved on to bigger tasks. To improve the customer interface, the company introduced minimally viable apps that complement specific drugs. The company sees these services as a way to engage with its customers “beyond the pill,” to differentiate its drugs, and to drive growth.

## Scale Up and Transform

Once the company has identified its most important digital priorities and accelerated a number of initiatives, it faces the challenge of scaling

up the successful ventures and transforming the organization. Several levers are available to accomplish this. The right one depends on the company's level of ambition, the strength of its existing digital capabilities, and external market factors (primarily, the degree of disruption posed by new digital competitors).

Building capabilities is a critical step that enables companies to develop new ways of working, new business models, and other building blocks of digital transformation. The key here is to take full advantage of the inherent scalability of digital and the ability of digital to empower individuals and teams across the company, motivated often by nothing more than the freedom and excitement of being innovative and entrepreneurial.

One path to capability building is to hire digital talent on a temporary basis and then bring it in-house over time. A temporary project management team may be required to run the newly established digital processes while the organization develops permanent digital talent through internal training and external hiring. As the company embeds permanent talent, it can create digital units that serve as a center of excellence and an internal repository of its current thinking on technology. This is an iterative and incremental model that allows the company to develop digital capabilities organically. Redesigning business processes in this fashion takes time, but it allows the company to develop its own expertise.

A second, often complementary approach is to create an internal incubator (or to leverage an external one) to scale initiatives without being bogged down by corporate processes and bureaucracy. This can be done through the early-stage funding of startups (the corporate venture capital model), a joint venture, or an outright acquisition. (See the sidebar “An Insurer Creates a Joint Venture to Enter a Challenging Market.”) Regardless of the ownership structure, the company takes an active role by investing in and developing the new entity, with the goal of cultivating digital capabilities that it can harness—and potentially bring in-house. This approach allows the company to move quickly into digital and build a startup mentality while limiting the risk of failure and the impact on existing operations. However, it requires capital, the willingness to act like an investor, and the right degree of oversight.

## AN INSURER CREATES A JOINT VENTURE TO ENTER A CHALLENGING MARKET

A global insurer wanted to enter a fast-growing Asian market, but several initial efforts had failed. The company then developed a joint venture that would enter the market through a “Trojan horse”—a noninsurance product marketed under a new brand name.

Aware of a potential new demographic for insurance—pregnant women and new mothers—the company developed a digital device that pregnant women could wear to monitor the heartbeat of the fetus. The joint venture was staffed with a combination of established insurance company employees and new hires who provided the needed digital capabilities, and it rolled out the product using quick, iterative cycles and customer feedback on prototypes.

In addition, the company created a website where women could monitor heartbeat data and exchange information with other expectant mothers. (Family members could also log on.) The site included original content from medical experts, and it was open to participation by other companies offering wearable technology. This approach allowed the insurer to establish a foothold in the market, which it then used to cross-sell its insurance products.

Critically, the joint venture was completely separate from the parent company, with different governance, financials, and technology. This allowed it to move fast and operate like a startup, free from any institutional inertia on the part of the parent company.

**With any of these approaches, companies should adopt strong change management processes. Many do this by establishing a digital transformation office with senior-level governance over all projects. This office controls the mobilization and allocation of resources for the digital projects and steers the portfolio.**

**After core digital capabilities and talent are acquired and developed internally, digital initiatives must be meshed with the company’s established operations, ensuring in the process that employees and**

managers on both sides continue to collaborate so that digital successes can spread throughout the organization. Many companies also need to break down institutional barriers and silos in order to foster more collaboration between IT and the business units. (See the sidebar “A Global Bank Revamps Its Organization Model.”)

Strong leadership in a digital transformation is crucial. Throughout the change program, the company’s digital agenda needs to be driven by

## A GLOBAL BANK REVAMPS ITS ORGANIZATION MODEL

With digital innovators increasingly influencing customer expectations, a global bank embarked on an internal transformation with three objectives:

- To allow the bank to respond to changing customer requirements more quickly
- To increase efficiency by breaking down organizational silos and bureaucracy
- To increase staff engagement and make the bank more attractive to digital talent

Drawing inspiration from innovative digital companies, the bank reorganized into mini-startups, with employees from marketing, product development, customer intelligence, digital channels, and IT working together in small, multidisciplinary, collocated teams. The

teams were empowered to develop, test, deploy, maintain, and adapt customer processes and propositions according to their specific mandates. At the same time, the bank adopted a new governance system that ensured that the teams were aligned with the company’s larger business objectives.

The traditional manager role was replaced by product owners, expertise leaders, and agile coaches geared toward building high-performance teams. This enabled the bank to reduce management layers and workforce size in functions like marketing, product management, and digital channels—by more than 30%. At the same time, the bank attracted new talent from digital innovators outside the company to strengthen its internal capabilities in the most critical areas.

executive management, with visible support and accountability. (Bottom-up approaches usually do not last.) Leadership must prioritize the hiring of high-potential employees with skills in such areas as agile development and analytics. And it must build a digital culture within both the business units and IT—including a trial-and-error mindset that not only tolerates failure but also understands that failure is a critical part of the process. The right culture has an agile orientation that embraces sprints and rapid adaptation, along with a strong emphasis on collaboration.

Moreover, the company needs to determine how IT can best support the company’s digital initiatives and whether to house its digital capabilities within the business units or in a corporate center of excellence (either inside or outside the company). Many companies choose to deploy dedicated new-technology platforms—particularly for customer- and analytics-focused initiatives—that function separately from the core IT department and have their own databases and other infrastructure. Digital initiatives require different capabilities and entail much faster development cycles, and they often benefit from having a clear place in the organization, along with dedicated resources.

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The digital world offers both major opportunities and threats. To succeed with digital transformation, companies must understand their starting position and plan the right path forward. We end this chapter with a few recommendations for leaders as they pursue digital transformation:

- Actively seek opportunities to become immersed in digital products, services, and capabilities to reduce the anxiety that can come from rapid change and to better enable you to lead from the front.
- Think more broadly about the customer journey. Do not limit innovation to the traditional realm in which the company has placed it.
- Innovation doesn’t need to be about one big idea; it can be a combination of many small things that elevate the overall experience of the customer.

- As the portfolio of digital initiatives comes together, leverage inspiring examples from within and outside the industry to spur new ideas.
- Plan plenty of time for iterations of new products—but start early!
- Ensure that enough focus is given early on to developing digital leadership, talent, and culture; any shortcoming in these areas will otherwise become the critical bottleneck.
- Strong navigation by senior leadership and the change management team is essential throughout to ensure that the transformation succeeds.

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This chapter draws on the following BCG publications:

“Acting on the Digital Imperative”

*How to Jump-Start a Digital Transformation*

“The Double Game of Digital Action: Structuring the Program”

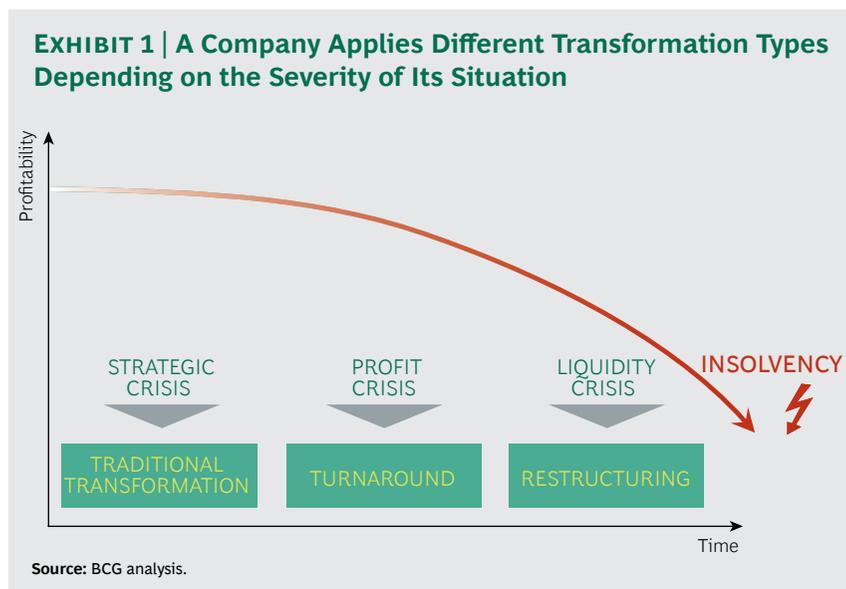


# 8. Turnaround and Restructuring

Many of the transformation initiatives described in this book focus on improving a company’s financial and operational performance from “good” (or moderate) to “great”—that is, the company is already doing well in some or most areas, yet management still sees a need to make improvements. Other companies occupy a separate category of transformation because they are in the midst of immediate, urgent crises. We refer to these as turnaround and restructuring efforts. With the business environment becoming so volatile and unpredictable, an increasing number of companies need to take dramatic actions to generate rapid impact or they risk going out of business.

Typically, business problems unfold in three phases. (See Exhibit 1.)

During the first phase—a strategic crisis—the company is no longer able to compete effectively. Sales numbers may be stable, or even growing, yet profitability has begun to decline. Very often, management has tried



a new strategy, or several, without success. (In some cases, management may not recognize the scope of the problem.) This is the phase at which traditional transformation programs are relevant.

If the company does not change its course, the second stage is a profit crisis. Sales are now stagnating or declining, while profit margins turn markedly negative. At this point, the company starts burning through cash reserves and needs to launch a turnaround.

Failure to do so—and continuing to burn cash—leads to the third and final phase: a liquidity crisis, in which the company may soon lack the financial resources to keep operating. At this point, the management team typically loses the ability to make changes on its own, and different stakeholders such as banks and other debt holders may have a say in trying to restructure the company.

Turnaround and restructuring programs involve applying the three components of the transformation framework:

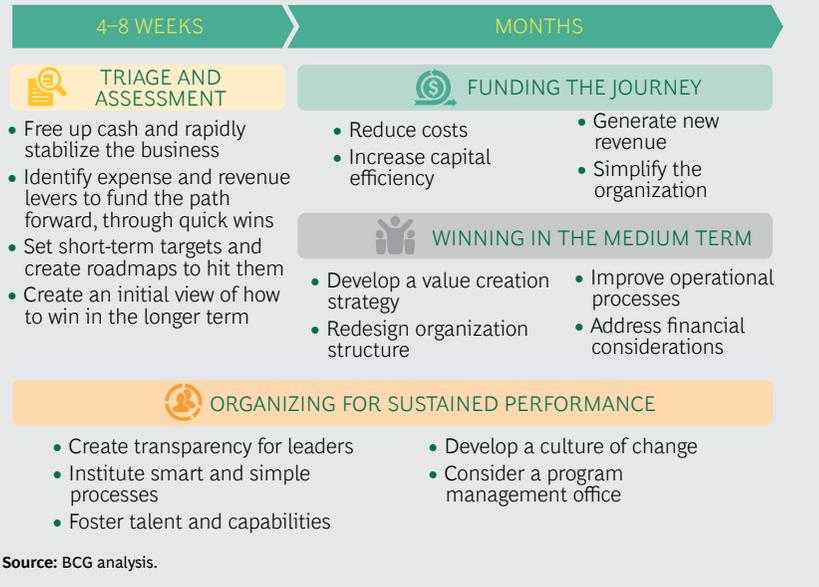
- **Funding the Journey.** Launch short-term, no-regret moves to establish and demonstrate momentum and to free up capital to pay back debt and help the company reposition.
- **Winning in the Medium Term.** Develop a business model and an operating model to increase competitive advantage.
- **Organizing for Sustained Performance.** Set up the right team, organization, technology, and culture to deliver long-term gains.

A turnaround or restructuring program should include all three elements, but the relative importance of each changes at various points in the process. In addition, it requires an initial triage and assessment stage, to determine the severity of the company’s challenges and determine the right path forward. (See Exhibit 2.)

## Triage and Assessment

The initial stage, triage and assessment, is aimed at generating a clear picture of the company’s financial situation and identifying the most immediate priorities. At this point, management needs to launch rapid measures to stop the bleeding and free up capital as soon as possible—

## EXHIBIT 2 | Components of a Turnaround or Restructuring Program



ideally in weeks; certainly no longer than a few months. (See the sidebar “A Retailer Cuts Costs and Fuels Growth.”)

For situations in which the company is extremely stressed and on the brink of going under, short-term measures include postponing or canceling capital investments, freezing new hires and salary increases, and improving working capital. Management teams can also reach out to financing partners and ask for a short-term infusion of capital to maintain enough liquidity to continue operating. More broadly, companies at this stage need to generate a fully transparent view of their true liquidity situation. Detailed data at the level of individual business units and entities is critical for the company to make accurate short-term forecasts. In addition, companies need to understand the legal requirements of various options. For this reason, many organizations set up a liquidity office that collects, synthesizes, and reports this data directly to the C-suite and board.

### Funding the Journey

Once the immediate crisis is over, companies can shift away from the

## A RETAILER CUTS COSTS AND FUELS GROWTH

A large international grocer was struggling with increased competition from discounters and online retailers. Its operations were overly complex, and its costs were too high. After decades of strong growth, the company lost considerable market share and half its profits in just three years—along with the trust of its customers.

In response, the company launched a full transformation program, which included:

- Improving promotions, thus freeing up \$250 million that it reinvested to boost sales growth
- Generating efficiencies across

the supply chain, saving \$75 million in annual operating costs

- Resetting product categories and renegotiating contracts with suppliers to focus on top sellers
- Rebuilding customer perceptions, leading to a 4% increase in sales (and significantly outperforming the market)

Collectively, these measures delivered \$500 million in cost savings, new revenue, and profit over the first 18 months of the transformation, helping the company regain its leadership position in the market.

intense focus on short-term liquidity and adopt broader measures to generate the capital needed to fund the forward-looking initiatives. Those measures—which typically generate results in 3 to 12 months—fall into several broad categories: revenue increases, organizational simplicity, capital efficiency, and cost reduction.

(For more, see the chapter “Funding the Journey.”)

Although companies tend to focus on cost reductions and capital efficiency at this stage, we find that measures to boost revenue and simplify the organization often have similar short-term effects and lead to more sustainable improvements. Measures to increase revenue include reorienting the sales force to sell the most attractive products,

identifying the most promising customer segments, and improving pricing. Organizational measures include simplifying the corporate agenda to focus on only a few critical areas, tasking the right people to oversee them, and clarifying roles and responsibilities. Removing management layers is also a powerful short-term tool to cut internal bureaucracy and complexity. (See the sidebar “A Vehicle Manufacturer’s Turnaround Generates \$700 Million in Savings in One Year.”)

## Winning in the Medium Term

As the company shifts to winning in the medium term, management will need to address four principal areas:

- **The Value Creation Strategy.** In most cases, companies find themselves in a crisis specifically because they had the wrong strategy in place. Accordingly, management teams need to understand the root causes of their current situation, where their previous strategy went wrong, and how they can then improve it. A strategic reboot entails addressing bedrock questions: What are the company’s most profitable products and services? How can the portfolio be reoriented

### A VEHICLE MANUFACTURER’S TURN-AROUND GENERATES \$700 MILLION IN SAVINGS IN ONE YEAR

A \$10 billion heavy-vehicle manufacturer was struggling to earn sustainable profits in a highly cyclical industry. A downturn led to consistent losses that threatened the long-term viability of the business.

To save the company, management launched a turnaround that focused on dramatically reducing costs and boosting sales, in part through an emphasis on aftermarket vehicle parts.

The company reduced head count by 25%. It generated more than 3,000 ideas about how to reduce product costs. And it rolled out a new pricing structure and boosted its market share in some segments from 35% to 50%. Overall, the measures led to \$700 million in savings in the first year and \$2 billion in margin improvements in the first three years (70% more than the company’s original savings target).

around them? What should the company include in its portfolio of products and services? Who are its target customers? In which geographic markets and steps in the value chain should it operate? And—critically—what does it clearly do better than the competition, in a way that leads to sustainable value creation? Collectively, the answers to these questions will enable a strategic repositioning and a long-term viable strategy, potentially including new products, services, and markets. (See the sidebar “A Technology Company Quickly Transforms Itself to Boost Value Creation.”)

- **Organization Structure.** With the right strategy in place, the company can turn to creating the right organization structure to execute. This process entails assessing how the company should arrange its business functions and units—both vertically (the number of management layers and spans of control) and horizontally (the segmentation

## A TECHNOLOGY COMPANY QUICKLY TRANSFORMS ITSELF TO BOOST VALUE CREATION

A leading global technology company was under pressure because of slowing growth and increased competition. In response, the company launched a detailed diagnostic to identify critical priorities. On the basis of those results, it developed a full transformation program to streamline the company’s cost structure and processes, build new capabilities, and increase margins.

Specific measures included:

- Reducing the size of the workforce to match the future revenue base

- Increasing efficiency across the organization to sustain innovation with fewer resources
- Improving pricing practices and discipline to increase margins
- Aligning sales and executive compensation with the right performance metrics

Within the first year, the company had reduced its run rate operating costs by more than \$1 billion.

of business units). Companies may need to make sizable changes to support the new strategy, such as closing or divesting noncore divisions, realigning or consolidating business units, and making other moves aimed at improving the way the company creates value. Similarly, it will need to address its geographic footprint and spans of control. And it will need to determine the right level of outsourcing. (See the sidebar “A Contractor Survives Thanks to a Nine-Month Turnaround.”)

- **Operational Processes.** In tandem with decisions about the right organization structure, the company will need to determine how to

## A CONTRACTOR SURVIVES THANKS TO A NINE-MONTH TURNAROUND

A contractor in Europe was struggling in the face of market conditions and a series of increasingly large one-time hits and revenue shortfalls. In 2014, the chair of the €2 billion company became concerned about the economic viability of the business and asked BCG to conduct a fast diagnostic of the situation, focusing on project risks, cash flow, and cost efficiency.

After the initial triage and assessment, the board determined that the company’s cash flow projections were at risk, to the point where a bank would likely take control of the company in weeks.

In response, the company launched a comprehensive

turnaround effort. Over the next nine months, it eliminated €40 million in overhead, removed two layers of the organization, and launched a new operating model. A thorough review of the balance sheet unlocked significant net working capital within four months. For the riskiest projects in the portfolio, the company added new management processes and other tools to reduce the downside. One country unit that was losing €20 million a year was restored to profitability. Another business unit was sold.

revamp its operational processes in order to support the strategy. By rethinking processes from the ground up, companies can retool them to deliver greater cost efficiencies in terms of material, personnel, and other operational expenses. For example, companies have successfully lowered their costs by increasing efficiency, producing more with the current level of staffing, and improving their effectiveness in areas like procurement and pricing.

In addition, the company needs to translate its overarching strategy into a new business model, with corresponding changes to how it goes to market and how it can best get products and services to market, all with the objective of increasing sales. Technology is typically a key factor in improving operations in this way.

- **Financial Considerations.** Fourth—and most important—the company will need to look at the financial implications of all decisions in the first three areas (strategy, structure, and operations). The company’s future target state should be summarized in a comprehensive business plan, including balance sheet structure, cash flow statement, and P&L. The company needs to quantify the benefits that each underlying measure included in the turnaround or restructuring will deliver to the company’s bottom line.

In some turnaround or restructuring cases, companies will need to secure additional capital in order to execute the transformation. (Successful funding-the-journey measures are often, but not always, enough.) Improving the capital structure of the company might also require extending the terms of its existing debt, stopping payments temporarily or even negotiating a “haircut,” in which lenders waive their rights to some of the payments they are due. (See the sidebar “A Bank Restructures to Regain Its Footing After the Financial Crisis.”)

## Organizing for Sustained Performance

Implementing turnaround and restructuring programs is extremely challenging in that management needs to fix the business as it continues to operate the business (often with scarce resources). Our experience shows that success comes from prioritizing several initiatives:

- **Create transparency for leaders.** Use the principles of change management to provide senior leaders with true operational

## A BANK RESTRUCTURES TO REGAIN ITS FOOTING AFTER THE FINANCIAL CRISIS

During the financial crisis, a large European bank needed an infusion of capital from the government to avoid bankruptcy. The bank's problems were clear: a weak business model, low profitability, complex and costly operations, and significant toxic assets in its portfolio. After the crisis ended, the bank had to get back to profitability.

In response, the bank launched a major turnaround effort, including a new business

strategy and a cost reduction of 30%. The bank shut down unprofitable units, sold most of its subsidiaries, and walled off toxic assets into an internal "bad bank" (reducing its exposure by more than 90%).

Through these dramatic measures, the bank returned to profitability in just three years, reduced its balance sheet by half, and paid back a big chunk of the capital infusion within five years.

insight through meaningful milestones and objectives for critical strategic initiatives. Such focus creates transparency into emerging issues and gives leaders the opportunity to correct course before problems become intractable, when small measures can have a big effect on the likelihood that a measure will achieve its target impact. This transparency regarding the status of the initiative also quickly gives company leaders a shot of self-confidence as they start to see it take root and generate results each week, with capital flowing to the bottom line and the company moving quickly in the right direction.

- **Institute smart and simple processes.** Establish program-level routines and processes that track these milestones and objectives systematically and communicate progress without adding undue burdens or usurping the businesses and functions executing the work.
- **Foster talent and capabilities.** Develop and nurture the right technical, strategic, business management, and leadership skills and capabilities within the organization. This is particularly important in periods of stress to ensure that the company retains key talent.

- **Develop a culture of change.** Actively build organization-wide support for—and commitment to—strategic-initiative implementation and change management as a real competitive differentiator.
- **Establish a PMO.** In our experience, an “iron fist” PMO plays a vital role in helping to coordinate and facilitate the steps of a turnaround or restructuring, leading to greater success in implementing strategic initiatives. This is particularly true for initiatives that cross business lines in the organization, where accountability and oversight need to be clear.

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## 9. Transformation in Emerging Markets

**E**merging markets have driven growth for many multinational corporations (MNCs) for years, and they will continue to do so. But these are turbulent times, as commodity prices plunge, currencies are devalued, and equity markets gyrate. The profitability of many MNCs' operations is already under attack, and future performance will be challenged by slower macroeconomic growth, increased costs, and heightened competition from local companies, which are rapidly gaining scale, experience, and capabilities. To reduce these pressures, MNCs will have to focus much more on improving their competitiveness through constant productivity gains.

Most MNCs have emphasized revenue growth in emerging markets at the expense of other metrics, such as operating margins. Shifting the emphasis to include profitability requires implementing process discipline, leveraging scale, and instituting behaviors that focus on constantly improving efficiency. Such changes are not easily achieved. For many MNCs, a fundamental transformation will be necessary, executed market by market.

### The Transformation Imperative

The shifts taking place in emerging markets are big, structural, and long term. As macroeconomic growth slows and competition rises, improved productivity is a critical capability that will allow MNCs to continue to increase revenue and profit and gain share. Our MNC clients today talk continually of the need to make operations in emerging markets as productive as those in developed markets. Given such issues as smaller scale and volatile political and economic environments, this is a tall order—and certainly not one to be underestimated. Moreover, companies in many markets should adopt an entrepreneurial approach and find innovative ways to overcome challenges related to talent, infrastructure, and the regulatory environment, rather than wait for governments or others to solve structural problems. (See *Overcoming Asia's Obstacles to*

*Growth: How Leading Companies Are Reshaping Their Environment*, BCG report, September 2015.)

Shifting focus away from growth alone toward a combination of growth and rapid, steady productivity gains requires changes in both strategy and execution. It also usually requires a shift in the way that both global and local management thinks about goals, processes, and governance.

Many MNCs will have to undertake a process of transformation in emerging markets. As we have discussed throughout this publication, transformations are not just for troubled companies; they have become necessary interventions in many, if not most, corporations. Less than half of BCG clients that have undergone a transformation effort over the past decade had been chronic underperformers, and more than half had been market leaders.

Because of their comprehensive nature and the need for companies to implement them quickly, transformations are complex endeavors. Most of them fail either to fully capture the potential value or to embed new behaviors and processes in the time allotted. The risk of failure in transformations in emerging markets is even greater. As we observed recently, only about 10% of companies believe they have the full complement of capabilities required to win overseas. Most think they are barely mastering the basics. (See *The Globalization Capability Gap: Execution, Not Strategy, Separates Leaders from Laggards*, a Focus by BCG and IMD business school, June 2015.) Moreover, while many companies get their broad globalization strategies right, they come up short on execution in individual markets. Issues related to execution were where our research found the biggest gaps between leaders and laggards.

MNCs should move quickly, but they should also advance with care. The biggest mistake they can make is to pursue a transformation driven by headquarters that tries to standardize and centralize processes and operating procedures for all markets. MNCs are much better advised to approach the challenge one market at a time, starting with a high-profile struggling market and experimenting with what works there.

## Transforming Local Operations

Historically, rapid growth in emerging markets allowed most companies to support behaviors such as approving investments without defined

returns or time frames, extensively customizing products, imposing limited process discipline, and building up teams in anticipation of future growth. A growth bias was vital to capturing share in markets that were expanding at breakneck speeds. Disciplines such as applying proven practices, cost containment, and investment prioritization were secondary considerations, partly because local organizations were overwhelmed just keeping up with their growth.

MNCs need to rethink and rebalance tradeoffs in their priorities, products, systems, and people as they seek to improve their competitiveness by moving from greater centralization to strengthening local accountability. In our experience, this sort of rebalancing is best achieved through a four-step transformation process:

- Resetting the strategy to focus on competitiveness
- Funding the journey by restructuring the local organization to make it leaner and more accountable
- Winning in the medium term through process and functional excellence—eliminating waste and simplifying, standardizing, and automating
- Establishing the right teams, platforms, and behaviors for longer-term competitiveness

**Resetting the Strategy to Focus on Competitiveness.** MNCs need to shift their focus from purely maximizing growth (typically accomplished by investing in all sizable emerging markets) to determining which emerging markets offer the best potential for establishing leading positions and achieving above-average profitability.

We have worked with many clients making such decisions. For example, one global medical-equipment manufacturer made its emerging-market plans on the basis of the projected number of devices to be sold ten years out. A global industrial-equipment manufacturer launched a massive expansion of its operations in China despite profitability concerns—in order to put pressure on local competitors in their home markets.

While the assessment of growth potential remains critical, MNCs' strategy also has to focus on profitability and returns on investment.

More and more, companies are asking such questions as, What is the investment risk in each of our markets? Which customer segments can we serve competitively? Do we have product segments in which slowing growth and declining profitability may threaten the viability of a business unit?

The biggest difference between past and future assessments needs to be a more radical examination of the actual competitiveness of the MNC's local operation in each market and segment. The best companies will know exactly how big the cost differentials are between their operations and those of their strongest local competitors. They will develop a systematic approach to gaining local competitive intelligence, regularly analyze their competitors' offerings (often by reverse engineering them), and assess the strategic and operational gaps.

For example, some MNCs undertake regular market-by-market analyses of their economics versus those of their local competitors in order to truly understand where their own advantages—and disadvantages—lie. (See Exhibit 1.) These companies have often found that their costs of goods sold are at least 20% higher than those of their principal local competitors because of product design and material costs. Their compensation costs are also higher because higher labor productivity only partially offsets higher pay packages. The companies use these insights as the basis for restructuring their local activities to address competitive weaknesses.

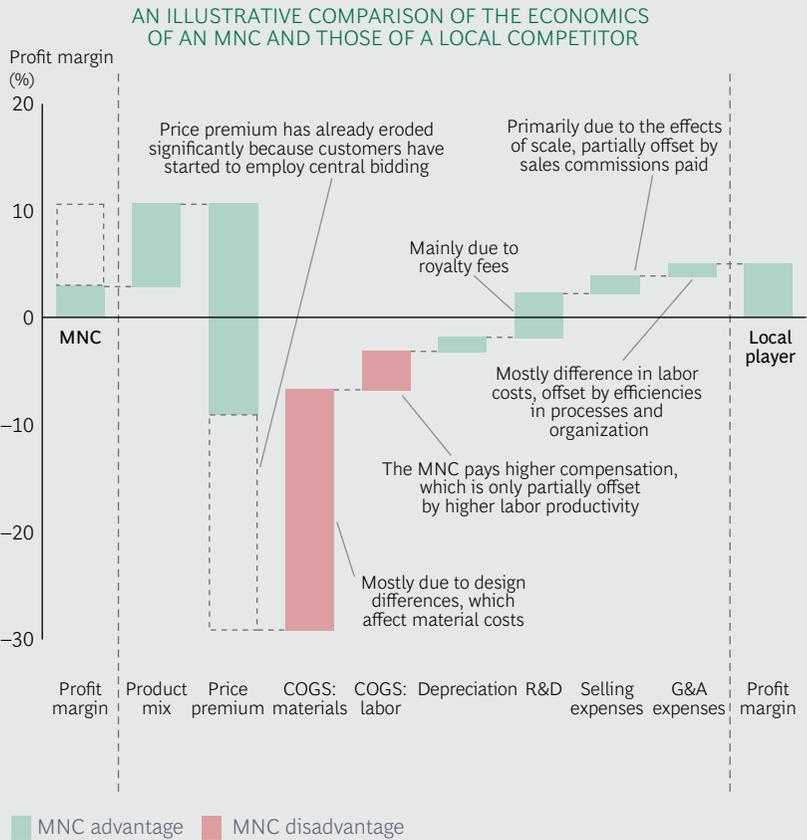
Another manifestation of this shift will be developing new ways to think about portfolio management. Many companies have developed a broad portfolio of offerings in emerging markets, often with individual products tailored for individual countries. These products lack the scale necessary to make a significant contribution to global results. This approach has been a big driver of growth, but a tougher outlook now requires a different kind of product portfolio management.

Leading companies are now applying a much sharper definition to targeted segments in order to assess products' cost-effectiveness. They are systematically using target costing to further ensure competitiveness, often setting targets of 30% to 50% less than that of the previous product. And they are rethinking how they can adapt offerings from one emerging market to others and thus gain scale advantages.

**Funding the Journey with a Leaner Organization.** Transformations take time, and local operations must continue contributing to results even while priorities are redirected. MNCs should take an outside-in look at their organizations and cost structures, as if examining the company through the eyes of a private equity buyer. After years of chasing growth, many local organizations are neither sized nor organized optimally for a tougher market environment.

The resulting restructuring often includes delayering of the local organization to make it leaner and faster, reducing back-office personnel,

**EXHIBIT 1 | MNCs Need a Clear Understanding of Competitive Economics in Emerging Markets**



Source: BCG analysis.

Note: COGS = cost of goods sold; G&A = general and administrative; MNC = multinational corporation.

lowering the dependence on expatriate executives, and rebuilding the leadership team to ensure that high-performing people are in high-impact positions when more fundamental work on process and functional excellence starts. Putting people with a strong competitive and entrepreneurial mindset into new leadership roles is vital.

**Winning in the Medium Term with Process and Functional Excellence.** While many companies have systematically replicated their manufacturing processes in new plants in emerging markets, the establishment of process excellence in other parts of the organization has been slow. Scores of manufacturing, quality, and engineering expatriates are normally sent to a market to build new facilities according to global blueprints and to establish strict process discipline. But in other key functions, such as procurement, sales, and logistics, we have found either that there are often no process definitions or that the definitions aren't thoroughly followed in emerging markets. Equally often, there is good reason for this: emerging markets need adapted processes, especially in externally facing functions; it isn't possible (nor is it a good idea) to simply copy global models as one copies a building design.

More and more, companies have to recognize that they should establish process excellence across all their functions in all emerging markets. For some processes, they must stringently foster global standardization; for others, they should require their local units to improve process transparency, discipline, and quality but adapt all of these qualities to local circumstances. Some companies are even starting to use emerging markets as pilots for completely new definitions of processes, especially in the area of digitization. Emerging markets can have distinct advantages in this regard: there are few embedded legacy processes or cultures to combat, and these markets are often technology savvy, so digitally enabled, leaner processes can be deployed with relative ease.

For example, one company operating in China through a joint venture launched a two-year productivity improvement program for all nonproduction processes, with the goal of optimizing them to be as effectively run as factory processes. Although most processes were already defined in some way, a number of employees were not aware of them or not sufficiently trained to do more than “check the boxes” in compliance. The program focused systematically on process redesign, training, new tools, and new governance mechanisms. Clear accountabilities for continuous improvement were also established.

Similarly, another global company recognized that its biggest opportunity in emerging markets lay in optimizing the go-to-market model and pushing a higher level of sales excellence. Starting in one country, the company deployed a systematic approach for reaching consumers more effectively through new channels and new sales management processes. It put enormous effort into training and skill building for sales teams. The approach was copied and moved to other markets one by one, using salespeople from one market to help deploy the program in the next. The company institutionalized the approach in each market by developing and regularly updating a handbook that combined standardized practices with local adaptations.

Getting the balance right between standardization and local adaptation of processes can be tough. In our experience, a general guideline is to be more aggressive in standardization for purely internal processes and to allow more freedom for externally facing ones. (See the sidebar “Go-to-Market Approaches Continue to Be Highly Localized.”)

**Establishing the Right Teams, Platforms, and Behaviors.** Most companies will need to redirect the behaviors of their local teams. The priority in the past was to gear up for growth by investing big in people development and potential needs; now, though, companies now should apply a tight focus on individual performance and accountability for costs.

We find that operations in emerging markets are beset by common problems, such as a limited sense of accountability beyond their own activities on the part of individual managers, little collaboration and a general hesitancy to ask for help, and an absence of cost consciousness.

Addressing these issues requires clarification of roles, KPIs, and targets; explicit efforts to promote collaboration and trust building (including through peer pressure); providing for cost transparency in management information systems, especially in middle-management levels; and making cost control a principal target in annual performance reviews.

It remains critical that local management teams retain, or be given, decision-making ability, but MNCs must clarify the responsibilities that accompany this authority. Too often, in our experience, local managers are clear about day-to-day activities but not about longer-term accountabilities. Companies need clarity about the main targets that local

managers are accountable for, both individually and together with others, and about the changes that managers must promote in order to achieve continuous improvement. This doesn't mean that local managers shouldn't make use of the advantages that their global platforms and capabilities give them; it's a question of striking the right balance between local authority and global support.

Most MNCs also need to retool their recruitment and training efforts, as well as their incentive programs, tying them all more closely to productivity improvement goals. For example, many employees in emerging markets spend a few years in an MNC, a significant portion of which is occupied by training programs, and then leave. In the future, training might have to de-emphasize formal classroom-type sessions in favor of on-the-job coaching.

Perhaps most important is rethinking the role of both expatriate and local executives in management. Expatriates in emerging markets should take the role of team builders rather than line managers. This happens in many companies, but most can go further, making expatriates accountable for developing strong local managers by actually transferring skills and know-how rather than simply meeting short-term KPIs. This is far from easy. Placing real responsibility in the hands of often-untested executives is difficult for many companies. Shifting from an executive role to a team-building or advisory role is often a tough transition for expatriate executives. But transformation is substantially about culture; putting local managers in key leadership positions is a big cultural shift for many companies and sends the entire organization a strong message of accountability for results (while at the same time leading to cost savings, thanks to fewer high-cost expatriates).

### Getting Started—One Country at a Time

In 2013, a BCG survey of more than 150 senior executives of MNCs revealed an eye-opening disconnect. (See *Playing to Win in Emerging Markets: Multinational Executive Survey Reveals Gap Between Ambition and Execution*, BCG Focus, September 2013.) More than three-quarters, or 78%, of respondents said that their companies expected to gain share in emerging markets, but only 13% were confident that they could take on local competitors. Not a single company stated that it had all the capabilities required for success. The biggest concern was not the ambition but the ability to execute locally. Our observations since then

## GO-TO-MARKET APPROACHES CONTINUE TO BE HIGHLY LOCALIZED

While the strength of many internal processes can depend on some level of global standardization and centralization, go-to-market approaches have to be rooted in local circumstances to remain competitive. The commercial success factors in emerging markets can be very different from those in more developed economies. For example, consumer segments are highly heterogeneous and much more fluid in their make-up. Different segments have widely varied needs and financial potential, both of which can be moving targets.

As growth slows and competition increases, it becomes more important for MNCs to understand the commercial environment. MNCs face very different competitive economics than their local counterparts. Product development costs can be much lower, but sales and distribution costs are higher. Companies need to adjust their bases of comparison and adopt new or revised KPIs.

Our analysis indicates that while a local company and an MNC might have similar costs of goods

sold, the local company's selling expenses are often 10% or less of a product's retail price, while the MNC's selling expenses can easily rise to 45%. Higher distribution costs must be offset with aggressive cost savings across other parts of the value chain. (See the exhibit "Cost Competition in Emerging Markets Is Often Not About the Cost of Goods Sold.")

There are many reasons for the disparities.

Emerging markets, especially those that are big and diverse, such as China and India, typically have much less well developed distribution systems. Companies must deal with a multistep regional, municipal, and local system, with players of widely varying competence and capability at each step. This adds to cost. MNCs also have to pursue multichannel distribution models and dealer networks to extend beyond tier 1 cities, maximize reach, and avoid coverage gaps. Distribution in such markets may involve accepting some level of sales cannibalization and dealing with distributors that also carry competitors' products.

## GO-TO-MARKET APPROACHES CONTINUE TO BE HIGHLY LOCALIZED (CONTINUED)

Retail sales are another issue. Many developing countries have large rural populations or populous secondary cities. Some 636 million Chinese lived in rural areas in 2013. India has 400 cities with populations of 100,000 or more. In Brazil, consumers in interior regions are expected to account for more

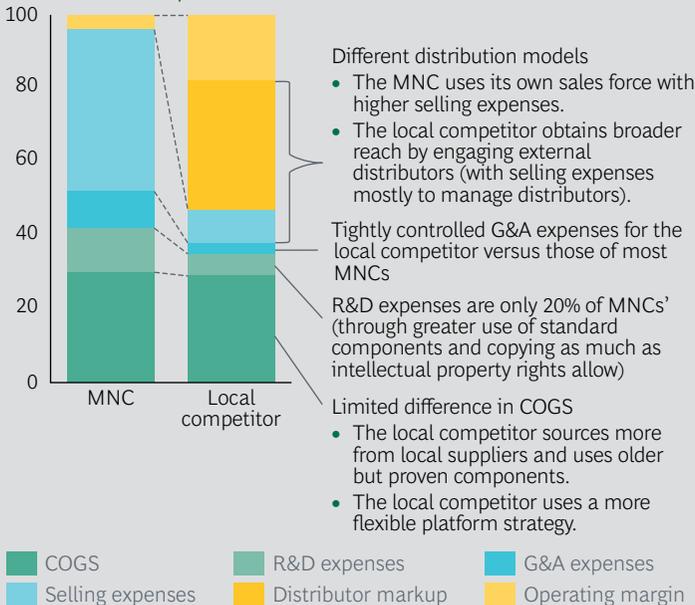
than 45% of growth in the retail sector, or \$60 billion in new purchases, through 2020. Such markets have widely varying, and often undeveloped, retail infrastructures.

Internet sales (which in many markets really means mobile commerce) are a big and

### Cost Competition in Emerging Markets Is Often Not About the Cost of Goods Sold

#### AN ILLUSTRATIVE EXAMPLE OF AN MNC AND A LOCAL COMPETITOR

% of market or street price



Source: BCG analysis.

Note: The local competitor's cost structure was adjusted to reflect a percentage of the market price.

Note: COGS = cost of goods sold; G&A = general and administrative; MNC = multinational corporation.

increasingly important factor in reaching these new customers. China has more than 730 million internet users and more than 380 million online shoppers. More than 16 million consumers from the country's tier 3 and tier 4 cities are using mobile internet. (See "The Chinese Digital Consumer in a Multichannel World," BCG article, April 2014.) Alibaba already has more sales than Amazon and eBay combined. The next wave of growth in India's online population will add up to 550 million new internet users, including large percentages of older, more rural, and female consumers. (See "The Changing Connected Consumer in India," BCG article, April 2015.)

In large developing markets, MNCs may benefit from new capabilities that target small geographic markets embedded in second- or third-tier cities. (See "Street-Level Segmentation

in India: Winning Big by Targeting Small," BCG article, December 2015.)

Rural markets and multistep distribution also mean that companies are a long way from their customers. It's easy to lose contact or to have to rely on second- or third-hand information about developments in local markets. Local staff or representatives make a big difference, and MNCs should make bigger investments in managing relations with and monitoring the performance of distributors and dealers. All of this entails another layer of cost.

Compensation models can also be very different in emerging markets. In Europe, for example, the variable component of compensation is usually less than half of the total. In many emerging markets, compensation is often 100% variable or incentive based.

**indicate that not much has changed—except the urgency with which many MNCs must address their emerging-market operations.**

**Emerging-market transformation has to start in one local market (or at most two or three) to ensure that it addresses gaps in local competitiveness and that a robust methodology is developed for subsequent rollout throughout the company. Once one market demonstrates results and positive momentum, the approach can be transferred to other countries.**

To take advantage of lessons learned in the first country or countries, companies should use the same templates and tools. They can develop handbooks and lessons for fast learning and ensure some continuity by transferring people who have experience with the approach to the transformation management team.

For many large global companies, this is not only the right time to rethink the operational models they deploy in emerging markets, it's the essential time. The kind of global transformation we propose better adapts the company to local circumstances and strengthens its competitive capabilities worldwide. MNCs must become "multilocal" players if they want to succeed.

MNCs should ask themselves the following questions:

- Do we need some minor fine-tuning of activities in emerging markets or a more fundamental reset?
- Are the tradeoffs we make regarding investments, product portfolios, process excellence, and people development still valid?
- How do we want to approach the transformation of operations to ensure immediate results and a fast global rollout of the program?

Growth in emerging markets will continue, but only for companies that are set up to be competitive and that make growth profitable. In the changing world of emerging markets, this will become the new definition of winning.

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This article draws on the following BCG publication:

*Transformation in Emerging Markets: From Growth to Competitiveness*



# Note to the Reader

## **For Further Reading**

### **Acting on the Digital Imperative**

An article by The Boston Consulting Group  
September 2016

### **Building Capabilities for Transformation that Lasts**

A Focus by The Boston Consulting Group  
June 2016

### **How Nordic Boards Create Exceptional Value**

A Focus by The Boston Consulting Group  
June 2016

### **Transformation in Emerging Markets: From Growth to Competitiveness**

A Focus by The Boston Consulting Group  
February 2016

### **The Double Game of Digital Action: Structuring the Program**

An article by The Boston Consulting Group  
January 2016

### **A Leader's Guide to "Always-On" Transformation**

A Focus by The Boston Consulting Group  
November 2015

### **How to Jump-Start a Digital Transformation**

A Focus by The Boston Consulting Group  
September 2015

### **The New CEO's Guide to Transformation: Turning Ambition into Sustainable Results**

A Focus by The Boston Consulting Group  
May 2015

**Transformation: The Imperative to Change**

A report by The Boston Consulting Group

November 2014

**Growth for Free: Embracing the Go-to-Market Revolution**

An article by The Boston Consulting Group

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**When the Growing Gets Tough, the Tough Get Growing**

A Perspective by The Boston Consulting Group

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**Taking a Portfolio Approach to Growth Investments**

A Perspective by The Boston Consulting Group

July 2014

**Time to Reengage with, Not Retreat from, Emerging Markets**

A Perspective by The Boston Consulting Group

May 2014

**Surviving the Sophomore Slump: The Moves That Matter Most**

An article by The Boston Consulting Group and Spencer Stuart

March 2014

**Beyond Cost Cutting: Six Steps to Achieving Competitive Advantage Through Cost Excellence**

A Focus by The Boston Consulting Group

August 2013

**Changing Change Management: A Blueprint That Takes Hold**

A report by The Boston Consulting Group

December 2012

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