

# Organizational health: A fast track to performance improvement

Working on health works. It's good for your people and for your bottom line.

*by Chris Gagnon, Elizabeth John, and Rob Theunissen*

**The central idea** underlying our organizational work for the past decade has been that the best way to run a business is to balance short-term performance and long-term health.

Healthy companies, we know, dramatically outperform their peers. The proof is strong—the top quartile of publicly traded companies in McKinsey's Organizational Health Index (OHI) delivers roughly three times the returns to shareholders as those in the bottom quartile—so strong, indeed, that we've almost come to take it for granted.

But now we see new, longitudinal evidence that redoubles our conviction. Companies that work on their health, we've found, not only achieve measurable improvements in their organizational well-being but demonstrate tangible performance gains in as little as 6 to 12 months. This holds true for companies across sectors and regions, as well as in contexts ranging from turnarounds to good-to-great initiatives.

Our recommendation is clear: start managing your organizational health as rigorously as you do your P&L, providing pathways for leaders at all levels to take part and embedding and measuring the new ways of working.

## HEALTH AND THE BOTTOM LINE

We think of organizational health as more than just culture or employee engagement. It's the organization's ability to align around a common vision, execute against that vision effectively, and renew itself through innovation and creative thinking. Put another way, health is how the ship is run, no matter who is at the helm and what waves rock the vessel.

### The case for health

Over the past ten years, we've monitored the health of more than 1,500 companies across 100 countries. We do this by aggregating the views of their employees and managers (more than four million to date) on management practices that drive nine key organizational dimensions—or “outcomes,” as we call them. We assign scores to each practice and outcome, allowing a company to see how it compares to others in the database.

We've long seen a strong, static correlation between health and financial performance. But our latest research is more dynamic: it highlights the potential for the vast majority of companies to *improve* their health and how this can correspond with enhanced performance. Our findings include the following:

- *Almost all companies perform better if they improve their health.* Around 80 percent of companies that took concrete actions on health saw an improvement, with a median six-point increase in their overall health (Exhibit 1). The majority of these companies moved up an entire quartile against all other companies in our database. Over the same period that the companies in our sample were making changes to their health, their earnings<sup>1</sup> and total returns to shareholders (TRS) were also increasing disproportionately—by 18 percent and 10 percent, respectively (against an average 7 percent increase in earnings and an average 9 percent increase in TRS for those companies in the S&P 500).
- *The unfit are the most likely to make the biggest health advances.* After working on their health, companies in the bottom quartile saw a 9-point health improvement, with notably strong improvements in the company direction (+17 points) and innovation and learning (+14 points) outcomes. This group of “health workers” made progress across every outcome.

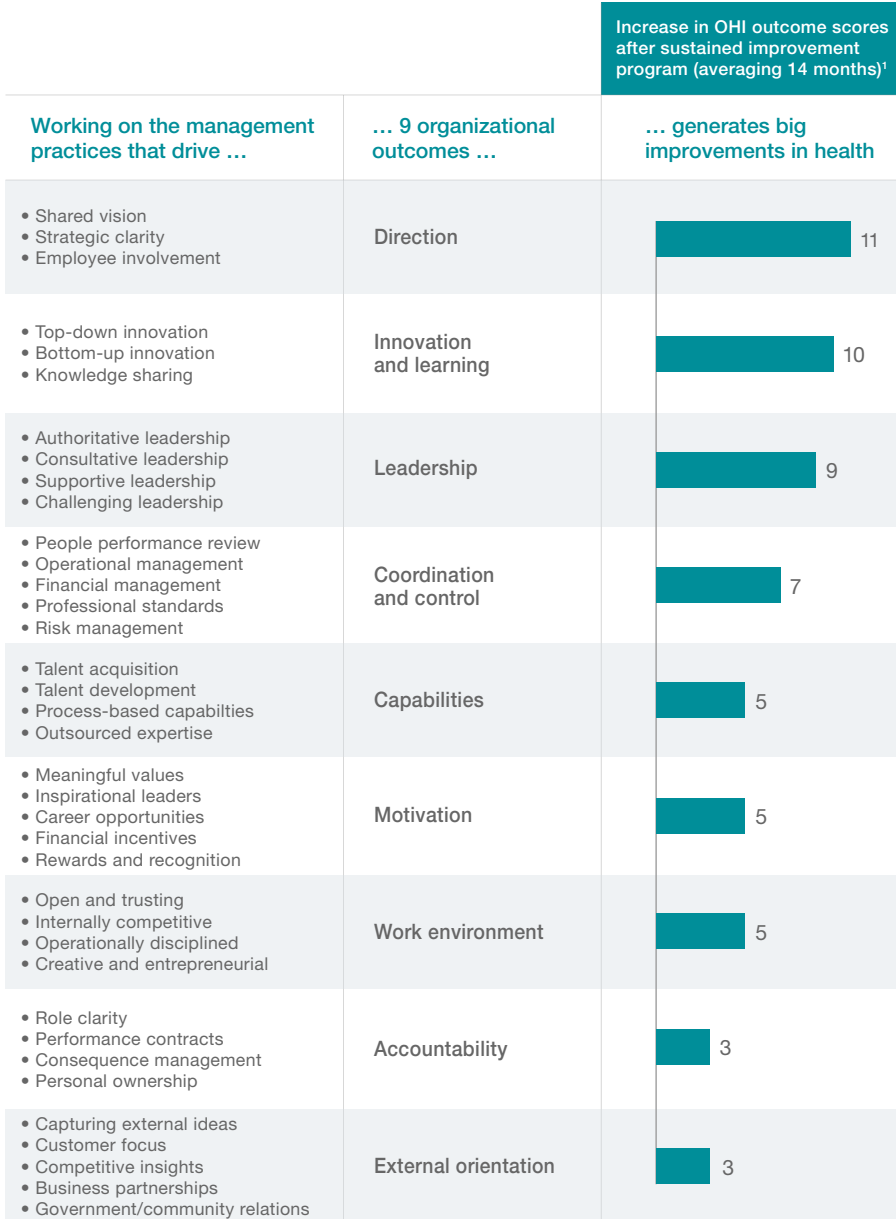
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<sup>1</sup> The earnings metric we used for this analysis was earnings before interest, taxes, depreciation, and amortization (EBITDA).

- *Those at the top achieve the biggest financial rewards.* Companies whose health-improvement efforts took them from the second quartile of the OHI to the top quartile recorded the biggest financial-performance boost, a clear sign that working on health is an important factor in going from “good” to “great.”

Exhibit 1

**Companies that take concrete actions to improve their health can deliver impressive results.**



<sup>1</sup>OHI = Organizational Health Index; n = 64 companies with 252,339 individual respondents; start and end dates differ for each company.

Could the causality run the other way? In other words, when companies improve their financial performance, might their people align, execute, and renew better and therefore be more likely to identify healthy changes in the characteristics of their organizations? In theory, yes. In practice, though, we've seen the opposite, over and over again. Consider, for example, the experience of a European entertainment company: Over the past three and a half years, it's moved from the third quartile of the OHI to the top decile. Financial performance has improved dramatically during that period as well (its market share is up 7 percent, customer volume is up 15 percent, and EBITDA is up 85 percent). But when the company was acquired recently by a larger competitor, it was the improvement in health that particularly stood out. The acquirer's CEO said that, in his mind, organizational health accounted for at least 10 percent of the entertainment company's value. Health, in short, isn't some survey artifact; it's something you can see and feel when you're inside a healthy company and a prerequisite for sustained performance.

### Speed and rigor

Given all the data and practical experience that supports working on health, companies' obsession with the P&L alone continues to puzzle us. It's right that leaders manage their P&L meticulously, but why not do the same for their health? In fact, why not measure health frequently throughout the year, since it's a leading indicator of performance, whereas financial results are a lagging one? Similarly, why do the vast majority of employee-performance dialogues focus on progress against financial targets, and not on whether behavior is contributing to organizational health?

In private conversations, executives often confess to being quite torn on this issue. They of course want a healthy organization, but they worry about how long it will take to realize tangible benefits from efforts to improve health and about distracting people from other mission-critical priorities. Our experience suggests that these concerns are misplaced. Just as anyone can compete in a 5K race if he or she trains properly, so too can companies be conditioned to improve their health in a short period of time—and those improvements can reinforce those mission-critical priorities.

The key to speed is a rigorous approach. This starts with making the quest for organizational health an integral part of forward-looking leadership: senior leaders need to consider themselves architects, not passive bystanders. Then it means integrating health into monthly and quarterly performance reviews, with data to show how both are trending versus targets. Supporting priorities include tying financial incentives to accomplishing health goals;

creating and holding accountable a health team dedicated to embedding the right behaviors in the organization; and weaving health into the performance initiatives already under way.

## **A FOCUSED APPROACH TO ACHIEVING ORGANIZATIONAL HEALTH QUICKLY**

So how do you make health gains quickly? In our experience, there are four areas forward-looking leaders must invest in to build a healthy, performance-driven organization (besides, of course, ensuring that they are fully aligned on the business strategy; strategic and organizational misalignment are a surefire path to poor health and general operating dysfunction). The first, most important step is choosing the performance culture—or what we call the “recipe”—that will best drive their organization’s performance. Then it’s about moving to adopt that recipe as quickly as possible, addressing the mind-sets that will drive new forms of behavior, building a committed team of people at all levels to get involved, and, finally, developing fast feedback loops to monitor progress and course correct if necessary. These actions will help companies target resources on the right priorities, move swiftly, and make the new habits stick.

### **Pick a health recipe**

It’s clear that there is no such thing as a single winning performance culture. But based on our OHI analysis, we have identified four combinations of practices (or “recipes”) that, when applied together, drive superior health—and quickly. We call these four the Leadership Factory (organizations that drive performance by developing and deploying strong leaders, supporting them through coaching, formal training, and the right growth opportunities); the Continuous Improvement Engine (organizations that gain their competitive edge by involving all employees in driving performance and innovation, gathering insights and sharing knowledge); the Talent and Knowledge Core (organizations that accelerate their performance by attracting and inspiring top talent); and the Market Shaper (organizations that get ahead through innovating at all levels and using their deep understanding of customers and competitors to implement those innovations).

They all sound pretty good, right? The reality is, though, that organizations can’t do all of them, which is why a focus on *one* of them will lead to better and speedier results. Our research shows that when organizations are closely aligned to any one of these four recipes, they are six times more likely to enjoy top-quartile health than companies with weak alignment or diffuse efforts (Exhibit 2). Achieving such alignment requires focus on a small set

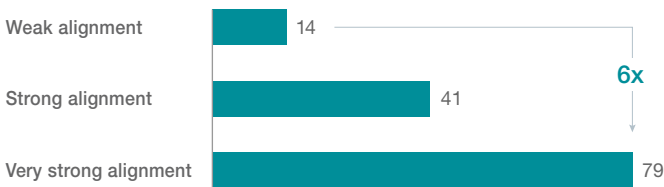
Exhibit 2

While there's no such thing as a single winning performance culture, any one of four 'recipes' can produce superior organizational health.

4 recipes for organizational health (combinations of management practices)



% likelihood of top-quartile health based on strength of alignment with any 1 of 4 organizational-health recipes<sup>1</sup>



<sup>1</sup>68% of sample had weak alignment, 22% had strong alignment, and 10% had very strong alignment; n = 501 organizations with 1,539,047 individual respondents.

McKinsey&Company | Source: Organizational Health Index by McKinsey

of organizational-health practices (usually no more than five to ten) that work in concert with each other. Contrast that with what happens more commonly: leaders in various parts of the business copy different external “best practices” across myriad management disciplines. This approach diffuses people’s efforts, can easily result in conflicting approaches, and hinders development of the sort of common performance culture that connects employees regardless of where they sit.

A family-owned Asian conglomerate faced this very challenge: People across the organization employed “best practices” from multiple sources and were adapting them in different ways. As the conglomerate’s leaders sought to change its conservative, risk-averse culture to a more innovative and entrepreneurial one, they began placing greater emphasis on organizational health and chose the Continuous Improvement Engine (CIE) recipe to govern their health strategy. Three themes were central to that strategy: improving knowledge sharing across business units, developing

innovation and entrepreneurship, and improving employee motivation. Heads of HR across the business units drove the subsequent learning initiatives under the CEO's sponsorship, launching a corporate academy on innovation, promoting regional innovation conferences, and providing extrinsic motivators such as nontraditional career paths for innovators and entrepreneurs. This consistent and coherent approach led to a nine-point improvement in health.

### **Get to the heart of the mind-sets**

Don't be fooled by the symptom; understand the cause. To create rapid and lasting progress on the set of practices that will drive health, companies have to identify and address the deep-rooted mind-sets influencing employee behavior and then define new ones to replace them.

When seeking to understand and address these mind-sets, we like to use the image of an iceberg popularized by MIT academics Otto Scharmer and Katrin Kaufer.<sup>2</sup> Above the surface (the tip of the iceberg) is the visible behavior repeated and reinforced by the organization every day. Under the surface are employees' thoughts and feelings (both conscious and unconscious); their values and beliefs (the things that are important to them); and their underlying needs, including their fears and the threats to their identity. These below-the-surface factors have to be understood and addressed before shifts in behavior and culture can be realized to drive organizational health.

Once a company has identified the mind-set or mind-sets it wants to instill in employees, it needs a set of actions to change the working environment and drive adherence. Here, McKinsey's long-established influence model defines practical interventions that help structure a way forward.<sup>3</sup> Is there a clear change story to foster an understanding of why a new approach is required? What incentives should be introduced to reinforce that new approach? Are training programs required to improve the skills of people in the organization? Are leaders across the business role modeling the appropriate mind-sets? Being clear on these four dimensions is likely to be critical to the long-term success of a program for improving organizational health.

A global equipment manufacturer was under pressure from cost-competitive entrants, challenging its long run of dominance in a specialized, capital-intensive industry. With the development costs of its most recently released

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<sup>2</sup> See Otto Scharmer and Katrin Kaufer, *Leading from the Emerging Future: From Ego-System to Eco-System Economies*, San Francisco, CA: Berrett-Koehler, 2013.

<sup>3</sup> See Tessa Basford and Bill Schaninger, "The four building blocks of change," *McKinsey Quarterly*, April 2016, McKinsey.com.

product coming in at several times its original budget, the company needed to drive down costs to maintain its market position. Leaders had been trying to address this problem, but their lack of results only led them to more frustration.

The breakthrough came when, supported by the OHI, they realized there were deeply rooted mind-sets across the organization that were holding it back. The leadership team ultimately identified five of these mind-sets—the most important of which was how, historically, the organization had prioritized on-time delivery and product performance, often at the expense of product cost. In practice, engineers felt it was their job to design incredible products, with cost being an output rather than an input. To shift this thinking, the leaders set out to demonstrate that adding value for customers, as well as efficient processes, were just as important as on-time delivery and product performance. They launched a number of highly visible initiatives that gave them the opportunity to role model the appropriate new behavior and highlight the rewards associated with it, then rolled the initiatives out across key parts of the organization—especially in engineering, operations, and supply-chain management.

The company also found simple and low-cost ways to embed the new mind-sets. One of these included giving all employees who attended a health town hall or participated in an initiative a lanyard with a red and green card. The red card shared the company's performance-limiting mind-sets, while the green card shared the performance-accelerating ones it sought to embed. This simple reinforcement made it quickly obvious who had the lanyards and who did not, providing a constant signal for all employees to take part in the program. It also served as a vehicle for providing feedback: in initiative team meetings, employees called out “red” behaviors by holding up their red card, allowing everyone to pause and colleagues to reset their approach. Employees reinforced “green” behavior, too, thereby encouraging others that they were on the right track. Thanks to these steps, the company's current pipeline of products is on track to meet its delivery, performance, *and* cost targets.

### **Engage employees at all levels**

It requires strong leadership and role modeling for change to take hold quickly. But change is not a top-down exercise. Health improvement happens quickly and sustainably when you drive it top to bottom, bottom to top, and side to side. This is best done by engaging a committed community or network of formal and informal influencers.

Influencers exist at all levels of an organization, ranging from assistants to middle managers. Such people often have an oversized impact on motivating



colleagues. They may be rising stars or simply well-liked and enthusiastic team players with a positive attitude. And while in many cases they are not immediately visible to leaders, they can be unearthed via simple survey-based technology that asks employees to identify people who meet the characteristics of an influencer. Companies that map them—the exercise should take no more than one to two weeks—are often surprised by how deep many of these people are within the organization. Such influencers reinforce leadership’s case for change, role model the new mind-sets, collect feedback on what’s going well and what’s not, and excite and engage the front line.

An electronics company in Europe successfully unleashed the power of a group of influencers as part of its drive to become more innovative and customer focused. Employees had been generally upbeat about the transformation, but the company noted that attitudes didn’t change and leaders were struggling to translate their vision into new forms of behavior. Senior leaders therefore identified a minimum of two people in each location or function who were acknowledged and respected by their peers, regardless of their level in the hierarchy, and invited them to help communicate the progress of the transformation, to suggest ways to intervene locally, and to act as role models. They assigned a project manager to coordinate this network of change agents, keeping in touch and checking in with them to facilitate knowledge sharing. Thanks to these influencers’ interventions—sharing information with the front line, taking time to talk to customers and feeding the information back to senior leaders, and calling out colleagues who did not adopt the desired attitudes—substantial behavioral changes began to take hold quickly.

### **Get ‘on the pulse’**

Organizational health is organic, and, like the human body, it evolves over time. If health is to be nurtured and improved quickly, it needs to be monitored and measured regularly. The days of conducting a survey and then waiting 12 months to remeasure are gone. This “on the pulse” measuring strategy, which requires fast feedback loops, pinpoints where course corrections are needed. Simple technology tools that put out one question a day provide real-time measurement while reducing survey fatigue. Weekly health huddles with teams offer instant feedback. And integral performance and health reviews reveal how an organization’s health is evolving in reaction to the actions taken. Leaders, as architects of the effort to improve organizational health, can then make changes to ensure that the new mind-sets are taking hold. High-performing organizations require leaders who can manage performance and health in concert.


A high-performing European telecom company embarked on a digital transformation only to discover that its highly directive and execution-

oriented management approach (a profile that had served it well for decades) was getting in the way of rapid renewal. It was at the bottom of the class in health, according to the OHI, with eight out of nine outcomes in the third or fourth quartile. Recognizing that the company had to be more agile if it was to respond to the industry shifts and technology disruptions, the company's leaders focused initially on four practices aimed at increasing employee motivation and giving the company a new performance edge: rewards and recognition, consequence management, role clarity, and personal ownership.

After three months of using the survey technique of one question a day, the company found that it was making progress across all practices except rewards and recognition. Such a fast feedback loop enabled the team to intervene quickly, celebrate the successes, and revisit its approach to rewards and recognition. As a result, leaders combined their internal learnings with external best practices and redefined their interventions to improve the ways in which they rewarded and recognized high-performing teams and individuals.

A global electronics company took a different approach, introducing a simple survey of no more than ten pertinent questions to check whether critical new practices—such as giving and asking for feedback—were being embedded. The responses, which were shared with and discussed by all the teams, showed which teams were taking the effort seriously. The results of the survey reinforced the right behaviors until they became routine.

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Companies often tell us that, while organizational health sounds like a great idea, it doesn't feel like a necessity to achieving their short-term goals. They also worry that it's going to be too much work. Both reactions are misguided. Far from being a distraction, a focused health-improvement plan should actually help companies achieve their short-term goals. And it will not be an added burden—in most cases, working healthy is doing what you're already doing but doing it differently. It's about redefining how to connect, engage, and communicate with employees. It's about sharing a company's vision and mission in a way that inspires employees to act in its best interests. Above all, it's about adopting a more innovative and effective style of leading, executing, and innovating. Working on health works, and it works quickly. 

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