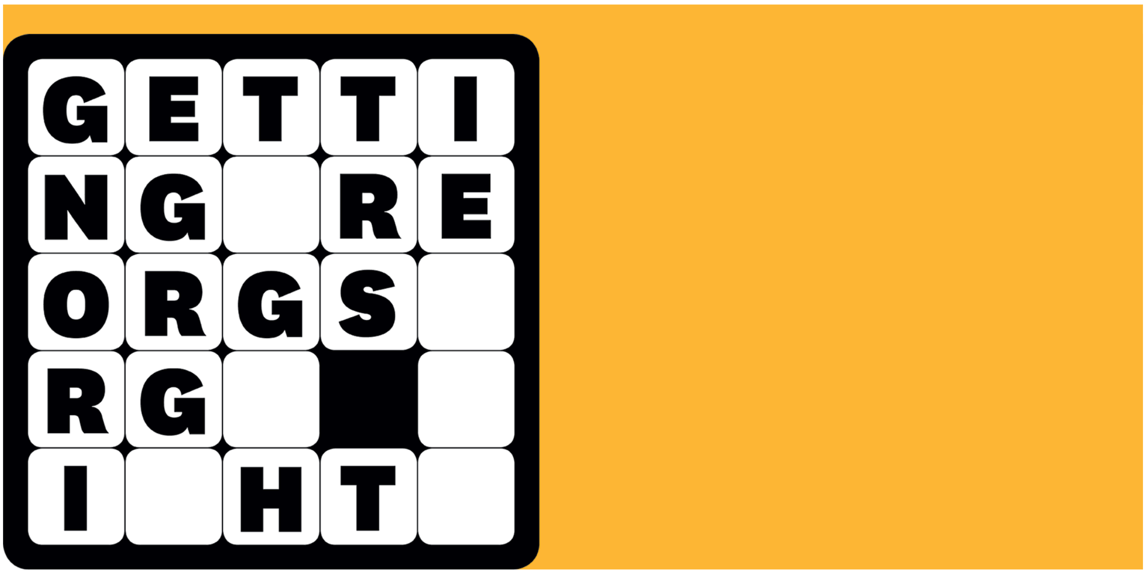
Harvard Business Review




MANAGING ORGANIZATIONS

# Getting Reorgs Right

by Stephen Heidari-Robinson and Suzanne Heywood

FROM THE NOVEMBER 2016 ISSUE

Chances are you've experienced at least one and possibly several company reorganizations. Reorgs can be a great way to unlock value: Two-thirds of them deliver at least some performance improvement, and with change in the business environment accelerating, they are becoming more and more common. As John Ferraro, the former COO of Ernst & Young, told us, "Every company today is being disrupted and so must frequently reorganize to keep up with the incredible pace of change. Those that can do this well will thrive in the current environment and be tomorrow's winners."

At the same time, few reorgs are entirely successful. According to a McKinsey survey we conducted, more than 80% fail to deliver the hoped-for value in the time planned, and 10% cause real damage to the company. More important, they can be damned miserable experiences for employees. Research suggests that reorgs—and the uncertainty they provoke about the future—can cause greater stress and anxiety than layoffs, leading in about 60% of cases to noticeably reduced productivity. In our experience, this occurs because the leaders of reorgs don't specify their objectives clearly enough, miss some of the key actions (for example, forgetting processes and people in their focus on reporting lines), or do things in the wrong order (such as choosing the way forward before assessing the strengths and weaknesses of what they already have). Yet the pitfalls they succumb to are common and entirely predictable.

### Why Reorgs Fail

A McKinsey survey of 1,800 executives identified the most common pitfalls for reorganizations (in order of frequency).

1. Employees actively resist the changes.
2. Insufficient resources—people, time, money—are devoted to the effort.
3. Employees are distracted from their day-to-day activities, and individual productivity declines.
4. Leaders actively resist the changes.
5. The org chart changes, but the way people work stays the same.
6. Employees leave because of the reorg.
7. Unplanned activities, such as an unforeseen need to change IT systems or to communicate the changes in multiple languages, disrupt implementation.

During our careers we have seen many reorgs, read lots of books and articles about which type of organization companies should adopt, and watched countless fads come and go. But we've found precious little advice on how to actually run a reorg. Many practitioners assert that reorgs are so fluid and dynamic that it would be naive and counterproductive to try to impose a process on them. Our conclusion, based on experience and analysis, is the opposite: *How* you go about your reorg is as important as—and sometimes more important than —*what* you do.

To help maximize the value and minimize the misery of reorgs, we have developed a simple five-step process for running them. We don't claim that this is rocket science; indeed, we're proud to assert that it is not. But we do know that companies need to take a more systematic approach if reorgs are to deliver on their potential. And we have personally advised companies through the five steps in more than 25 reorganizations—companies with 100,000 employees or a handful, in the Americas, Europe, the Middle East, Asia, and Africa. In fact, survey data shows that companies using this process are three times as likely as others to achieve their desired results.

## Step 1: Develop a Profit and Loss Statement

A reorganization is not some esoteric pursuit but a business initiative like any other—similar to a marketing push, a product launch, or a capital project. So you should start by defining the benefits, the costs, and the time to deliver. Remember that the costs are not just those of employees and consultants involved in the reorg; they also include the human cost of change and the disruption it can create in your business. We have accumulated data on these factors for 1,800 reorgs. Previous reorgs in your company, and the experience of employees who have worked elsewhere, can help you estimate the impact.

It may seem like common sense to weigh costs and benefits, but according to McKinsey research, only 15% of executives set detailed business targets for their reorgs, and 17% of reorgs are launched at the whim of an executive or because the leadership team believes the company needs to be shaken up—reasons that typically lead to problems. Both the objective of the reorg and the process for running it should be as fair, transparent, and reasonable as possible. Not only is that right for your employees, but it will make them much more likely to accept, get behind, and improve your ideas.

## Communicating the Reorg

To be considerate of your employees and get their buy-in, the process needs to be fair and transparent.

- **Plan communications across all steps of the reorg.** Start with transparent information: what will happen, when, and whom it will affect. Try to excite people only after it's clear what they will be doing (in step 4). If you try earlier, they won't listen, and you'll come across as detached.
- **Focus your communications on topics that matter to your people, not just to you.** Sadly, few of your employees will care as much as you do about ROIC. You have to find something about the change that motivates them. Elon Musk says of the companies he's founded and their organization going forward, "People at Tesla, SolarCity, and SpaceX feel that they are doing things that matter: If we can advance sustainable energy by 10 years, that is 10 years of less carbon."
- **Make sure communication is in person, not just in e-mail cascades.** Too often your carefully crafted e-mails will get no further than your direct reports' in-boxes. Make sure your leaders are spelling out the practicalities of the reorg for their staffs and answering employees' questions.
- **Communication should be two-way.** This is especially true in steps 4 and 5, when you are trying to get the details of the reorg right and ensure that it is working properly. On-the-ground feedback from your staff is essential. Reflecting on his experience of reorganizations, John Browne, the former CEO of BP, told us, "Your people are sometimes aware of what is going on before you are, so you need to listen to them."

Let's consider the case of an international media company. Its reorg started with an exercise to define the revenue-improvement opportunity worldwide. At the time, it was a federation of local businesses with no net growth. Teams of company strategists and business experts estimated that a more integrated global approach could significantly grow flat revenue and set a specific target for the reorg. The cost of internal project support and external consultants was agreed on, and a timeline was proposed: The new organization would ideally be set up and running within a year—in time to deliver results in the latter half of a new three-year business plan. A reorg P&L had been constructed.

## Step 2: Understand Current Weaknesses and Strengths

No surgeon would start operating on a patient before conducting tests and reaching a diagnosis. And when excising a tumor, he or she would be careful to avoid removing healthy tissue. So should it be with a reorg. Unfortunately, this step is often skipped, which means that changes at best have no impact and at worst undermine previous strengths. Those companies that do take the time to self-diagnose before embarking on major surgery typically rely on interviews with senior executives to get input. That's a good place to start, but we would recommend adding an electronic survey, which will enable you to capture a companywide range of input and to see the differences between headquarters and the front line and between levels and geographies. In addition, since reorgs are all about performance improvement, take time to understand how outcomes vary across the business. For example, if you have multiple sales teams, which one is most successful and why? These inputs will help you decide what to retain, what to roll out elsewhere, and what to change.

The media company interviewed 23 leaders across all parts of the business, using a "card sort" in which 40 attributes of the existing organization—such as innovation, local responsiveness, and leadership bench strength—were written on cards, and interviewees were asked to categorize them as "significant issue," "somewhat of an issue," or "not an issue." This process highlighted problems that the company was having finding the right people to fill roles, sharing information across geographies, and incentivizing innovation. Yet the company scored well on P&L accountability and local responsiveness—strengths that needed to be preserved. (Although these interviews were helpful, we realized in retrospect that the responses represented too thin a slice of the organization. In subsequent reorgs elsewhere in the company, we used electronic survey tools that captured a much wider range of opinions across levels, business units, and geographies.)

## Step 3: Consider Multiple Options

The next step is to decide on the design of your new organization. You can take one of two approaches. You can change the entire organizational model—for example, organizing by customer segments instead of along geographical lines. That approach is best if your organization is completely broken (although such cases are rare) or is facing a fundamental market shift that cannot be navigated under the current model. Or you can change only those elements that don't work—for example, altering the executive board process for financial approvals, removing a layer of middle management, or upgrading your frontline leaders while leaving the rest of the organization unchanged. That approach is best when the overall organization works well or the focus is on cutting costs. The analysis you conducted in the first two steps will help you make the choice. If in doubt, choose the second approach.

A common mistake in this step is to focus on *what the organization looks like* (its reporting structure, for instance) and forget about *how it works* (management and business processes and systems; and the numbers, capabilities, mindsets, and behaviors of its people). In our experience, the latter is usually more important than the former.

Finally, you should explicitly choose from a number of options for exactly how to restructure your organization. Any solution has its downsides; only by weighing alternatives will you see what you might gain and what you might lose. Too often leaders realize late in the day that they missed something in the original design. If they insist on adding it later, the company may end up with a push-me-pull-you design that blunts the effectiveness of the new organization and unnecessarily complicates people's lives.

At the media company, the top 12 global business leaders gathered offsite to debate the relative merits of three options. They were assigned to teams—one for each option—and asked to advocate for their given option (no negatives allowed) and to answer questions from the other teams. Leaders who were expected to dislike a particular model were deliberately put on the team for that model: For example, the most autonomous local leaders were put on the team for the most centralized option.

During the debate it became increasingly clear that the most centralized model was the only one that would provide sufficient benefits to justify the disruption and the human cost of the change. At the end of the meeting, nine of the 12 leaders voted for that option, and the specific concerns of the remaining three were accounted for in the detailed design. After the exercise, the CEO reflected, “There is always more than one right answer, so how you bring people along and get them behind the new organization is really important. Through the workshop, we came to a good answer, and—perhaps more important—we brought our leadership team along with us.”

## Step 4: Get the Plumbing and Wiring Right

After step 3, most executives stand back, trusting their teams to handle the details of the new organization and the transition plan. External consultants usually clock off at this point as well. Yet we’ve repeatedly found—and a 2014 McKinsey survey confirmed—that step 4 is the hardest part of the reorg to get right. The secret is knowing all the elements that need to change and planning the changes in the right sequence. For example, you must create new job descriptions before the jobs can be filled, and they must be filled before you start location moves, potentially across countries. Similarly, you need to agree on how your P&L will be managed before you can allocate costs and revenues, and only then can you design the required IT changes, test them, and ultimately implement them. All this takes effort, and if you miss something in any area of the detailed design—structural changes, processes and systems, or people—you may either hold up the whole reorg or find that your new organization has been launched half born. In many cases the organization has changed but the systems (notably the P&L) have not, and leaders are left driving a fast car with no steering wheel.

Executives at the media company put in extra effort at this stage. The CEO continued to spend significant time on the reorganization; leaders were appointed to their new roles before the switchover so that they could begin to own and steer the work; and the reorg project team members moved from managing the process out of HQ to visiting the regional businesses that would be most difficult to transition and working with the local management teams to hammer out the plan. In particular, they took pains to understand how the P&L of each local business broke down and who would be responsible for each revenue or cost lever in the new organization. Of course, this process highlighted previously unappreciated challenges—such as the fact that customer segmentation, which was clear at the global level, was sometimes less clear in a few countries where customer groups blended together; and the need to account for acquisitions that were midway through integration when the detailed design was developed. This prompted the company to make some tweaks and exceptions to its new structure and processes and to lengthen transition periods for some units. But its leaders stood fast on something we’ve found to be a fundamental rule for successful reorgs: 80% of the business (by revenue, profit, and people) must make the change, and the exceptions must not be allowed to hold up progress for the rest.

## Step 5: Launch, Learn, and Course Correct

No matter how much thought and preparation you put into a reorg, it's unrealistic to expect that it will work perfectly from the beginning. As Nancy McKinstry, the CEO of another client—the information services company Wolters Kluwer—says, "You have to live with and digest it, and rapidly course correct when you find issues." That doesn't mean you need to do a 180 in the design as soon as you hit a snag. But you do need to encourage everyone to spot and point out the new organization's teething problems, openly debate solutions, and implement the appropriate fixes as soon as possible, in line with the logic of your original plans.

The media company's reorg was altered in several ways after the launch. One activity around developing content, which had been allocated to a new business line, was returned to its original unit, because synergies that had been persuasive on paper turned out to be less impressive in practice. Back-office activities, untouched by the revenue-focused reorg, were further consolidated afterward, bringing cost savings into the mix.

Within three years of the reorg, the company had met its goal: The issue of flat revenue had been addressed and the growth target met.

### CONCLUSION

If you're contemplating a reorg, you owe it to your shareholders and employees to follow a rigorous process rather than winging it, as so many leaders do. You'll make better decisions, keep your people more involved and engaged, and capture more value.

A version of this article appeared in the November 2016 issue (pp.84–89) of *Harvard Business Review*.

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LEIF SØRENSEN 19 days ago

When a survey of 1800 executives is done by @mckinsey the answer is NOT surprising.... only one of the top 7 pitfalls to change #reorg. is not about people... I think we need to focus on #resistance as the key to our #change work. It is inspiring to get practical communication insights. Thanks for your article I will incorporate some of your ideas in my work with changesetter.

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