Reorganization rules that work

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Companies should view reorganization as a routine practice essential to remain competitive and keep pace with technological change and disruption.

Reorganization doesn't have to be an overwhelming undertaking, and, in fact, it can be quite rewarding for a company and its employees—especially if approached in a methodical way. In this episode of the *McKinsey Podcast*, McKinsey senior partner Aaron De Smet and partner Shannon Hennessy speak with McKinsey Publishing's Monica Toriello about how companies should think about and execute reorganizations to become much more agile and to set themselves up for success in the face of disruption.

Podcast transcript

Monica Toriello: Hi, I'm Monica Toriello, an editor with McKinsey Publishing. Today we'll be talking about a topic that's very challenging for many companies: reorganization. Joining me to talk about reorganization are two experts on this topic. We have Shannon Hennessy, who is a partner in our Dallas office and who recently coauthored an article titled "Rethinking the rules of reorganization." Welcome, Shannon.

Shannon Hennessy: Thanks, Monica.

Monica Toriello: And Aaron De Smet is a partner in Houston who is one of the firm's foremost experts on organizational design and reorganization, and has been on a *McKinsey Podcast* before, talking about agility. Thanks for joining us today, Aaron.

Aaron De Smet: Thank you, Monica. Glad to be here.

Monica Toriello: Reorganization can be a scary word for people at any level of a company, whether you're an executive or a manager or an employee. But some see reorganization as a necessary evil. Is it? Or is that the wrong way to look at it?

Shannon Hennessy: Monica, I see reorganization as a way of life in today's corporate environment. There's unprecedented disruption in the way that companies are working with higher requirements for things like analytics, consumer touchpoints, and complex and remote work.

There's also a really big shift in the underlying demographics and expectations of the workforce. I'd say most companies these days are conducting a pretty big reorganization every couple of years, and some companies have actually stopped viewing it as an event in and of itself. Instead they've started to view it as part of how they evolve and do business. There are big benefits to reexamining the way you organize to get work done beyond just cost savings. There are ways to free up resources to invest in new capabilities and make things faster and more agile.

Aaron De Smet: I would echo that. We're seeing—because of the pace of change in the market and a lot of turbulence caused by globalization, technology, hypercompetition, mergers and acquisitions, and regulation and deregulation—it's getting harder and harder to stay competitive if you don't reorganize fairly frequently. Some companies do continue to see it as a necessary evil because every time they reorganize, it's superdisruptive.

Many of our clients and other companies experience not only a lot of distraction and disruption but also, in the end, after all that work, they feel like they didn't get all the objectives out of the reorganization that they had hoped for. The success rate is actually pretty low.

One piece of research that we did found that only about 23 percent of reorganizations are deemed successful by the companies as they look back on them. Of the unsuccessful reorganizations, most of the failed attempts actually unwound a number of the changes they had made because they weren't working.

A lot of this is because they're doing it wrong. The fear of doing a reorganization actually contributes to the problem. Many of these companies are waiting until the problem is so dire and so urgent that they can't possibly wait anymore.

Then they're just dealing with the fires and the problems that are such a burning platform that, by the time they're done, they've missed a number of opportunities right in front of them. One of the biggest success factors that we've seen is design for the future. Design for where you're headed, not for the problems of the past. You need to fix the problems, of course. But if you only fix the problems, by the time you're done with your reorganization, you'll already need to be doing another one.

Monica Toriello: It's interesting that you talk about companies doing it consistently or doing it every couple of years. But Aaron, in the past, you've talked about the organizational structure and the governance and processes being a stable backbone. That would last five to ten years. Reconcile for us what it means to have a stable backbone but also to be constantly thinking about organizational redesign.

Aaron De Smet: The concept is that some of the things that you might change in your organization would be under any circumstances pretty massively disruptive. But there are a lot of other things that don't need to be disruptive, that can feel fluid.

A natural evolution like this is just part of working differently and better, and for the people who have to change some aspect of how they work, it doesn't feel that different. So getting this

basic platform right, of the stable things that won't need to change that often, getting that right can make all the other changes a lot easier. The analogy I often use is a smartphone. If you were to try to hard wire in every possible capability, what you'd end up doing is saying, "I need my smartphone to have every possible functionality and capability built into the hardware and operating system."

Even if you got it exactly right—you might get your brand-new smartphone and it does everything you ever dreamed you wanted it to do—then two weeks later, Shannon comes up to me and says, "Hey, did you hear about this thing called Uber? It's awesome. I just say I want a car, and somebody comes and picks me up. It's great."

And I say, "I want Uber." Now that I've hard wired everything into the smartphone, I have to design a whole new phone if I want that functionality. Whereas a smartphone that's left huge areas of functionality completely blank, open, to be designed, to be determined for the future, there's still a platform. There's still hardware and an operating system that doesn't change very frequently. But now I can just download the app. And it's not hard. It doesn't feel disruptive at all. It feels great. I download an app and then I can just start using it.

Organizations need to start building themselves like that. The minimum spec hardware and operating system on which I can apply dynamic capabilities. In some ways, a natural fluid reorganization would be deleting one app and adding a new one.

Monica Toriello: You mentioned designing for the future. Does either of you have good stories about companies that have done that well?

Aaron De Smet: This success factor is what I call the Wayne Gretzky rule. Wayne Gretzky is a famous hockey player. One of the best ever. When he was asked how he was so successful, he said, "I skate to where the puck is going to be, not to where it is now."

We were helping a company that had just made a couple of acquisitions. It was putting them all together into this new company, and it was figuring out what structure it wanted. As it was figuring out who the business leaders were going to be at the top of the house—the commercial organization was organized regionally—I said, "Well, where's the future of the business? You've divvied this up so that all the regional leaders have roughly the same book of revenue. But where's the growth?" The answer was, "Actually, almost all the growth that we see coming in the next three to five years is all in two countries: the US and China."

I said, "What if, instead of having three or four regional leaders, you had five or six regional leaders? And one of them was just the head of the US and one was just the head of China?" They didn't debate it for long. After a short period of time, they said, "That's exactly the right answer. That's the level of focus we need." The only difference was that the first time we had built the regional structure, we looked at historic revenue. In the next conversation, the question was, "Where's all the growth?"

Shannon Hennessy: I've seen lots of companies that have made big shifts toward global

growth. I think another common example of designing for the future in the retail and consumer sector is preparing for the growth of e-commerce and digital.

Several years back, I had many clients who were looking at their e-commerce businesses and saying, "Wow. This is dilutive, right? And look at the span of control that some of these folks are working with. I have these buyers who are buying not that much sales volume."

But there was another one of my clients who looked at that and said, "This is where the world is moving. This is where the puck is going," to use Aaron's analogy. So the client said, "I am going to plan to resource this business based on a three- to five-year business plan. And I am going to be prudent about how many resources I'm going to put into place. I'm going to think about attracting talent and building an organization to deliver that."

Monica Toriello: Much of what you've talked about is actually resource reallocation. It's very hard for companies to do. In your recent article, Shannon, you talk about one of your provocatively stated rules, which is "Play favorites." It's about setting different cost-reduction targets and different investment levels for different business units. It seems to make perfect sense. It's intuitive, right? But in your experience, why is it so hard for companies to do that?

Shannon Hennessy: It's hard because folks are rightly so protective of making sure that they don't make big cuts or shake things up in what are the core growth-driving and revenue-driving areas of the business. What I've seen is oftentimes those areas of the business have gotten a bit of a free pass when you're looking at organizational change, because people are fearful of rocking the boat. Because the pace of change has been so fast in business and in the consumer and retail sectors specifically, a lot has changed for those functions. They're feeling overburdened and overworked and probably not as effective as they should be on some of the newer areas and new capabilities.

What I've seen to be quite empowering is taking the time to get the facts. Take a look at what's been going on in those functions. When we've done that, we've found that there's a bigger need to reshape those functions than there is the back-office functions, which folks have looked at time and time again for efficiency.

Aaron De Smet: There's also a mind-set issue that a lot of our clients don't realize they have: leaders naturally equate the size of their empire with how much power and decision authority they should have, and the size of their empire is often based on historic success. "It's been a successful business. It's a big business. It makes a lot of revenue. I have a lot of resources to keep that engine going and keep that revenue coming in. Therefore, I should decide how we allocate resources."

And guess what? When you ask people where they want to allocate resources, they usually want to allocate them back to themselves. The person in the new business that's still small—it's where all the growth opportunity is, where all the innovation is, where in the next five years the whole market is going to go. Even if you can see it coming, even if you had

a crystal ball and you knew that, it would be very hard in a current organization that isn't playing by the new rules that Shannon's talking about. If they're playing by the old rules, even if they knew, they would have a hard time getting resources because all the authority to make decisions about resources sits where the resources already are.

Shannon Hennessy: That is what can be so powerful about undertaking a holistic look at your organization. When you do take those cross-functional, cross-business-unit lenses that Aaron's referring to, you can make those shifts, and it can be an incredible moment for an organization to line up with where the puck is going.

Monica Toriello: That actually relates to one of your other rules, Shannon, which is, "Ask for bad ideas." That's basically a way of saying, "Has somebody who's objective, or have several somebodies who are objective, made decisions for the good of the entire business rather than just for one business unit or for one group within the business?" What are some ways that you've seen companies do this well?

Shannon Hennessy: I had one client who had the CFO, who was one of the more progressive change agents in the organization, commit to taking a look at all the ideas that the individual teams were surfacing, and particularly the ones that had been rejected through some of the approval processes that led into the final decision making. He would flag and surface ones he thought may have been rejected too soon. I had another client that said, "For every individual area, I'm going to have the functional leader, say the chief marketing officer, in charge. But I'm also going to make someone equally in charge who is going to be a fresh set of eyes, a provocateur, someone who's going to make sure that the person who may have built that organization is considering different ways of doing things and new lenses."

Aaron De Smet: It also helps to be aware of some of the conventions and orthodoxies that you are carrying with you. Companies don't always have the self-awareness of what their own biases are. Most of those biases are toward what's made them successful historically.

These are the companies that, if they can't get past that, rather than disrupt themselves and continue to be at the top of their game, they're going to be disrupted by somebody else. This has happened; this isn't new. It's just becoming a bigger problem as the pace of change accelerates.

Monica Toriello: One way to come up with ideas, whether they're good ideas or bad ideas, is to look around you, look at what competitors are doing. Shannon, in your fourth rule, you talk about some people paying too much attention to benchmarks. Is it fair to say that benchmarks can be a thought starter for idea generation, but they shouldn't be the be-all and end-all?

Shannon Hennessy: Yes. That's one of the questions I get the most often. Everyone loves to hate on benchmarks, and I can understand where that comes from. There are people who have deep scars from watching benchmarks get misused and from trying to compare

one company to another in a way that they aren't similar.

That said, I have not seen anything be as effective as benchmarks in triggering some hard questions, such as "Why does it take 50 percent more resources in your organization to do an activity that's quite similar to a peer?" Or, "How is it that this process takes a peer company 30 percent as much time as it does for you?"

Aaron De Smet: The broader point is, get data and information and case examples and anecdotes and benchmarks. Get all that to inform your thinking, to open your thinking, to ask the right questions. But don't let the benchmark make the decision.

Don't look at a best practice and feel like you should copy it just because somebody said it was a best practice. Use it to inspire you, inform you, educate you.

Monica Toriello: Does either of you have stories about companies that either used benchmarks or external inspiration well? And companies that didn't?

Shannon Hennessy: I was sitting in a meeting with the head of planning for a consumer company, and we were looking through some of the benchmarks that we had brought to the conversation. He said to me, "Tell me which one of these companies looks exactly like us." And I said, "None." But I think that's oftentimes where folks' minds go. So they throw it out, and they don't want to entertain the conversation.

But what was magical in the room was, we started saying, "Let's just take a look at what peer company A, B, and C are doing. They're not exactly like you. Here's why they do it a little bit differently." As we worked through that, we worked through maybe 20 different sets of ideas for things other companies were doing. Only about five to ten of them were applicable to my client. But they were applicable in a way that they hadn't really thought about. When benchmarks work well, they work, as Aaron was saying, as a source of inspiration.

Aaron De Smet: I have seen companies look at something and say, "Wow, if we automate that, we should be able to take out a lot of cost." The problem is they sometimes will take the cost and the people out before they have actually built the systems that fully automate what they're trying to do. That can be disastrous. Or they look at something and say, "We're 20 percent over." Then they just give a budget cut of 20 percent. But why are we at 20 percent over? It may have been 40 percent over in some places and resourced exactly right in others. You have to get a little more granular. You can't apply benchmarks mindlessly.

Monica Toriello: Shannon, another rule that you talk about in your article is to stop wasting people's time. Skip meetings where you're not needed and stop producing reports that are not impactful. It's a common gripe, right? "I have to go to another meeting." Do you have any specific tips for how to stop having so many meetings?

Shannon Hennessy: My absolute favorite tip is standing meetings. It's amazing. If you ask folks to just get rid of the chairs and stand up, you'll see how much faster they'll go and how

much they'll get on track. It doesn't work all the time, but I think it's a physical and visible way of cracking down.

Take a look through a calendar. Blow up meetings that have existed for a long time but that are a waste of everyone's time. Ask the question, "How many people actually need to be in the meeting?" Think of how many meetings you see where it's someone's boss, the boss's boss, and the boss's boss's boss all there in the same room, and just think about how you could actually get that done with fewer people. It not only eliminates time but it's also incredibly empowering for the organization to think that way.

Aaron De Smet: The first thing I would ask is, "Is this a decision-making meeting, or a problem-solving meeting, or an information-sharing meeting?" If it is an information-sharing meeting, the first question is, "Do you need it, or could you just do email?" If you do need it, you should be able to keep it to 30 minutes max.

A problem-solving meeting should have a small team of people doing real work. You should never have a problem-solving meeting that's more than six to ten people. If it's a decision-making meeting, you need to make sure that you're spending almost all your time debating and discussing the decision. It's important not only to list the decisions you're making but also to list who the decision makers are, because it should almost never be everyone in the room.

It's OK to have 30 people in the room, but you shouldn't have 30 decision makers. You shouldn't even have ten decision makers. You should have two or three. Everyone else in the room is either there to inform them and advise them, or just to hear the discussion because they're going to have to go execute it and it's a lot more efficient to not have to translate.

If you have three decision makers, all three better show up, and if they don't, you should cancel the meeting. If they feel like they don't need a meeting to make the decision, then cancel the meeting. This sounds very basic, but almost nobody does this.

Monica Toriello: For managers or executives who have just gone through a reorganization, what are some day-to-day experiences that have proved to them, even anecdotally, that this reorganization is working? That we did the right thing?

Aaron De Smet: There are a couple of questions you can ask. One is, "How easy is it to get things done?" And if the answer is, "It's not," then, "Why not? How quickly are we able to make and execute good decisions? Do you know the value you're adding?"

Ask someone what their job is, what value they deliver. Let's say they work on an important report that comes out every week—who uses the report, how do they use it, and what would the problem be if suddenly we weren't able to deliver the report. They should be able to answer. If it were me, and I were doing management by walking around, I would ask, "Who is the one person who most benefits from your report?" Then I would go talk to that person, ask them, and see if the answers match. I have had situations where I've asked that question, and the

person says, "This report is great; it delivers a ton of value." And I've had situations where the person says, "I delete that every time I get it; I never read that report."

Shannon Hennessy: Aaron, that reminds me of *Office Space*.

Aaron De Smet: It does. The reason *Office Space* is so funny and such a cult classic is because it is so true in so many ways. Shannon, you've probably had many *Dilbert* moments, where you just can't believe what you're seeing. But it's true. This stuff really happens. They're often really good, smart people. These are things that evolve slowly over time, and things just get disconnected. It just ends up in a place that's kind of crazy. You don't know how this happened.

Shannon Hennessy: Monica, when I think about measuring whether or not a change has been successful, I typically think about it in two ways. I think about the military part of it and the marketing part of, as I call it, the military and the marketing campaign.

On the military campaign, if a reorganization is successful, it should've delivered its objectives. Whether those were financial objectives or cost objectives or strategic objectives. It's important to measure those sorts of things. Did it meet the time lines, et cetera.

And then there's the marketing-campaign side. One of the favorite things I love to ask is simply, "Are people clear on their roles in the new organization?" That's oftentimes one of the biggest failure modes. I also like to find out if they're asking, "Is this the sort of company that I'd recommend to a friend to work with?" Is it? Do they have job satisfaction? Are they actually feeling better about the new company than they were about the company before?

Aaron De Smet: For companies that have been reorganizing poorly for a long time, haven't followed any of these rules, fundamentally don't have clear roles, and have a bunch of problems—usually the first one is somewhat painful, or at least hard. I don't know if painful is the right word, it's hard. If you get it right once, you can start allowing your organization to reorganize more incrementally, fluidly, and easily in a way that's not painful and not even hard.

It's actually quite easy and natural. But if your starting point is really bad, then the first one usually is somewhat of a heavy lift. To go back to this idea, once you get it right the first time and have built that stable backbone upon which you can then overlay much more fluid and dynamic capabilities—the questions that Shannon was asking about: is this a place you would recommend for someone else to work, is it easy to get things done, how energized are you to come into work every day.

The whole feeling of a place when the answer is, "It is easy to get things done, and I love being at work. I'm hugely energized when I'm here. I would totally recommend this place"—there is a buzz and an electricity that's pretty remarkable and pretty special. If you get the reorganization right, you can help it to feel that way.

Shannon Hennessy: I do believe it's hard to do an effective reorganization without at least some moments of pain. Typically, what you're trying to do is change the way the organization works. An organization is a bunch of people who have feelings, right? And legacies. No pain, no gain is probably more apropos for me, rather than when folks avoid painful decisions—they usually just prolong it, or drag out the agony. That said, I think you can manage it in a humane way.

If you do a good job, you might have some pain in the beginning associated with change. Most people still don't love change, but you emerge on the other side with an organization that is happier and has less pain than it started with.

Monica Toriello: Let's end on that positive note. Thank you very much for joining us today. If you're interested, you can go to McKinsey.com for more on organizational redesign and agility. ☐

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