NOVEMBER 2014
McKinsey Quarterly

From bottom to top: Turning around the top team

A case study of change at Philips illustrates the importance of the "soft stuff."

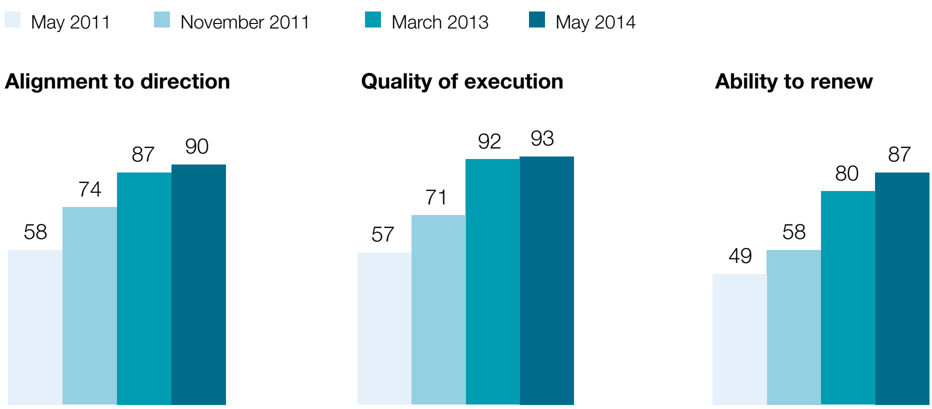
When Pieter Nota joined Philips, four years ago, to run the Dutch technology group's Consumer Lifestyle sector, he found a business in poor shape. The market shares of several important products were falling in the wake of harsh trading conditions and a lack of earlier investment. Sales of the company's televisions were declining alarmingly following a brief spike ahead of the 2010 FIFA World Cup. More fundamentally, an overcentralized and functionally led organizational structure was proving ill suited to the task of managing the two formerly separate companies (small domestic appliances and consumer electronics) first brought together under the Consumer Lifestyle umbrella, in 2008.

The story of the unit's subsequent turnaround, from Philips's problem child to part of a group that recently announced its tenth consecutive quarter of strong revenue and profit growth, is one of astute portfolio divestment and renewal, clear strategic choices, more disciplined operations, and a rigorous focus on performance management. Underlying and driving the recovery, however, has been a less visible, but no less important, improvement in the effectiveness of the Consumer Lifestyle sector's top team—that handful of senior executives who provide the energy, inspiration, and vision for any enterprise. As the accompanying exhibit illustrates, the results of successive surveys carried out from May 2011 to May 2014 demonstrate a remarkable rise in team-effectiveness scores rating alignment on strategic direction, the quality of execution, and the ability to change.

Exhibit

How Philips Consumer Lifestyle's top-team ratings improved

% of respondents citing agree or strongly agree[1]



Does the team share a view on where to lead the organization and how to lead it there?

Is the team effectively designed, and does it have high-quality interactions that drive superior performance?

Is the team able to sustain its energy and does it have the capacity and ability to adapt to change?

[1]Scores in the first survey (May 2011) were among the lowest of any company surveyed; scores in the most recent survey (May 2014) were among the highest. Questions noted here are a synthesis of more detailed survey questions.

Source: Four surveys of Philips Consumer Lifestyle's top team

This summer, Pieter Nota sat down with McKinsey partners Udo Kopka and Michiel Kruyt to discuss the journey and the lessons he and his team have learned along the way.

The *Quarterly*: *As an outsider to Philips, how did you determine what the most serious issues were?*

Pieter Nota: One of the first things I did when I joined, in late 2010, was to write an open letter to about 700 people—basically, the group we call the Consumer Lifestyle leadership and a layer below them. I invited them to tell me what they thought was working well in the business and what wasn't. This gave me a pretty good idea of what was cooking and a lot of useful insights: the sense that two of our biggest businesses, small domestic appliances and consumer electronics, were not functioning well together; the frustration with the lack of investment and innovation, particularly in domestic appliances; and empowerment issues in the sales organizations. All that came out of this exercise.

The *Quarterly*: *What were your initial actions as the new CEO?*

Pieter Nota: Consumer Lifestyle was the biggest of Philips's three businesses at the time, and it was not performing well. The business environment was flat, and we were challenged on both sales and profits. It became clear quite quickly that we might have to divest the TV business. Given TV's central place in the group's history, this was pretty drastic. The emotional response was how I imagine it would be if Unilever were to suggest getting out of detergents.

The *Quarterly*: *How did you find morale in the top team—and in the organization more widely?*

Pieter Nota: I inherited a large and diverse top team of 15 people, representing various businesses, geographies, and functions, with team members from Europe, the United States, and Asia. Morale was pretty low. For example, the two very distinct businesses in Consumer Lifestyle—consumer electronics and small domestic appliances—each had very different rules of the road. There was a lot of tension and friction, since we were structured to manage them as one business. Financial performance was poor, and there had been a reluctance to invest during the financial crisis of 2008. Nor did it help when, in mid-2011, we had to issue a profit warning for the TV business, a unit we retained until late 2012, when a majority stake was sold to TPV Technology.

For all these reasons, the team was insecure and couldn't understand why things were going so badly. The top-team survey we did in May 2011, in preparation for our first off-site meeting, exposed some of the challenges—it showed how misaligned we were on the direction of the business, the poor quality of our discussions, the lack of trust, the lack of confidence in our ability to implement strategy, and the perception that we were ineffective at making change happen.

The *Quarterly*: *How and when did you go about starting to rebuild the team?*

Pieter Nota: In retrospect, I think our first big off-site meeting—in May 2011, at Huizen, in the Netherlands—was significant. This is where we put the issues on the table. Two things remain clearly etched in my memory. One is a no-holds-barred conversation on team loyalty, which emphasized the importance of our values, our core purpose, and the essential notion of trust. The second is the introduction of some critical new thinking on how to improve the quality of our operations and implementation capabilities.

On the first, I knew that I did not have all my team members on board and that this needed to be addressed. Even after my predecessor had gone, some who had been in his very close circle were continuing to have conversations with him. During the opening of the off-site meeting, this topic had already come up. We ended up spending three hours talking about the past, clearing the air, and gaining a better understanding of each other. At the end, everyone got to the point where they could decide whether they wanted to be in or not. That was a pivotal moment.

The other discussion was aimed at breaking down the silos that had developed between central marketing and product development, on the one hand, and the regional market units, on the other. We wanted to move from a functional organization to an organization built around customer-focused business-market combinations. These were to become the performance units in which the central business folks—marketing and product development—and the regional market folks would plan and deliver results as a team. They were to be jointly responsible for the results, so they could no longer point fingers at each other if they failed to carry out the plan.

In this way, we created more transparency and accountability around the performance of individual business-market-combination units and improved resourcing decisions across them. We pioneered this idea in Consumer Lifestyle as part of the company's wider Accelerate! transformation program—the program launched in 2011 by Frans van Houten, the group's CEO, to unlock the full value of Philips. There are now roughly 150 business-market combinations in Consumer Lifestyle at Philips, and they are the vital conduit through which we allocate our resources, drive the business, and run granular performance management.

The *Quarterly*: *How receptive was the team—and the organization—to these new ideas?*

Pieter Nota: In mid-2011, this was all still new. People didn't understand it, and the team members' first reaction was to say I did not trust them and wanted to micromanage the business. It was a year before we really started implementing business-market combinations effectively and before the market and business folks on the team started to gel. Once the members of my team began to act as role models for this new form of collaborative accountability, the idea started to trickle down to the rest of the organization as well.

The *Quarterly*: *Given the dissension in your top ranks, many CEOs might have fired half the team. Why didn't you do that?*

Pieter Nota: I take the view that structure follows strategy, so for me it was important, first off, to know where we were going with the businesses before changing the team. That said, I did take early action on a few team members who could not let go of the past. Once the new strategy became clear, I made some specific appointments in the team to support the new direction. For example, I moved the headquarters of our Domestic Appliances businesses from Amsterdam to Shanghai—China was our biggest growth region—and appointed an Asian leader. In the time I have been with Consumer Lifestyle, the size of the team has fallen from 15 to 12, but on the whole I'd characterize what's happened as evolution and not a big bang. It is always important to have a balance between old hands with domain expertise and new people.

The *Quarterly*: *It seems that by the time of the second survey—a year into your tenure—things were starting to improve. Why?*

Pieter Nota: We were starting to gain more team cohesion. And our strategic alignment was improving. In this respect, the strategy paper we prepared for our Capital Markets Day, in September 2011, was another turning point because it showed explicitly the transformation route from a consumer-electronics business toward a personal-health and well-being business. It showed that the audio/

video business was a separate animal and made people realize that we would probably exit this activity as well as TV. In the end, we completed this portfolio shift in early 2013.

What was equally clear from the second survey, though, was that the business-market-combination initiative wasn't gaining enough traction. People still didn't know clearly enough what the implications were at the operating level. Nor were we yet sufficiently willing to have the sorts of tough conversations that would allow us to make the necessary trade-offs and hold each other accountable with the help of increased transparency through business-market combinations.

That said, we managed to put in a decent financial performance in Q4 of 2011, admittedly from a low base—something reflected in what was then a rare positive reference to Consumer Lifestyle results in the subsequent Philips earnings press release. I remember noticing at this time that people were starting to recover their pride and fighting spirit.

The *Quarterly*: *Can you remember the moment when you realized you were making real progress on the business-market combinations?*

Pieter Nota: I can remember a moment—in the second team off-site meeting, at Amsterdam, in November 2011—when the "us versus them" mentality that had characterized team discussions between marketing and the business units really started to change. During the day, we spoke about new ways of collaborating. Over dinner, a business leader's side comment to the head of the China unit about its performance sparked a huge gloves-off debate, which, though stormy, led to a better understanding of both sides' positions and needs. After a few more conversations, the two leaders initiated a major end-to-end transformation project in China from which we are still benefiting today and which has proved to be a model for Philips overall.

From that point onward, we started to have much more hard-nosed performance and collaboration discussions, where people were really challenged in direct language but where tensions would be dissipated by humor. We called these "courageous conversations"

Pieter Nota

Vital statistics
Born in 1964, in the Netherlands

Education
Graduated with a degree in business administration from Erasmus University, Rotterdam

Career highlights

Philips (2010–present)
Chief executive officer, Philips Consumer Lifestyle
Member of the Executive Committee

Beiersdorf (2005–10)
Chief marketing and innovation officer
Member of the Executive Board

Unilever (1990–2005)
Various executive positions in marketing, sales, and general management in Germany, the Netherlands, Poland, and the United Kingdom

to make them easier to start, and we still explicitly make time for them in our face-to-face meetings. That session in Amsterdam and its sequels turned a lot of negative energy into positive energy and taught us to address difference and conflict in a quick and constructive manner, thus enabling the business-market-combination model to work.

The *Quarterly*: *When did the emphasis really change from thinking about the short term to the long term?*

Pieter Nota: If you look at the results, it is clear that in the period before and around the first two surveys, we were putting the basics of strategy and team collaboration in place. After that, we concentrated on turning those basics into habits and on making our execution more disciplined. Throughout 2012, in addition, a lot of management time and attention was given to innovation and the championing of new products. I think people started to notice, at this stage, that we cared about the innovation pipeline, particularly in kitchen appliances, and that we weren't just speaking at a high level about structures and processes.

In our March 2013 team off-site, for instance, we spent a lot of time on blue-sky thinking, coming up with an exciting vision for Consumer Lifestyle. We then ended the day with a very powerful exercise in which we brainstormed "the ten excuses we would use two years from now for not having made the aspiration a reality." We addressed each one and made it clear that we would not be allowing ourselves to use these excuses in the future. It was a great combination of dreaming and realism.

The *Quarterly*: *Looking ahead, where does Consumer Lifestyle's top team need to improve?*

Pieter Nota: Instead of divesting businesses, such as TV and audio/video, the challenge now is to show that we can build new categories for Philips. The most important areas for future improvement are our capabilities, particularly digital capabilities, and our ability to reallocate resources dynamically. It's hard to take resources away from one area and deploy them elsewhere, particularly with a strong team. Everyone tends to treat the past as an entitlement. But with the right trust between teams and a willingness to reward those who drive higher profits and sales growth, you can get significant top- and bottom-line improvements with resource reallocation.

The *Quarterly*: *To what extent do you think the turnaround was the result of a clearer strategy and operating model, and to what extent has better leadership been responsible?*

Pieter Nota: It's true that our Accelerate! program and the design of the whole business-market-combination approach was a prerequisite for improved performance. But without a better team dynamic and the sort of courageous conversations I've talked about, our turnaround wouldn't have been as fast. One doesn't go without the other. The team is critical, and you have to ground people in the new reality and remove those who are wedded to the past. The whole experience of the last four years has confirmed what I thought at the outset—that team leadership and general management are about 70 to 80 percent of the battle, with domain expertise accounting for the rest. This experience has proved to me that the soft stuff is what really makes the hard stuff happen.

This interview was conducted by **Udo Kopka,** a director in McKinsey's Hamburg office, and **Michiel Kruyt,** a principal in the Amsterdam office.