BAIN & COMPANY

Making Change Stick

By Stan Pace and Paul Rogers

Why "fast, focused and simultaneous" works best in corporate transformations

Seventy percent of change programs fail.[1] Depressing news at a time when more and more companies face upheaval. They fail because leaders shy away from making changes broad enough, deep enough and—above all—swift enough to revive the company. Instead, they administer a series of half-cures, which often serve only to prolong the agony and don't always save the patient.

By contrast, companies that implement change programs that are fast, focused and simultaneous have the chance to create enormous and long-lasting shareholder value.

The top five performers in our sample, generating annual stock-price appreciation in excess of 250%, each completed its transformation in 20 months or less.

Consider Optus Communications, a 1992 start-up and the No. 2 telecommunications firm in Australia. After a promising start, by the mid-1990s the company faced a host of problems, including the end of Australia's telephone duopoly, a subsidiary hemorrhaging cash, a twice-delayed IPO and a revolving door to the CEO's office. In 1996 these problems culminated in a staggering before-tax loss of $667 million. In June 1997, shareholders came "within an inch of liquidating the company."[2]

But instead of a line gone dead, investors soon heard the clear tone of a profitable company. First, Optus' CEO and CFO were replaced and an entirely new management team installed. The new leadership integrated the problematic subsidiary, Optus Vision, and brought its cash outflow under control. A cost-saving initiative, Project Breakeven, targeting a variety of short-term opportunities, yielded $260 million in pretax earning improvements. Management completely

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[1] Michael Beer and Nitin Nohria, "Cracking the Code of Change," *Harvard Business Review* (May-June 2000): 133-141.

[2] Alan Deans and Finola Burke, "The Day Optus Shareholders Nearly Pulled the Plug," *Australian Financial Review,* July 4, 1997, p. 1.

reworked Optus' balance sheet, put an employee stock ownership plan in place, and restructured senior management team objectives and incentives. Finally, they launched the long-delayed IPO.

Elapsed time? One year.

Optus then grew its profits for four consecutive years and became one of the top 10 Australian companies in market capitalization. In September 2001, Singapore Telecom acquired Optus for more than double the IPO price, locking in over $9 billion in shareholder value created since the turnaround began.

The speed and scope of Optus' turnaround is remarkable. Yet it is consistent with other highly successful transformers. Bain & Company conducted an in-depth study of 21 companies that executed high-value-creating transformations. We found that the stock prices of the companies rose on average 250% per year in the period during and after their transformations, and more than 1000% per year for some companies. These companies from all types of industries were large and small, public and private, diversified and focused, international and regional, and facing a variety of scenarios: turnaround, business redefinition, disruptive technologies, slowing growth and so on. In all of these remarkable stories, management followed the same four principles in their approaches to change:

- Focus on the results, not the process
- Change out key senior management…
- …Then re-energize the ranks.
- Do it fast and all at once

We are the first to concede that no transformation is a simple exercise. But in the great maelstrom that often accompanies organizational change, these four principles can give managers a simple and consistent framework for organizing and executing action.

The common threads of successful change

Beginning in 1997, a team of Bain consultants began an investigation to identify the key principles common to the most successful corporate transformations. We studied 21 of the most extraordinary business "transformers" of the past decade and conducted interviews with the senior executives who directed them. The list of companies included maturing start-ups, spin-outs and corporations undertaking major change initiatives. ***(See Figure 1)*** Across all 21 companies, four common themes emerged:

Focus on the results, not the process

The best transformers focused first on developing a clear strategy. They established non-negotiable goals (financial and nonfinancial) to support that strategy and incentives to reinforce those goals. Then they stepped back and let managers figure out how to get the results. They did not dictate every step in the process or construct elaborate "change management programs."

Just ask Continental. When Greg Brenneman took over as president and chief operating officer of Continental Airlines in 1994, the company was about to crash-land. Legend had it that the airline had never met a budget forecast. It had churned through 10 presidents in 10 years, was on the brink of a third bankruptcy, and ranked last on nearly every measure of customer satisfaction. Continental needed results in a hurry.

Brenneman and his team began by introducing a host of measures to track and guide key levers of company performance. They divided the measures into four categories: marketplace, product/customer, people and financial. They set targets for their employees, provided meaningful incentives to meet them, and then let the employees figure out how to achieve the results.

Figure 1: **Successful transformers**

Pacific Bell	Wesley Jessen*
Citizens Bank	Nutraceutical*
Ned Corp	Duane Reade*
Continental Airlines	Dade Pharmaceuticals*
General Dynamics	US West
Accuride*	Dell Computer
Stage Stores*	Power Financial
Cambridge Security	Hilti
Vetco Gray*	Armstrong
Gartner Group*	Optus
Medtronic Physio-Control*	

*Bain Capital acquisitions

For instance, because Continental had failed to meet budget forecasts, Brenneman and Continental Chairman and CEO Gordon Bethune instituted a tantalizing bonus program: For each quarter that the company met its revenue and earnings forecasts, senior executives would receive bonuses equal to 125% of their quarterly pay. They offered similar bonuses on a six-month schedule to lower-ranking managers.

Lo and behold, Continental soon met its first budget forecast.

A similar program was instituted for the airline's on-time performance. When Brenneman arrived at Continental, the company ranked near the bottom of all airlines in on-time arrivals and departures. This hurt Continental's image with travel agents and customers, particularly with busy—and highly profitable—business travelers. In response, management offered all employees an after-tax bonus of $65 for every month that Continental was in the top five airlines for on-time performance, and $100 per month if the airline was first.

Within months Continental was near the top of all airlines in on-time performance. The program remains in place today, and so do its results: During the second quarter 2002 Continental had an on-time arrival rate of 85.2% and a completion factor of 99.8%.

The key to getting results, says Brenneman, is not to tell people what to do. Instead, he says, find ways to keep them focused on the right things and for the most part, let them figure out how to achieve the goals. If you provide incentives, make sure they tie to short-term achievements, such as monthly or quarterly targets.

Says Brenneman, who since leaving Continental in 2001, has served as CEO of TurnWorks and PwC Consulting, "The monthly on-time bonus (of $65 or $100) has become a point of pride and a fact of life for employees; every month they expect to get that check, and every day they work hard to make sure it comes through. And for executives, the quarterly bonus program keeps everyone focused on delivering results early in the year, day in and day out. It's like when you were in college: It's pretty hard to get an A if you fail the midterm. Same goes here: If you fall behind in March, you can't throw in the towel and expect to make it all up in Q4."

Six years after the turnaround, Continental employees are still focused on results, and it shows: In Q3 2001, Continental marked its 26th consecutive profitable quarter.

The sluggish economy and heightened security costs in 2002 have presented challenges for the entire airline industry. Yet, with the right principles in place, the dramatic results of Continental's turnaround should allow it to rise again.

Change out senior management

Changing out personnel is a key component of successful turnarounds. But too many companies make the mistake of pursuing broad employee layoffs instead of getting at the root of the problem: senior management. Consider these findings:

A Bain & Company study of 288 Fortune 500 companies showed that the stock prices of companies that laid off more than 3% of their employees performed no better over a three-year period than those of companies that made smaller cuts or none at all. Companies that announced layoffs greater than 15% of their workforces actually performed significantly below average over three years. And companies that announced repeated rounds of layoffs did even worse.[3]

This is not to say that management should never lay off employees. But it does suggest that who you change out matters more than how many. Indeed, our research of highly successful turnarounds reveals that nearly all the most successful transformers substantially replaced senior management. The most leveraged people to replace are the burned out among senior executives who channel strategic energy and direction to broad networks of employees.

Of the top 15 executives at Optus, 13 came on board after Chris Anderson took over as CEO in October 1997. At Continental, 50 of 61 senior executives were let go in the early months of the transformation, with only about 20 new faces replacing them. The turnaround of contact lens-maker Wesley Jessen hinged upon the hiring of a new CEO, Kevin Ryan, who subsequently hired a new CFO and replaced many senior managers.

Ryan sums up the philosophy neatly: "It's better to build boys than mend men. You can't spend all that time trying to convert a person unwilling to meet change who has been beaten up for months." Changing out senior management is sometimes necessary even if they are still functioning. At Continental, the "context of history" prevented otherwise competent executives from getting results. Remembers former COO Greg Brenneman, "When I got there, there were several senior operations guys who had had to implement some of [former CEO] Frank Lorenzo's more draconian policies. However competent they were, they would just never again be viewed by the workforce as trustworthy. We absolutely had to change them out."

Changing out senior management was a theme echoed by nearly all of the highly successful transformers in our study. In addition, underscores Wesley Jessen's Ryan, when you do let someone go, you've got to treat him with dignity.

"Cutting people was the hardest part of the whole turnaround," he says. "But we were totally honest with everyone. The first thing is to look them in the eye and say, 'Yes, some people will lose their positions. But I guarantee that you will be treated with great respect, and that we'll give you a pay-out plan that is second to none.' And we did just that."

Making personnel changes can be extremely painful for the entire organization. Often, personal friends must be let go. Yet, as our research demonstrates, this most difficult step is also one of the most critical in successfully turning around a company. Almost without exception, meaningful improvement in the highly successful transformers we studied began only when they made significant personnel changes at the most senior levels.

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[3] This information is available in Bain & Company's 1999 study, "Winning in Turbulence: Strategies for Success in Tumultuous Times," by Darrell Rigby.

...Then re-energize the ranks

After changing out key executives, the next challenge—and arguably a harder one—is to re-energize the employees who remain. How does one restore confidence and drive to a workforce that most likely is severely demoralized? Removing managers who are viewed by employees as incompetent or untrustworthy can provide a quick boost to employee morale.

But in a broader sense, says Kevin Ryan of Wesley Jessen, you have to restore trust, dignity and drive to company culture. You start by making it a place where people want to come to work again. You practice and require honesty at all levels. And you communicate a simple, powerful set of messages to employees. Then you communicate those messages again.

Wesley Jessen, a maker of specialty contact lenses, was a misfit in the portfolio of healthcare giant Schering-Plough for years. The subsidiary was just breaking even and was almost out of cash when Schering-Plough sold it to Bain Capital and the Wesley Jessen management team in June 1995 for a fire-sale price of $6.4 million. It was no obvious bargain: For the first 90 days, no one was sure whether Wesley Jessen would survive at all.

But instead of fading away, Wesley Jessen executed a dramatic turnaround. Ryan and his team started by refocusing the company on its core business (specialty contact lenses) and getting out of the mass-market lens business where it competed with—and lost to—larger competitors like Johnson & Johnson and Bausch & Lomb. Wesley Jessen cut costs, recaptured key customers and jettisoned some unprofitable customers. It also executed some key acquisitions.

The result? In two years, Wesley Jessen nearly tripled revenues and grew net income to a healthy 8% of sales. In 1997 the company issued a successful IPO, garnering a market cap of $290 million (a 45-fold return on equity for shareholders in two years). Then in May 2000, the company agreed to be acquired by Novartis AG's CIBA Vision Corp. for $785 million, another 2.7 times appreciation in equity. In the same month, *BusinessWeek* included Wesley Jessen in its list of top 100 "Hot Growth Companies." The company is now the world's largest maker of specialty contact lenses.

How Wesley Jessen regained 20/20 vision has everything to do with CEO Ryan's ability to crank up the voltage for his employees.

For example, Ryan cites one incident that occurred just a week after he took the company reins. He had called an international sales meeting in Chicago. He told the sales force that he understood the sales job, the loneliness, the frustration. But then he told them to put all that aside.

"You chose it," he said. "Now...let's do it."

Ryan intended to establish the ground rules for what was to come. Across the company, everybody would pull his or her own weight, with no excuses, including Ryan. "You are here," he would say time and time again to employees, from senior management down to the factory floor, "because you want to be." The message: Those who didn't believe that the company could be saved were free to leave. Those who remained would do so because they believed the prospects were enormous if everyone worked together.

In the same vein, Ryan made no effort to retain managers. Those committed to the turnaround and to the challenge stayed; those without the stomach for a bumpy ride or who were blind to the vision Ryan laid out were free to leave.

At the same time that Ryan was replacing executives and reinvigorating operations, he was repeatedly communicating a very concise set of messages to the employees that remained.

"You have to communicate really, really simply," he says. "People are going through a very traumatic event. Don't be cute about it. No big presentations. We had four statements, seven words. They were: 'Build volume. Spend effectively. Be accountable. Cash.' This is what we all have to do. Simple."

Ryan and his team built initiatives around each of the statements and communicated those in more detail to relevant managers. But in terms of transmitting the vision for success to the broader employee base, their communications were concise, simple and hammered home again and again.

Ryan and his team took many steps to create an environment where people would once again want to work. They shared successes: A "victory board" by the cafeteria celebrated new ad campaigns and sales achievements and displayed pictures of Hollywood movie stars wearing Wesley Jessen contacts in their movies. They raffled off a Saturn automobile every six months, with raffle "chits" accumulating only if an employee had a perfect month's attendance ("That solved our direct labor attendance problem pretty quickly," notes Ryan). An informal "kangaroo court" also sprang up, with peers fining peers nominal sums for their more egregious mistakes; it was all done in good fun, and the proceeds went to a local charity.

Even more important than the fun, says Ryan, was the "ELM Principle" that he instituted when he took over the CEO job. ELM stands for Ethical, Legal and Moral, and these became the guiding principles of the company. Implicit in them was a complete honesty and openness with and among employees, even about the bad news. Leading by example, Ryan let people know when cost-cutting or layoffs were happening, and why. He also made a point of sharing the company's financial results with employees on a monthly basis, something that previous management had not done and that Ryan didn't have to do (the company was privately held).

As it turned out, this policy quickly became a morale booster: From a run rate of a $40 million annual loss, the company turned a profit in its first month under Ryan's stewardship. And Wesley Jessen maintained a consistent track record of quarterly profitability until CIBA Vision acquired it in October of 2000.

Ryan acknowledges that a lot of factors went into Wesley Jessen's turnaround. But he believes you cannot ignore the morale and drive of employees if you want to turn a company around.

"You don't do the skill set first. You do the mind-set first."

Do it quickly

In addition to focusing on results, replacing managers and re-energizing the ranks, the best transforming companies do it swiftly. This means implementing change quickly and all at once, rather than easing change into the organization.

How quickly? The most successful transformers we studied substantially completed their turnarounds in two years or less. None took more than three years. And in all cases, some form of tangible, improved results appeared almost immediately.

For example, consider Italy's SEAT Pagine Gialle, or the Italian Yellow Pages. SEAT was a traditional paper-based directory when a consortium of private equity funds purchased it in October 1997 for 1.7 billion Euros. A near monopoly for many years, SEAT, though profitable, was sleepy and inefficient. When an online startup launched by the Berlusconi media group began attacking SEAT's core business (business-to-consumer advertising), the company was caught off guard.

New SEAT CEO Lorenzo Pellicioli understood the threats presented by the Internet, but he also understood the opportunities inherent in it. With the determination of a new owner, he set about transforming SEAT into a European Internet leader.

In the first 18 months of his tenure, Pellicioli built a new management team and slimmed down the company's corporate structure. He cut costs dramatically, yielding 100 million Euros in savings in the first year. He automated several key processes, raised prices, and introduced customer segmentation and sophisticated marketing programs to a monopoly-oriented organization. Finally, he sold the company's main printing plant (Europe's largest), outsourced manufacturing and restructured the sales force. The message was clear: SEAT's future rested in sales, communication and efficiency, not industrial printing.

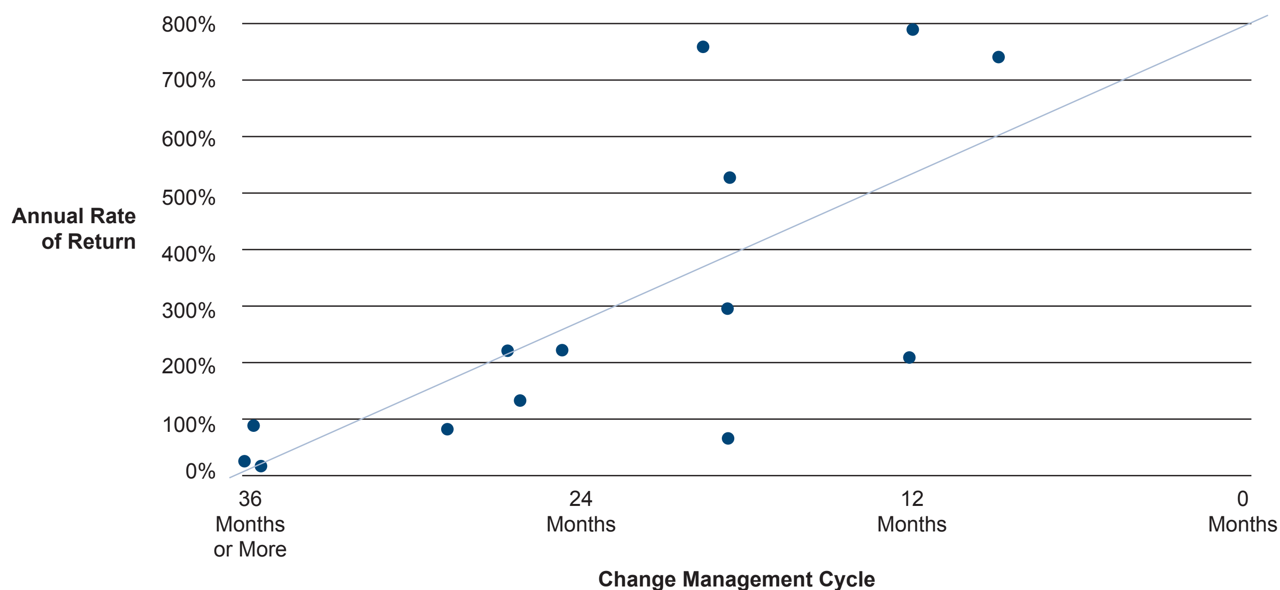
Having shored up the core business, Pellicioli next introduced a series of Internet-based initiatives, including an audio version of the yellow pages. He also led several successful acquisitions, including the landmark purchase of Matrix, the leading Italian portal/search engine.

The result? In less than three years, Pellicioli transformed SEAT from a sleepy paper-based monopoly into the leading consumer Internet portal in Italy, now one of the hottest Internet companies in Europe—in essence, the America Online of Italy. When SEAT's owners sold it in September 2000, it yielded investors a more than 30-fold return.

SEAT, Optus, Continental and Wesley Jessen all created enormous value by implementing fast, focused and comprehensive change. As it turns out, they are not alone. ***Figure 2*** plots the annual share-price appreciation of the public companies in our sample against the amount of time their transformations required. As you can see, longer change efforts correlate with lower returns. The inverse is also true; the top five performers in our sample, generating annual stock-price appreciation in excess of 250%, each completed its transformation in 20 months or less.

This was true for companies in all types of industries and for all types of transformations, not just classic "turnarounds." This finding also correlates with the observations we have made in more than two decades of work in the change management field.

***Figure 2*: Change management cycle: time vs. stock price return**



Source: Bain survey of business transformers

Let us be clear. Our call to transform quickly doesn't mean that managers should act recklessly, nor that moving faster will make a transformation easy. It means that if your company is facing a situation that demands transformation, the window of opportunity for creating value is probably brutally narrow. For every day you hesitate, shareholder value disappears, and the farther you fall behind your competitors, the harder it becomes to catch up—exponentially so.

By hesitating, you may miss important new market opportunities, critical acquisitions, or even the chance to play at all. In capital-intensive industries, for example, a competitor that builds a new plant while you stand by may preempt you from making a similar investment.

Your customers may also give you only one chance to get it right. If you let down a customer once by, say, fumbling an order as your company goes through a sales-force reorganization, he may give you another chance. If six months later you restructure again and transfer that customer's favorite rep to Idaho, your customer may walk.

Your employees, too, are more likely to tolerate a brief interval of change than prolonged uncertainty. Uncertainty breeds distraction and saps productivity. Morale plummets as each "final fix" is followed by yet another, while the company falls ever farther behind. Top performers, seeing the writing on the wall, head for the exits, while the people you'd like to see move on, remain. The result is a doom loop of deteriorating performance, plummeting morale and dwindling talent.

Breaking this cycle requires the managerial equivalent of a cold bucket of water over the head: rapid, comprehensive and dramatic change. Even if you are wrong, you will find out sooner, and the cost will almost surely be less than that of prolonged indecision. If you are right, the rewards can be enormous.

Conclusion

Corporate transformation may be the most difficult professional test an executive will face. Nothing we say here will change that. There is no simple formula for a successful turnaround, because companies and their challenges vary too widely. But the simple, powerful principles that characterize the most successful transformations—focus on results, change out the senior management and reinvigorate employees, and most importantly, do it all fast and simultaneously—apply across industry and company boundaries.

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