

Organization Practice

# What makes an organization 'healthy'?

Research shows that companies can improve short- and long-term performance by focusing on a small number of carefully selected management practices.



**In this episode of the *McKinsey Podcast*,** Simon London speaks with McKinsey partners Rajesh Krishnan and Brooke Weddle about the ins and outs of organizational health.

### Podcast transcript

**Simon London:** Hello, and welcome to this episode of the *McKinsey Podcast*, with me, Simon London. Today we're going to be talking about health—organizational health. But before you reach for your yoga mat, no, this isn't about health and wellness. Instead, we'll be talking about organizations that are healthy in the sense of being high functioning and high performing over the long term.

The concept is based on 15 years of research into the management practices of enduring, successful organizations. To understand more, I spoke with Brooke Weddle and Rajesh Krishnan, McKinsey partners who spend a lot of time with clients working to improve their performance by focusing on their health. So, Brooke and Rajesh, welcome to the podcast.

**Brooke Weddle:** Great to be here, Simon.

**Rajesh Krishnan:** Likewise, Simon. Thank you for giving us the opportunity to do this.

**Simon London:** Brooke, when I hear the words “organizational health,” the first thing that comes to mind for me is Zumba classes and fitness trackers. But that's not what we're going to be talking about, right?

**Brooke Weddle:** No. It's not. But I think the metaphor, in some ways, helps. Organizational health is about the way in which you run your organization to effectively deliver against your performance goals, much as you would with physical health. You want to have an exercise regime that allows you to achieve a level of mental and physical health to be able to deliver against your own ambition levels as an individual. Organizations need to do the same thing.

There's a technical definition associated with this as well. We like to say that organizational health

is composed of three things. One is how well the organization aligns around a common strategy. Two, how the strategy then translates down into the work environment—how well the organization executes against its strategy and its ambition. Three is how well it renews itself over time, which basically means two things: one, looking outside, staying in tune with the customer or its clients, and two, having an internal innovation engine so that you can allow those insights to be brought into the organization and turned into something useful in terms of driving innovation and new capabilities.

**Simon London:** That all sounds very reasonable, but how did we decide that these are the things—alignment, execution, and renewal—that define a healthy organization?

**Brooke Weddle:** The research dates back over 15 years, Simon. Initially, we were trying to understand what set apart organizations that performed for long periods of time. Many of us have seen the data from the S&P 500 where the tenure of the average company is decreasing.

The idea is that the organizations that lasted focused on what we later called organizational health as much as they did on performance [Exhibit 1]. When you break it down, you see that there are nine outcomes and 37 management practices. Those are the things that organizations do to drive the outcome.

**Simon London:** I'm feeling a little bit slow today, Brooke. So, just make sure I understand this distinction between outcomes and practices.

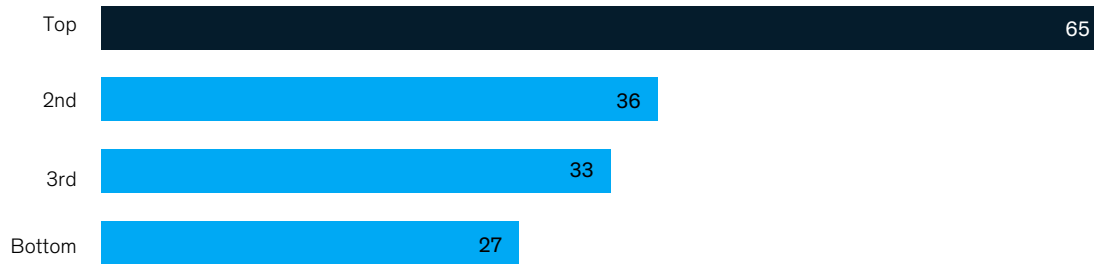
**Brooke Weddle:** Let's take motivation. What do you do to motivate your employees? You pay them. You give them career opportunities. You reward them, and you recognize them using nonfinancial tools and levers. You want to help them find meaning in their work. We've all seen that research. And you need to lead them by being inspirational.

Those are exactly the practices that sit behind the motivation outcome. When we look at those levels of data, we can help an organization understand what

Exhibit 1

## Companies with a strong long-term orientation were predominantly the healthiest.

Organizational health by quartile,<sup>1</sup> % that are long-term companies<sup>2</sup>



<sup>1</sup>McKinsey's Organizational Health Index (OHI) measures an organization's performance across 37 different management practices, looking at how behaviors, actions, and processes contribute to 9 dimensions of organizational health. The quartiles are based on the global OHI database with 750 organizations and 1,583,787 individual respondents.

<sup>2</sup>Businesses in McKinsey's Corporate Horizon Index (CHI) categorized as long or short term by reference to patterns of investment, growth, earnings quality, and earnings management.

Source: McKinsey analysis, published in 2017, of 51 companies for which both CHI and OHI data are available

the levers are that they're using to drive motivation. What is working well? What is not working well from an impact standpoint on that outcome?

**Simon London:** And just to clarify, the data about practices that companies are using and whether people are indeed motivated, aligned, and so on: How do we get it?

**Brooke Weddle:** Well, it's actually quite simple. We ask employees. So, all of our organizational health data comes from the tool, the Organizational Health Index [OHI]. It's a survey that we generally deploy to the entire organization. We ask for their views and perspectives on the nine outcomes that we talked about and the 37 management practices.

We have over six million respondents in the database. I think we're up to two thousand companies that have deployed the OHI—25 percent of the Fortune 500. We like to say that when you add it all up, we have a billion data points on organizational health. The interesting thing about doing it in this way is that, of course, you hear directly from employees, and that's important. But the other things that you see through the data are differences.

One that frequently comes up is that leaders in the company have a very biased view of their organization's health. They have an overly positive view of it. We've been in many eye-opening conversations with leadership teams where we show them the difference in perception between the front line and the leadership team. It's a real moment of clarity, looking at how people are seeing the way in which the place is run, compared to the way you see it, and the blind spots that that suggests.

**Simon London:** And then, of course, you can link the health goals back to performance metrics, which is where the rubber hits the road.

**Brooke Weddle:** That's right. We have research that looks at outcome measures that are related to total returns to shareholders to productivity measures in a call center and even to patient-error rates in a hospital. We're able to look at a diverse set of performance outcomes and link that back to organizational health in terms of positive correlations.

**Simon London:** Rajesh, let me bring you in here. I know a lot of your work is with organizations

going through performance transformations. Just to play devil's advocate: Why are you interested in all this soft stuff about management practices and behaviors?

**Rajesh Krishnan:** It is definitely the behaviors. But I wouldn't characterize it as soft stuff. When we talk about transformations, we're talking about dramatic change in the performance of that organization, which means that the organization is underperforming right now. Something needs to materially change so that it can do better—better margins, better revenues, whatever the metric might be. They're unlikely to do that unless they fundamentally look at what's not working today and changing the way that's done.

Ripping costs out, for example, is not a transformation. If you go in somewhere, you can always find things you can stop buying, but you haven't fundamentally changed the issue that got that company to underperform in the first place.

Looking at the company holistically, running the OHI, which is our instrument to measure health, we understand the behaviors that are getting people in that organization stuck in the first place. We then figure out why that's happening and fix them. This is a commitment you have to make if you want to transform.

When you run the OHI, you might find out, for example, that there's poor consequence management. That people often sign up for goals and targets, but they miss them, and when they miss them, they're not held accountable. Well, if that behavior persists—even if you choose to set a transformation and you have a big aspiration—chances are, people will continue to fail. As a result, you will never get out of the hole you're in.

We think the key is being holistic. Looking at performance: Where do we think there are opportunities, whether from a sales standpoint, an operations standpoint, or a function standpoint? And then looking at health in performance: What is a behavior we need to emphasize and reinforce? We think these two together give you an answer that'll

allow you to get to the end state that you want as a company or as an institution.

## The 'recipes' for strengthening organizational health

**Simon London:** This sounds mighty complicated. I think Brooke mentioned earlier that there are, what, 37 different management practices underpinning the OHI? I mean, surely, in any context, that's too many for managers to hold in their heads.

**Rajesh Krishnan:** We don't recommend that people focus on 37. In fact, we know that if you try focusing on all 37, you will fail. What is important to understand is that when you look at your team, or when you look at your unit, as a manager, you want to get a sense of what's not working well, or as well as you would like it to, and what is important for your success.

And then we would recommend that you prioritize a manageable set of behaviors that will help you go after the performance improvement that you want to unlock. For the transformation contexts that I serve, that number is typically around eight to 12 things, because these are companies or organizations that are looking to drive a material performance gain. For them to do that, there are a number of things they need to change about the way they run their places.

On the other hand, there are some organizations that are quite well run. Maybe it's just a handful, three to five things, that they want to focus on. So, just like when you go to the doctor, there might be a couple of things that look out of whack, and you might want to focus on those and make sure they are under control. This is a true diagnostic. It helps identify the areas of opportunity. Then you should prioritize them, and that becomes the right thing for you to focus on.

**Brooke Weddle:** To build on what Rajesh is saying, we use a concept called the "recipes" to help organizations prioritize the management practices that they're going to focus on, knowing that they shouldn't focus on all 37. The way that we develop the recipes is that we say that it's not good

enough to have the perspective that all 37 management practices are created equal. We should look at the data and see what the top-performing companies in our database, from a health perspective, are doing when it comes to prioritizing these different practices.

When we did a cluster analysis, there were four recipes that emerged. We've done this twice now. The recipes have remained the same in terms of the general clustering. The four recipes are "Leadership Factory," "Market Shaper," "Execution Edge"—or "Continuous Improvement Engine"—and "Talent/Knowledge Core" [Exhibit 2].

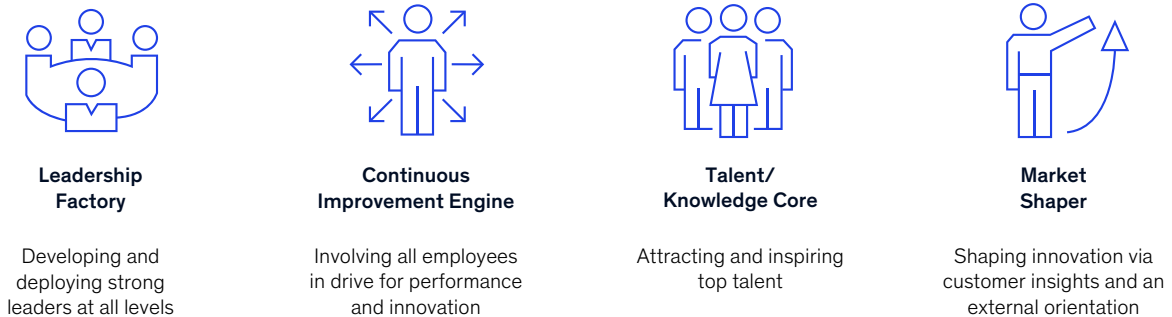
**Simon London:** And just to clarify, each of these recipes describes a kind of management philosophy or an archetype, right? A bundle of different practices.

**Brooke Weddle:** That's right. Leadership Factory would be about deriving a competitive advantage from building a strong leadership advantage. When you look at iconic companies that are doing this, you see them overinvesting in leadership development—in talent programs that put leaders in stretch opportunities and stretch roles—to try to enable that development to happen more quickly, and deriving a competitive advantage.

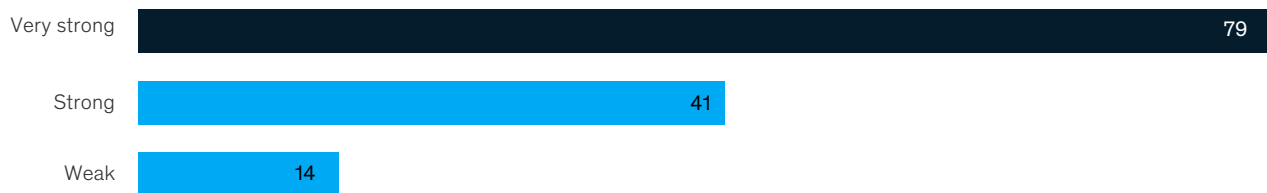
Exhibit 2

**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)**



**Strength of alignment with any 1 of 4 organizational-health recipes,<sup>1</sup>%**



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

Source: McKinsey analysis

For Market Shaper, you see companies that have an outside emphasis on shaping the market, shaping customer preferences, and building goods and services to meet those needs—and even creating goods and services not only to meet a need but also to actually create something that customers didn't even know they needed in the first place.

Third, the Execution Edge is a group of companies deriving competitive advantage from getting better every day. This is where you would see some of the classic lean principles playing out. The heart of the Execution Edge recipe is the group of management practices that focus on innovation—bottom-up innovation, top-down innovation—and leverage the full power of the workforce. You see employee involvement, you see performance transparency—holding people accountable in visible ways.

Finally, you have Talent/Knowledge Core. That's the only recipe that emerges more as an industry-specific type. Here you would find companies that are involved in professional services, R&D. In some cases, you see some of the sciences show up here. Innovation.

The companies here are focused on getting the best talent and expertise and cultivating that in ways that allow them to stay ahead of the competition. Giving people great career opportunities. Of course, paying them very well, in some cases. Rewarding and recognizing them. And ensuring that their recruiting engines are always best in class.

**Simon London:** Rajesh, just to bring us home, maybe give us a concrete example. What are the kind of management practices that underpin one of these recipes? Pick any one you like.

**Rajesh Krishnan:** Let's say you're a manufacturing organization and you have picked the Execution Edge, or the Continuous Improvement Engine, recipe. The practice that is probably the most important to that recipe is performance transparency, which is, very simply put, how to make results in an individual, in a unit, easily accessible and widely available for people to look

at, with the belief that if that information is made available, good things happen.

Let's say you're a manufacturing plant and your yields are low. You're not producing as many units as you would like. Providing performance transparency in that instance, taking the time to say, "Let's have a dashboard that shows—for every single line that we have in this plant—how many units we are producing and how many units have quality defects, or whatever the metric is. And let's just make that available across all the different teams that we have."

What tends to happen in those situations, instantly, is everyone always anchors on who's at the top and if it is possible for them to get from where they are to where they can be, because you made these results accessible. If that line can operate at 96 percent utilization, why are you operating at 72 percent utilization? People try and understand. They're motivated to do better. But they also understand, perhaps, what is allowing that line to operate at its best. And they make changes to their maintenance schedules. They bring in more knowledgeable people to fix things. And it gets better.

Similarly, let's say you're a sales manager who has to sell the products of this plant. And you have a number of salespeople, and your margins have been declining, even though your sales have remained flat. Providing transparency, not just on revenues but also on margins generated by salespeople, often helps, because salespeople tend to be a competitive bunch.

The performance transparency you're providing here is not a culture exercise that's happening on the side. It is a management behavior that allows us to get better by learning what the other person is doing, and just knowing where to aspire to. That's why we don't think these things are separate or that health often is at the detriment of near-term performance. If anything, it is used to accelerate and provide performance gains when used in the right way.

**Simon London:** Presumably, when you open this conversation with clients, most management

teams have a fairly clear idea of the recipe or the management philosophy that they're pursuing. And, therefore, the management practices that they should be prioritizing.

**Brooke Weddle:** A lot of the companies that Rajesh and I work with actually *don't* have at least a common understanding of the recipe or management philosophy that they are pursuing. This causes a lot of cognitive dissonance in the organization about how to run the place: Where should I be spending my time if I have an incremental hour? Should I be on the front line trying to get an hour's worth of improvement out of the frontline crew there? Or, should I spend an hour of my time investing in and trying to understand the next generation of insights from a customer focus group?

It has significant implications for the alignment around a common way to run the place, when you think about this recipe. But most companies wouldn't be able to clearly articulate what that is. The organizational-health discussion allows them to have a clearer conversation about that using a common language.

**Rajesh Krishnan:** You want to constantly—not every year, but every two, three, five years—reevaluate where you are, what recipe you have selected, and what is likely to lead you to success. We think the recipes are useful to get a sense of what sets of behaviors work.

But the recipe, to me as a manager, is not that helpful. What I want to know is, What are the things that my teams think we're not doing as well as others are? Where is there room for improvement? If, for example, you say there are not enough career opportunities, there are not enough rewards or recognition, or that I'm not being a supportive leader, that's helpful for me, because I know what behaviors can help overcome that.

If I'm overanchoring on challenging or authoritative leadership, what are the behavior changes that I need to bring in, so that I'm seen as a balanced leader who's able to get the most out of my team? If

there's a lack of role clarity, it's clear that I probably need to have discussions with all my team members and make it clear who's responsible for what and who they need to go to for help.

Once you move the expectations from "let's follow a recipe for success" to the behavior being the unit at which change occurs, it just makes it tangible. I can get specific actions. If I act, I will improve the health of my team. As the statistics say, when that happens, the performance improves as well.

## The importance of organizational health in performance transformations

**Simon London:** Let's talk a bit more about companies going through real performance transformations, which was the topic for the article "The yin and yang of organizational health." What are some of the considerations in a transformation context in particular? What does the data tell us about what works?

**Rajesh Krishnan:** When we looked at a set of transformations that we worked on over the past few years, there were four themes that emerged, with eight practices, in particular, that led to material improvements in health and in performance. The four themes were, one, making sure there's a clear direction for the transformation. What are we trying to achieve? Is there a vision that all of us can rally around? Is there strategic clarity in terms of all the business units, the teams, and everyone knowing what the goals are that we're going for? What are the milestones? When do we need to accomplish them?

Two, that cascades down to providing clarity and meaning for employees. Does every individual employee know their role in delivering this vision that the company has? Do people feel engaged? Are employees involved in being able to set the direction for themselves? In doing so, do they look for ideas, and do they look for innovations?

Three is about capturing external ideas—looking outside, from your suppliers, from your customers, from other parties that you engage with. Can you



bring innovations in that you can try? It is also about encouraging bottom-up innovation, which is asking your front line to think about how they can provide input that changes the way in which work gets done.

Finally, there is making sure there's a strong performance cadence. The transformations that we undertake have a strong infrastructure that makes sure that you're operationally disciplined, that you live up to the commitments that you have made, and that you deliver on time and in value. But the theme also includes making sure that that's supplemented by supportive leadership, so that if there are genuine reasons why we couldn't perform at the level we wanted to, there is an environment that allows for us to care about the employees' welfare and that gives them a chance to be able to come back and do better.

These are the four things that we think of, when they come together, that are powerful in having a direction, making sure that there is clarity for the individual, that we have ideas that we bring in to spark the transformation, that we have an infrastructure that allows for us to be disciplined. But at the same time, they allow for support and welfare to be priorities that leadership focuses on.

**Brooke Weddle:** The research was interesting—because it was interesting to see operationally disciplined leadership side by side with supportive leadership. Those seemed to be, in some ways, not opposite, but working against each other. How can you be a supportive leader but also have a fair amount of discipline?

When we looked at the other practices, we again saw this theme of balance across the two elements. So, yes, strategic clarity. But that's not enough. You also need to create this more kind of qualitative shared vision. In the case of sparking ideas and innovation, it was about, yes, the bottom-up innovation inside the organization, but the only way to do that well is to look outside and to capture those external ideas.

That's why we ended up calling the article “yin and yang,” because there was a sense of balance

between the two elements. I think that resonated with us in terms of our own personal experience, because even if you go back to the physical-health analogy, you can see that just doing the hard lifting every day would probably not enable you to achieve your health goals. You also have to balance that with stretching, with doing some yoga, with some of the softer elements of exercise. It was interesting the way that that research played out.

**Rajesh Krishnan:** One of the clients that I served made a strong point to emphasize innovating from within. When it had to design new safety equipment, it went to its front line and said, “Well, what do you need? And can we get your input in making sure that we design the best possible visor for you?”

In terms of capturing external ideas, it was a very siloed organization. It was very insular. There was a “not invented here” syndrome, because at some point in time, it had been the best at what it was doing. But then it completely turned around. For any new hire who joined the organization, it spent a few days to a week trying to understand how stuff happened in the old job. Even if the industry was different. Could those ideas have relevance for how this organization worked?

In one of its Asian markets, it found out that there were ways to manage trade, to access different markets, and to manage the regulatory system. This was immensely helpful for unlocking new ways of doing things. These things combined can become powerful.

**Simon London:** What I love about that example is that it's intensely practical. It really answers the question, “What should we be doing differently as a management team today?”

**Brooke Weddle:** I think the point, linking it back to behaviors, is that the recipes can help you, alongside the transformation practices, in focusing on a short set of management practices to focus on. But from there, it is about basically running workouts. You need to build some new muscles. That's when behaviors, and frankly the mind-sets that underlie them, come into play.



This is not about just talking at the level of “we need better role clarity.” It’s about understanding: “Well, what’s the mind-set holding us back from not having straightforward conversations about my role versus yours?” Maybe that feels uncomfortable. Maybe there’s an issue around power and me wanting to keep doing this part of the job because I get a lot of recognition for it. Without going and doing that deeper work, you won’t be able to make those behavioral shifts that we know are critical to driving improvements in health.

**Simon London:** What are some of the dos and don’ts for getting substantive, sustainable improvements in organizational health? What are some of the failure modes? What are some of the things not to do?

**Rajesh Krishnan:** Probably the most important thing that we’ve found is that you shouldn’t do this on the side. This is not a culture program for a culture’s sake. This is not about trust falls and doing cartwheels and singing “Kumbaya.” This is about “if we look at how we get work done, what do we need to do better?”

You need a top team that is committed to making the change happen. Because, as with everything, role modeling is the single most important thing to do. In general, there are people who don’t know what is being asked of them. Or there are multiple people doing the same thing. It often tends to be because the top team has overlapping responsibilities or has a misunderstanding of who’s actually responsible for what outcome.

Fixing those issues means getting those people to be clear in terms of: Who’s responsible for what? Who do they need to go to for authority? By when do they need to get things done? Who else do they

need to get input from? If that role modeling is done by the top, we find that that flows down across all the ranks of the organization. Having the CEO and the top team bought into the types of change that you’re bringing about is important.

**Brooke Weddle:** I think the common trap here is that when working on organizational health—because it is perceived to be, and in some sense rightly so, a way to change the culture of the organization—it is seen to be an HR topic only. I think Rajesh and I would both say, based on our experiences, that keeping it only in the realm of HR significantly limits the potential of the organization to drive health.

Rajesh mentioned the need to have the top team fully bought in and role modeling the organizational-health behaviors. When it’s seen as something on the side, something driven only by HR, the impact of role modeling is that it doesn’t happen or is that it doesn’t happen as well.

**Simon London:** On that note, I’m sorry to say we are out of time for today. Brooke and Rajesh, thanks for your patience putting up with a lot of basic questions. It was enlightening and great fun talking to you.

**Brooke Weddle:** Thanks, Simon. It was a lot of fun to be here.

**Rajesh Krishnan:** Thanks. We appreciate your questions, and hopefully, we can do this again at some point.

**Simon London:** Thanks, as always, to you, our listeners, for tuning in. To learn more about organizational health, OHI, and the link between performance and health, please visit [McKinsey.com](https://www.mckinsey.com).

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