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**Sustained High Performance and the
Role of Agility**

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*Competitive environments change continuously, and the pace of change continues to increase. Yet some companies in every industry show superior performance relative to their peers over very long periods of time. Does your company have the **agility** required to keep up?*

Through the 1980s, Exxon was the largest, most profitable oil and gas company in the world. It had shed ancillary businesses, like steel and office equipment, to focus on oil and gas, and was exiting peripheral operations like coal and chemicals. In an era of low oil prices, it reduced overhead costs by shrinking corporate headquarters and moving it from Manhattan to Dallas. Exxon moved aggressively into Asian markets where it had little presence historically.

But by 1989, Exxon was in trouble. The company was reeling under the regulatory, legal, and media scrutiny brought on by the Valdez spill in Alaska's Prince William Sound. It spent \$2 billion on the clean-up effort, and was subject to more than \$6 billion in punitive fines and damage claims over the next seven years. Moreover, the perceived arrogance and indifference of Exxon management created a public relations disaster. Also in 1989, Exxon's Baton Rouge refinery exploded and 567,000 gallons of heating oil spilled into an estuary between New York and New Jersey. These incidents sullied the industry and killed prospects for oil and gas development in the Arctic National Wildlife Refuge. When Lee Raymond took over from Lawrence Rawl as Chairman in April 1993, Exxon had dropped on Fortune's list of most admired companies from number 6 to 110. As Lee Raymond noted in a rare interview, a good day for him was one in which "Exxon" or his name did not appear in the papers.

Following the events of 1989, Exxon internalized the lessons of the Valdez spill by implementing a rigorously tested global drug and alcohol policy, and quietly went about the business of finding, producing, and selling oil and gas. It relentlessly drove for efficiency over the 1990s as gas prices collapsed, finally settling at less than \$20/bbl. in 1997 before beginning its apparently inexorable rise. It exited businesses and markets where it did not have critical mass, and steadily reduced employment by 3% per year.

Exxon improved their exploration capability, where it had historically not been strong, and pushed production efficiency, for which it was known. Exxon halved its cost of finding oil and greatly improved its success rate thanks in part to a rigorous project evaluation process. As Raymond told the FT in 1995, “Exxon is now much more efficient at getting on with it.”

Exxon’s focus on execution, technical excellence, and capital efficiency positioned the firm well to exploit the rise in oil prices beginning in 1998. In 1999, Lee Raymond, dubbed by Business Week as the “anti-celebrity CEO,” engineered the largest acquisition in history to that point, and one of the most successful, with Exxon’s purchase of Mobil. In 2000, the combined company became the most profitable in history and launched a new series of exploration initiatives to spur growth in oil and gas reserves.

What can we say about Exxon’s evolution and performance? First, Exxon’s repeatedly ability to successfully respond to environmental change, to react to and learn from events, to innovate both technically and organizationally, and to plan a course of action different from its competitors implies a level of agility that is uncommon among oil and gas firms. Second, based on our study of 243 large firms in 17 industries over the 30-year period from 1979 to 2009, Exxon is a great performer. Between 1979 and 2009, Exxon’s return on assets exceeded the industry average 97% of the time.

The story of Exxon and ExxonMobil is one of agility, redemption, learning, and performance. News stories that make interesting reading or, in Exxon’s case, an absence of publicity, do not often reveal or reflect a company’s real performance pattern, and they can lead to erroneous conclusions about the drivers of firm performance. Stock prices and shareholder returns in particular, often do not tell the whole story. Equity markets are subject to fads, irrational exuberance, and panics that have little to do with the quality of the business strategy, management insight, and organization designs that produce profits. Exxon and ExxonMobil stock languished despite exemplary

performance during the dot-com craze. While all industries are subject to the effects of recession, inflation, and social change, the relative performance of industries changes according to their own events and cycles, causing even industry darlings to revert to market means.

But when the measure of performance is profitability, there is a surprising persistence overlong time periods that begs explanation. In every industry, we found three performance patterns:

- A few “outperformers” that consistently surpassed the industry average return on assets (ROA) at least 80% of the time;
- A larger number of “underperformers,” with ROAs below the industry average at least 80% of the time; and
- A third group we labeled “thrashers” to describe their oscillation between under-performance and out-performance relative to the industry average.

As shown in Exhibit 1, both Exxon and Shell are outperformers in the oil and gas industry, with ExxonMobil outpacing everyone after 2000. Other outperformers in their industries include GlaxoSmithKline, Johnson Controls, Campbell Soup, and Nike. BP and ConocoPhillips thrash about the oil and gas industry mean. Thrashers in other industries include such well-known firms as Procter & Gamble, IBM, Pfizer, and Apple. The spectacular press descriptions of some well known companies can result in reputations for excellence that far exceed their actual financial performance. These companies are admired for their peaks and forgiven for their valleys. Meanwhile, Exxon and Shell, despite their occasional stumbles, have consistently delivered the goods.

What could explain these performance patterns and their persistence over time?

Exhibit 1 about here

Agility and Performance

Our answer to that question emerged from surveys and interviews with more than 6,000 directors and executives at more than 55 companies, 33 of which were Fortune 500 firms. We asked about the way their organizations formulated strategy, designed their structures and processes, led their people, and changed and innovated. We then compared the answers with our lists of outperformers, thrashers, and underperformers.

The data showed a strong relationship between long-term profitability patterns and a company's basic style of management, specifically the way it responds to changes in the outside world. When markets and technologies changed rapidly and unpredictably – as they have in every industry – the outperformance pattern could only have resulted from the capability to successfully change and adapt – what we call agility.

Although the increasing popularity of the agility concept provides an enticing opportunity to call anything that can change “agile,” agile organizations change and adapt in more timely and more effective way than thrashers and underperformers. They are able to see the need for change sooner and more accurately, they have a measured and disciplined way of innovating, and they implement large-scale change LESS frequently by more effectively. Whereas one any one of the features listed above can drive effectiveness at a particular point in time, agile organizations possess all of these features – more or less – and that's what allows them to sustain above average levels of performance over long periods of time.

That's why Exxon and Shell have outperformed the industry over the long term. Both firms demonstrated the ability to formulate and implement strategies that were successful in the short run and both firms were able to make small and large adjustments in their organizations. They continue to do so today.

What Makes an Organization Agile?

Agility is a dynamic capability that enables timely, effective, and sustainable adaptations to environmental change. It is an internally consistent and mutually reinforcing system of knowledge and skills, processes, tools, and experience. Academic researchers distinguish between capabilities that determine what an organization is able to do (e.g., enter new markets, expand retail outlets quickly, or integrate acquisitions well) and “dynamic capabilities” that provide the ability to reconfigure assets, people, and structures. In this sense, agility is a specific type of dynamic capability. It can be applied to large strategic bets that transform the organization – think IBM’s transformation from products to solutions – or to modifying or extending existing capabilities, dropping ones that no longer drive value, or building new ones. The outperformers, such as Limited Brands, Honda, and Nokia, are able to maintain or enhance their relative advantages in ways their competitors fail to see or do not fully implement. It is a strategic-level analog to the “continuous improvement” concept in the quality movement.

Pharma Sidebar about here

Agility is built on a foundation of good management, but with an important twist. Amidst all the dynamism associated with agility, organizations require some stable grounding. In the short-run, most effective organizations have a widely shared and understood strategy and business model, a clear purpose that articulates what the firm does (products, services), whom it serves (customers, stakeholders), and how it delivers value (makes money, measures success) in a differentiated way, ideally applied to every product and service in the enterprise. Well managed firms also have strong sets of values and codes of behavior that revolve around honesty, integrity, and mutual respect.

But agile firms specifically twist each of these traditional strategy and management frameworks in favor of change over stability. Executives recognize that strategies and capabilities are wasting assets that must be tied to market and customer changes, their

cultural values must support the importance of changing, and the organization’s brand and reputation must be grounded in responsiveness. In short, agile organizations have what we call a change-friendly strategy.

In addition to change-friendly strategies, respondents from outperformers consistently identified three things that differentiated them from the chronic underperformers and the thrashers: the ability to accurately *perceive* changes in a company’s external environment, *test* possible responses, and *implement* changes in products, technology, operations, structures, management systems, and capabilities as a whole (see Exhibit 2). The ability to do this over and over again confers sustained, superior performance relative to competitors.

Exhibit 2: The Components of Agility

Component	Observable Behavior	Description
Perceiving environmental change	Sensing	The organization explores the future deeply, and many parts of the organization touch the environment continuously.
	Communicating	Information from the environment gets to decision makers rapidly, in an unfiltered way. Information flows easily, in both directions, between the bottom and top of the organization.
	Interpreting	Information is evaluated on the basis of the company’s existing identity, strategy, business model, and risk tolerance.
Testing responses	Slack resources	Capable resources (people, money, time, tools, etc.) exist that can be readily deployed to experiment with new ideas.
	Risk management	These experiments are bounded by risk tolerance and clearly agreed-upon criteria for judging success and failure.

	Learning	Experience with running experiments is captured and applied with each new round, so that the company's capabilities continuously improve.
Implementing change	Management and organizational autonomy	Executives delegate sufficient authority to line and business managers to make experiments successful; there is no second guessing from HQ, only alignment around basic strategic objectives.
	Embedded change capability	The pragmatic ability to change collective habits, practices, and perspectives is embedded in line operations, not isolated in functional groups.
	Performance management	Clear, unambiguous, accepted performance measures and targets are based on business model drivers with rewards that matter.

Perceiving environmental change. Agile companies take care to sense what is going on in the environment – short, medium, and long term - through multiple touch points and structural choices that put managers and employees in direct contact with customers, regulators, and other stakeholders. They are skilled at communicating those sensations in unbiased and unfiltered ways to decision-makers in the company, and they have the support and knowledge they need to interpret those messages as important or unimportant, opportunity or threat. All three elements are essential. Sensing without communicating is wasteful; communicating without interpreting is just noise.

Thrashers and underperformers, with inward looking and politicized managements, find this congenitally difficult. They are too busy vying for turf, resources, and position to dispassionately consider the implications of outside signals. Management in agile organizations is outward-looking and objective. They can face up to brutal facts and balance the need for clear accountability against the equally important need for versatility in facing options.

Testing responses. Agile organizations want to know, “What can we do with the insights from our perceiving process?” They answer that question by running relatively low-cost experiments to test and refine their interpretations of the information they have gathered. Effective testing and innovation activities range from gathering further intelligence, to trying out new ideas on a small scale, to full-scale product development programs. In most cases, there are explicit risk management processes – with valid success criteria so the plug can be pulled if the test fails – and continuous learning efforts so that the insights gained from the tests spread to all relevant parts of the company. They invest significantly in learning and continuous improvement, never resting on their laurels or believing they have “cracked the code” once and for all. Decision makers in these organizations are pragmatic.

To run these tests, agile organizations are not always and everywhere “lean and mean.” They build in extra “organizational slack” -- investment that doesn’t go directly to the bottom line, but allows the agile organization to rapidly deploy capable people and resources against opportunities that may or may not pay off, without jeopardizing day-to-day operations. These people also play an important role in capturing and disseminating learning that the organization can use later. While agile organizations often change, they are not overburdened by change and they do not pursue change for change’s sake.

Implementing change. Successful tests or promising innovations lead to full and unambiguous commitment. The agile organization rapidly changes to adopt them. In general, agile companies have mastered the internal program development and change management capabilities needed to implement large- and small-scale changes with speed, certainty, and precision. These companies have histories of successful transformations, restructurings, and merger integrations when required. Limited Brands successfully shed its original brands and implemented a shift to its Victoria Secret and Bath and Bodyworks brands; Cisco Systems, Oracle, and GE’s have highly refined merger and acquisition integration processes.

The implementation of change relies on managerial autonomy and shared leadership. The change capability is not relegated to a staff function at headquarters. Rather, it is embedded in line and staff organizations. Once a decision is made, managers charged with implementation are monitored, but not second guessed. There is little resistance since people are comfortable with transitions. Finally, there is a strong-form performance management system: performance targets are objective and unambiguous while positive and negative consequences are real and transparent.

While it is convenient to describe organizations as agile or not agile, that's too simplistic. Agility is a matter of degrees, not an all or nothing characteristic. Any organization that has survived over some relatively long period of time is, *prima facie*, agile. When it comes to agility and performance, however, the issue is whether the organization is able to make a *series* of timely, effective, and sustainable adaptations (as opposed to ill-timed, somewhat effective, or un-sustained adaptations). The point of most organization transformations is to adapt; the point of pursuing agility is to become more adaptable.

Our data suggest that firms with high scores on three or four of the agility attributes (change-friendly strategy, perceiving, testing, implementing) are 6 times more likely to be a sustained outperformer in their industry. On the other hand, fewer than 20% of the firms in our sample have this performance pattern (see Exhibit3).

Exhibit 3: Agility and Long Term Performance

		(% of years ROA is above industry mean)		
		<50%	51% - 79%	>80%
Number of Agility Components scoring above sample mean	3 or 4	6%	30%	18%
	0, 1, or 2	27%	15%	3%

Percent of Firms in Each Category

Note: I would like to see this converted into an information graphic. Not sure what type, but would like our information graphics specialist, Linda Eckstein, to look at it.

Making Organizations More Agile

Developing the agile capability from a more stability-oriented mindset is no small feat, but it has been done. For example, transformations at IBM, DaVita, and Harley-Davidson demonstrate that it is possible by committing to the approach and following through. Harley-Davidson is one of a handful of companies in our survey group that transitioned to a more agile form and demonstrates how organizations can build perceiving, testing, and implementing routines.

As exhibit 4 shows, the company's performance has been consistently higher than auto industry norms for more than 20 years. Yet in 1980, H-D was as good as dead. Its corporate parent AMF had put the company up for sale and found no takers. Japanese competitors like Honda had not only encroached on America's last domestic motorcycle brand, but had opened up entirely new segments of commuter and recreational users.

Exhibit 4 about here

In 1981, Vaughn Beals and twelve other H-D executives took the company private in a leveraged buyout. In a desperate bid for survival, they shrank the company by one-third and rapidly implemented a number of Toyota production system techniques to improve product quality and reduce cost. In 1983, they successfully petitioned for the "Harley Tariff" on imported motorcycles over 700cc to give them some breathing room. 1983 also saw the formation of the Harley Owners Group (HOG), a stroke of marketing genius that created the largest factory sponsored club of its kind and enabled direct communications between H-D and its most fervent customers.

When Rich Teerlink took over as CEO in 1987, he inherited a company that had been rescued from the brink through a strong form of "command and control"

management. Naturally, there were questions about whether Harley could sustain its success without a crisis to compel its employees. But instead of reverting to their past levels of performance or top-down management style, Teerlink and his senior management team engineered a further transformation of Harley-Davidson to a model of shared leadership and accountability, continuous improvement, and investments in learning and development. H-D managers and employees were asked to go from a “tell me what you want me to do,” to a “given where we’re going, I’ll figure out what’s best to do” style of managing.

Through a series of initiatives, including a “joint vision process” involving the top 130 executives and union leaders that clarified and codified H-D’s identity and the installation of a planning and performance management system called the “business process,” Teerlink’s management team made a variety of managerial improvements. They built an integrated, cascading organizational goal setting process that provided line of sight from the executive to the worker on the floor. Personal and organizational goals were incorporated into appraisals and variable compensation. Leadership and accountability were distributed throughout the organization. Along the way, they paid close attention to the three components of agility:

- Perceiving environmental change: At Harley-Davidson, every employee engages with the outside world – particularly the needs and wants of customers. Through the Harley Owners Group (HOG), employees from CEO Keith Wandell on down ride with customers, attend HOG rallies, and participate in sponsored musical and sporting events. There is also constant formal and informal contact with H-D dealer and supplier networks, and an expanded website where customers can interact directly with marketing and product development. To help communicate the ideas that come in, H-D has a shallow hierarchy and little cultural tolerance for gatekeepers and apparatchiks who would impede or filter information flow to executives.

- Testing responses: The ideas coming from HOG and dealer connections are routinely vetted for viability. Everything is tested: marketing programs, model customizations, new motorcycle models, new engines, new styling, new manufacturing methods, new ways of working with customers, and new markets. Harley also adopted the quality movement practice of “plan-do-check-act” planning, where each new activity is developed in the context of a test of its results; and the military practice of “after action reviews,” where participants in a campaign meet in intensive sessions to analyze successes and failures.
- Implementing change: Harley-Davidson has repeatedly demonstrated its capacity for ongoing change since its leveraged buyout. In 2011, for example, and building on data from its customers and manufacturing operations, the company embarked on an ambitious, integrated program to deliver a full-blown “mass customization” capability. This involves standardizing and streamlining the product development process, enabling a wide variety of customization options through dealers and the web, and restructuring the manufacturing process to a flexible system that can produce any custom version of any bike in any plant on any day. To accomplish this, Harley engaged its unionized workforce to dramatically change work rules and move from 62 job classifications to five. They also reorganized and scaled down their manufacturing footprint.

By the time Rich Teerlink retired in 1999, his team had transformed Harley-Davidson from an inward-looking, marginal, command and control organization to an agile, dynamic, market leader permeated with shared leadership and accountability. Contact with the environment is direct and pervasive. Information flows freely across an organic structure that mirrors major process flows. Curiosity, experimentation, and direct action are explicitly encouraged and rewarded. But it is a controlled chaos, held together by the centripetal forces of a strong identity and shared values.

The Agility Challenge

Many of the “usual suspects” in agility - Cisco, Google, Microsoft, etc. - may have had this capability from the beginning. Some seem to have it innately; others deliberately created it. Their basic sense of purpose and management supports adaptability over stability and flexibility over inertia. Their leaders and employees see the ability to change and adapt as the key to long-term success. They do not fear or avoid change; they embrace it as their primary advantage.

Managing agile organizations means being willing to give up the activities that make you successful today - but that won't be appropriate tomorrow - over and over again. By contrast, thrashers often increase their commitment to successful courses of action but miss important inflection points in the market. BP continued to emphasize cost performance over process safety and compliance for years, resulting in disasters like Texas City and Macondo. Toyota was enamored with being the biggest auto company in the world (“Global 15”) and ignored important safety issues. Most outperformers do not make those mistakes.

But perceiving the value of constant change is only the first step. Translating that perception into productive action requires know-how, processes, infrastructure, and resources. Leaders must commit the organization to a new course of action, mobilize resources, and implement. Machiavelli's insight on change is as relevant today as it was in the fifteenth century: “Whosoever desires constant success must change his conduct with the times.”

Beginning of Sidebar

SIDEBAR: Agility and Advantaged Capabilities in Pharmaceuticals

At any particular time in competitive markets, companies cannot generate profit without a set of advantaged capabilities – in order to *do better* than peers financially, they need to *be better* at what is critical to success. As Paul Leinwand and Cesare Mainardi suggest in *The Essential Advantage: How to Win With a Capabilities-Driven Strategy* (Harvard Business Press, 2010), an advantaged system of capabilities can establish a “right to win” and contribute to profitability. But winning in one period does not guarantee success in the next, and highlights the underlying necessity for agility to drive performance over time.

The story of three pharmaceutical companies – Merck, Pfizer, and Glaxo-Smith-Kline -- illustrates this insight. During the mid-1980s and early-1990s, the central driver of value in pharmaceuticals was research productivity. Scientific drug discovery was awakening in companies like Merck and in emerging companies that would become giants of the biotech industry, such as Genentech and Biogen. As Merck built a leading position in the industry, it developed a system of differentiating capabilities that reinforced one another, including:

- Consistency and efficiency in the product development and launch process;
- Highly effective marketing and distribution for new and existing pharmaceuticals;
- Scientific prowess and a reputation to match, based on deep trust and advantaged relationships with key opinion leaders and clinicians;
- Disciplined management, able to drive low SGA ratios.

Many specific activities supported each of these capabilities – for instance, Merck’s investment in the Merck Manual, a bible for clinicians, underscored its commitment to science and medical practice. These capabilities hung together coherently: the emphasis on science went hand in hand with the ability to control SGA; the scale of their research operation enabled stronger formalization of development processes and the creation of a more consistent discipline for ensuring successful launches. Merck led the industry in return on assets from 1986 through 1992.

As industries change, however, the capability systems that confer a right to win in one era may not deliver that right to win in the next. Partly because of the example set by Merck’s own successes, widely followed by others in the industry including GSK, and also because of technological advancement, pharmaceutical research broadened. The number of new drug applications approved by the FDA expanded significantly from the mid 80s through the mid 90s. As a result, a different model, anchored in

commercial productivity rather than an R&D productivity edge, became dominant. A different company, Pfizer, became more successful after 1995, rising to the top of the industry ROA rankings and dramatically outgrowing its peers. Its capabilities system was as coherent as Merck's had been, but with a distinctly different center of gravity. It included:

- Marketing prowess based on superior analytics and a field sales force with almost military discipline;
- A company-wide understanding of how “blockbusters are made,” so that Pfizer could determine early exactly what claims needed to be supported to deliver \$1B+ revenue from a compound
- Aggressive licensing and promotion strategies so that Pfizer could be the “partner of choice” with other medical organizations
- Relentless innovation in its own business processes. Pfizer went beyond conventional functional excellence in supporting its business objectives. For instance, it was a very early leader in strategic outsourcing, which enabled its IT organization to build superior analytics and sales force automation capabilities around the world.

These capabilities were the envy of the industry, and earned Pfizer the honor of being Fortune's Most Admired Pharmaceutical Company in 2001 – while Merck faltered, both in reputation and profitability. By then, however, a set of forces were already operating that would undermine Pfizer's ability to achieve an economic advantage from this capability system: strengthened generic alternatives in primary care, a shift in the balance of power from clinical decision-makers to economic buyers of pharmaceuticals, healthcare affordability crises for major governments, and an industry-wide decline in the productivity of large R&D organizations.

During each of these eras of pharmaceutical industry evolution, GSK, like ExxonMobil, continued to be an above average performer. GSK was rarely the best performer at any point in time and did not get the attendant media and street press, but year in and year out, they performed. Their capability systems – at any point in time – may not have been as good as Merck's or Pfizer's, but they were good enough to be effective. And more importantly, their capability sets were not so refined that they could not be changed to support a new set of environmental success factors.

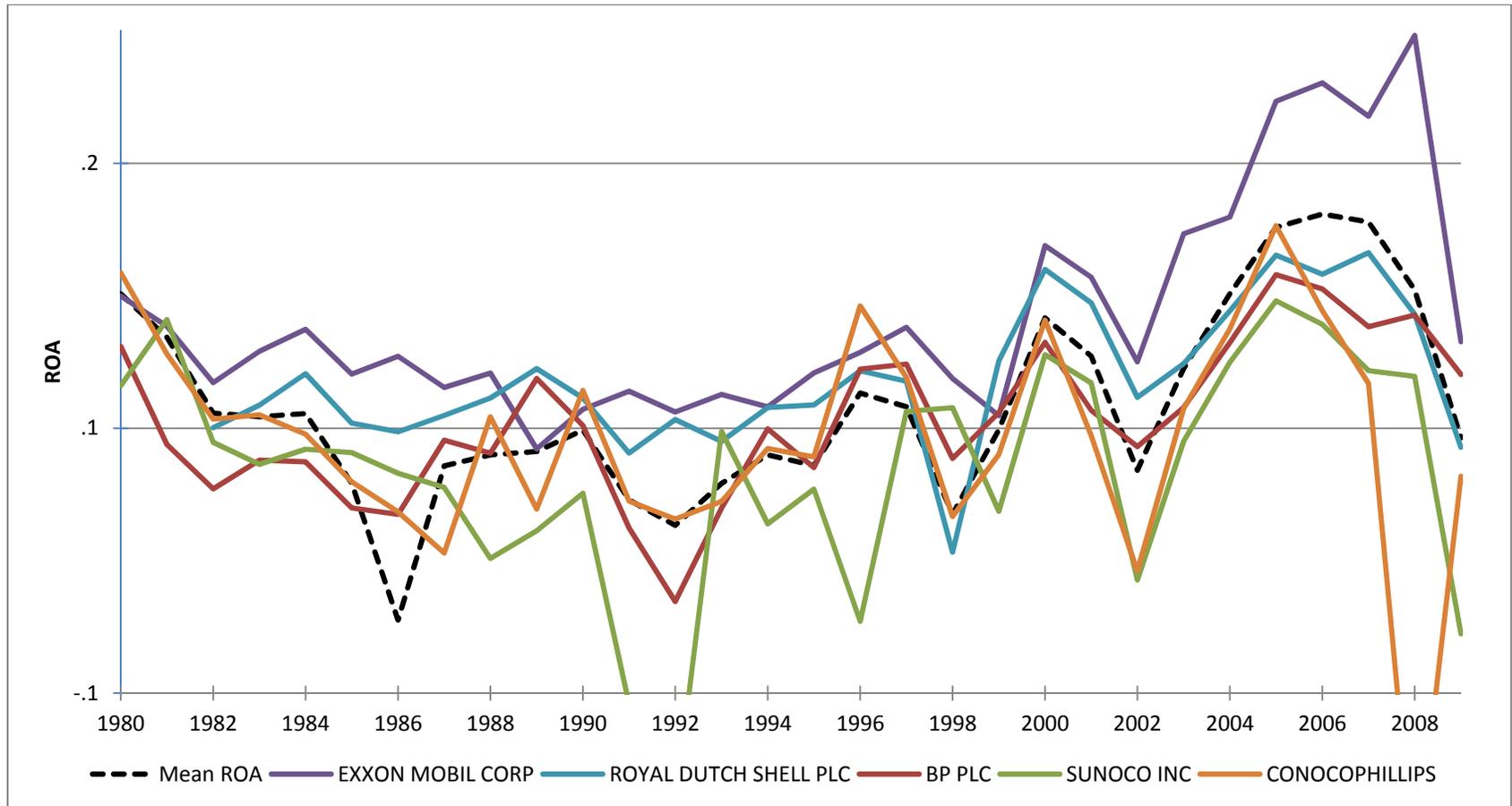
The types of changes reflected in pharmaceuticals were mirrored in every industry sector we studied over the arc of three decades. Capabilities systems, in themselves, change more slowly and generally lag changes in the industries around them. Successful companies therefore need two types of change capability - they need to be able to improve their capabilities more rapidly than competitors can copy them and they must be able to rebuild and revise their system of advantaged capabilities in time to meet disruptive changes when they occur. Every industry we studied had at least one

firm that demonstrated this ability to shift their strategies, structures, and capability systems. Neither Pfizer nor Merck were able to meet this standard, but GlaxoSmithKline was.

Capabilities are hard for organizations to build, and harder still for competitors to replicate. That is why they confer advantage. But as environments inevitably change, the hard-won advantage that a capability provides may no longer suffice.

End of Sidebar

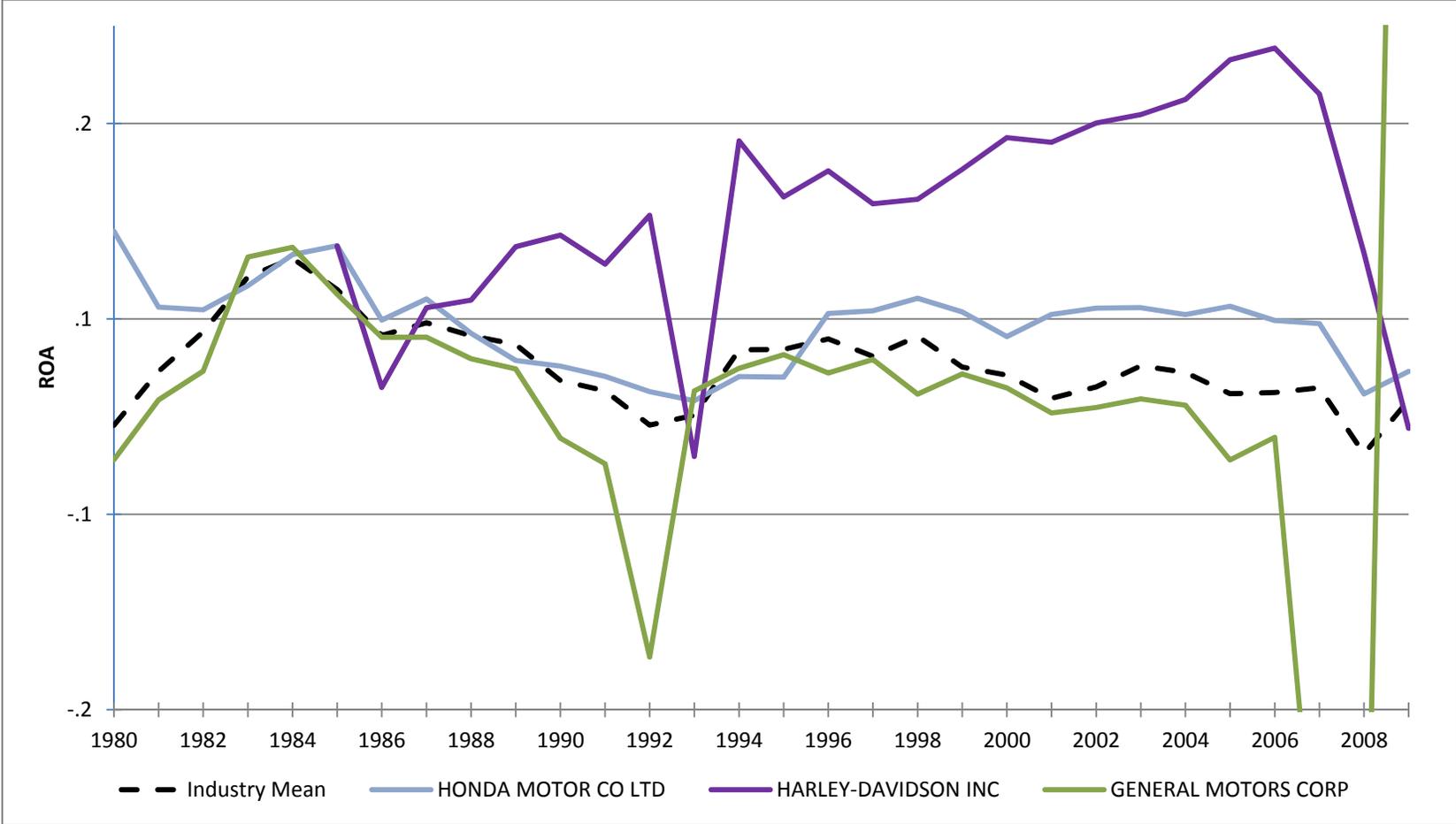
Exhibit 1: Shell and Exxon Performance Compared to the Oil & Gas Industry



Caption: Contrary to the scribblings of a fickle business press, both ExxonMobil and Shell are outperformers. In fact, Exxon beat the industry average in 29 of 30 years.

Source: Williams, T. and C. Worley. (2012). "Performance where it matters." White paper, USC Center for Effective Organizations, Los Angeles, CA.

Exhibit 4: Return on Asset Performance for Harley-Davidson and Selected Auto Industry Companies



Caption: After its leveraged buyout in 1981, Harley-Davidson enjoyed a rapid boost in performance to levels it sustained for over 20 years.