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Competing through organizational agility

Three distinct types of agility—strategic, portfolio, and operational—help companies navigate turbulence. Each of them has its own sources and challenges.

Donald Sull

Market turbulence did not begin with the fall of Lehman Brothers, and it will not end when the global economy recovers.[1] Indeed, a variety of academic studies—using measures such as stock price volatility, the mortality of firms, the persistence of superior performance, the frequency of economic shocks, and the speed of technology dissemination—have concluded that volatility at the firm level increased somewhere between two- and fourfold from the 1970s to the 1990s (see sidebar, "Recommended reading").

In turbulent markets, organizational agility, which I define as the capacity to identify and capture opportunities more quickly than rivals do, is invaluable. Executives know this: a recent McKinsey survey found that nine out of ten executives ranked organizational agility both as critical to business success and as growing in importance over time.[2] The benefits of enhanced agility, according to survey respondents, include higher revenues, more satisfied customers and employees, improved operational efficiency, and a faster time to market.

Don Sull is a professor of management practice at the London Business School and author of *The Upside of Turbulence*, which introduced the concept of operational, portfolio, and strategic agility.

Over the past decade, I have analyzed more and less successful companies in some of the world's most turbulent geographical and

[1] I define turbulence as a measure of the frequency of unpredictable changes affecting the ability of companies to create and sustain value.
[2] "Building a nimble organization: A McKinsey Global Survey," mckinseyquarterly.com, July 2006.

product markets, including China, Brazil, European fast fashion, and financial services. This research underscores the importance of agility for success in turbulent markets. My findings also revealed three distinct types of agility: strategic, portfolio, and operational. Strategic agility consists of spotting and seizing game-changing opportunities. Portfolio agility is the capacity to shift resources—including cash, talent, and managerial attention—quickly and effectively out of less promising business areas and into more attractive ones. And operational agility involves exploiting opportunities within a focused business model.

Many organizations rely on a single form of agility—companies like Southwest Airlines or Tesco excel at seizing operational opportunities, while private-equity groups like TPG Capital or Kohlberg Kravis & Roberts (KKR) succeed through active portfolio management. In turbulent markets, however, overreliance on a single type of agility can be dangerous. An operationally agile company, for example, is at risk if its core business becomes less attractive. By detailing how companies have enhanced each type of agility, this article seeks to help other managers do the same.

Recommended reading

The works below present evidence on rising market turbulence, which can be measured in a number of ways:

Firm-level volatility

Diego A. Comin and Thomas Philippon, "The rise in firm-level volatility: Causes and consequences," *NBER Macroeconomics Annual*, 2005, Volume 20, pp. 167–228.

Probability of exit

George P. Baker and Robert E. Kennedy, "Survivorship and the economic grim reaper," *Journal of Law, Economics, and Organization*, 2002, Volume 18, Number 2, pp. 324–61.

The speed with which industry leaders fall from their thrones

William I. Huyett and S. Patrick Viguerie, "Extreme competition," mckinseyquarterly.com, February 2005.

Robert R. Wiggins and Timothy W. Ruefli, "Schumpeter's ghost: Is hyper competition making the best of times shorter?" *Strategic Management Journal*, 2005, Volume 26, Number 10, pp. 887–911.

Strategic agility

Many complex interactive systems—such as weather patterns, seismic activity, and traffic—follow what mathematicians call an inverse power law: the frequency of an event is inversely related to its magnitude. In turbulent markets, an inverse power law implies that companies face a steady flow of small opportunities, periodic midsize ones, and the rare chance to create significant value. Examples of golden opportunities include major acquisitions, transformational mergers, the opening of booming markets such as China or India, launching a breakthrough product like the iPhone, or securing hard assets on favorable terms during an economic crisis.

Given the unpredictable nature and uneven distribution of golden opportunities, a combination of patience (to wait for the right time to strike) and boldness (acting when that time arises) is crucial. Carnival, for example, entered the cruise business in 1972 but didn't build any new ships until the late 1970s, when CEO Ted Arison recognized that airline deregulation would reduce the price of flying to Miami just as the television series *The Love Boat* was serendipitously educating consumers on the merits of cruises. As Carnival commissioned the industry's first new ship in nearly a decade, the industry leader, Royal Caribbean, enlarged two existing ships by carving them in half with welding torches and inserting a new midsection. By the time Royal Caribbean ordered new ships, Carnival had seized a large chunk of the growing market.

An effective combination of patience and boldness is easy to recognize in hindsight. But pulling it off in the heat of battle is no mean feat. Observing a sizable number of organizations that have demonstrated strategic agility has highlighted for me three principles that may prove useful for other companies.

Probing for opportunities

In recent decades, few companies have demonstrated more strategic agility than Spain's Banco Santander, which rose from a midsize Spanish bank in the 1980s to become one of the world's ten most valuable banks today. Santander built a strong presence in Latin America when the opportunity presented itself and snapped up two UK banks, Alliance & Leicester and Bradford & Bingley, during the current economic crisis.

Santander's approach illustrates the value of small-scale probes to help companies explore potential opportunities. In the late 1980s, Santander explored other European markets, the United States, and Latin America through small acquisitions, minority stakes, and alliances. Some of these probes paid off, others didn't, but collectively they exposed Santander to diverse opportunity streams. When currency crises roiled Latin America's markets in the late 1990s, Santander seized the moment, making a series of investments to build the region's largest banking franchise. While waiting for golden opportunities to emerge, Santander executives introduced a series of new products while improving operations and risk management.

In the current environment, many start-ups and established companies need funds to bolster their balance sheets. Established companies can invest modest amounts of cash—in the form of minority stakes or participation in joint ventures—to buy access to information on future opportunities.

Mitigating risk

Some managers cloak recklessness under the mantle of strategic agility. The most effective leaders, however, systematically minimize the downside risk of upside bets. Consider the example of Mittal Steel (now ArcelorMittal), which rose from a single minimill in Indonesia to global leadership through a series of acquisitions in some of the world's most volatile markets.

Mittal actively managed risks by screening potential acquisitions for access to growth markets, low-cost labor, energy, and raw materials to boost the odds of future profitability. The company avoided over-paying, instead buying money-losing mills from government owners in Trinidad and Mexico for about 10 percent of their construction cost, while convincing the governments to finance most of the purchase price. The company's due-diligence teams consisted of operating executives from other Mittal plants, who would be responsible for integrating the plant if acquired—an approach that ensured a realistic assessment of its potential and an actionable integration plan.

It is a buyer's market for many assets right now. Companies should not only haggle over price but also, like Mittal, negotiate hard on nonprice deal terms in order to surface and mitigate possible risks.

Staying in the game

Sometimes, the key is simply staying in the game until a big chance emerges. Apple's launch of the iPod and move into the digital music business is, rightly, the stock example of game-changing strategic agility. But it was Apple's ability to stay in the game long enough to wait for the opportunity to arise that made the difference. During the 1990s, Apple's share of the personal-computer market fell below 5 percent, relegating the company's products to the "other" category, while its stock price was flat from the late 1980s through early 2004. Loyal customers and a strong brand allowed Apple to wait for new contextual circumstances to generate a golden opportunity.

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Many managers equate staying in the game with a strong balance sheet. A war chest of cash, however, is only one of several structural attributes that allow a company to weather changes in the market and live to fight another day. Other attributes include sheer size; diversification of cash flows; customer lock-in; low fixed costs; rare resources, such as brands, expertise, or hard assets that customers will pay for; and a powerful patron, such as a regulator, investor, or customer with a vested interest in a company's success.

An environment like the one we've been experiencing, where cash is scarce, represents an opportune moment for executives to inventory all of their companies' sources of resilience and to develop a plan to stay in the game. The plan might include actions such as lobbying for trade finance from the government or taking steps to decrease fixed costs as a hedge against future price or volume reductions.

Portfolio agility

A set of common pathologies often gets in the way when companies with diverse business portfolios try to shift resources out of less promising areas and into more promising ones. Resource allocation in most large, complex organizations follows a bottom-up trajectory: frontline employees spot opportunities, middle managers lend their support to promising projects, and senior executives rubber-stamp proposals from trusted subordinates. This process stalls in reverse, however, and fails to foster disinvestment, since managers rarely recommend killing projects that might damage their reputations or endanger the livelihoods of their subordinates.

Portfolio agility can also break down when managers apply a uniform set of objectives, such as a fixed gross-margin percentage or time-to-break-even, across all opportunities, regardless of their stage or long-term potential. And portfolios grow stale when executives grip the reins of power for too long, blocking up-and-coming managers from leadership positions and sticking to traditional businesses because that is what the veterans know best. Facing difficult portfolio choices, seasoned executives may err on the side of loss aversion by protecting established businesses (which they often built and ran) while avoiding risky bets on the future. For example, the late Reginald H. Jones, Jack Welch's predecessor at GE, shied away from some difficult decisions, such as exiting the Utah International mining-company deal, which he himself had pushed.

Many companies think that developing disciplined processes for evaluating individual business units will ensure portfolio agility. This is incorrect. Reginald Jones had the formal tools to classify the company's strategic business units but still failed to make some hard calls. Portfolio agility requires managers to base these decisions on logic and data rather than emotion and politics and to have the courage to implement unpopular decisions. When Jack Welch became CEO, he reversed many of his predecessor's missteps, pruning GE's portfolio in his early years on the job. More impressive still, Welch also reversed his own mistakes. For example, when Welch's Kidder, Peabody acquisition failed to meet expectations, he first fired the head of the business—an old friend—and ultimately sold the company. Simultaneously, Welch oversaw a massive investment in GE Capital, even though he did not always see eye-to-eye with its leadership.

Top executives also need the power to control and allocate key resources at the group rather than business unit level. One large North American bank conducted a major study to profile its diverse business units in painstaking detail and made a compelling argument to shift cash, management talent, and IT resources from two established businesses into promising new ones. The bank, however, was a

Watch a video interview with Don Sull, in which he discusses his book *The Upside of Turbulence*, on mckinseyquarterly.com.

loose federation of units, and the group CEO lacked the power or precedent to reallocate resources across fiefdoms. The cash cows continued to hoard their resources while the promising businesses withered for lack of funds.

To enhance portfolio agility, companies must reallocate not only cash but also people. Before doing so, they should cultivate a cadre of general managers versatile enough to move from business to business. Companies such as HSBC and Mars invest heavily to develop general managers by giving them P&L responsibility early on, rotating them through functions and markets, and offering leadership training. As a result, such companies can redeploy their managers to emerging opportunities, even if they do not know in advance what form those opportunities might take.

During a boom, managers tend to spread resources evenly—like peanut butter on bread—to maximize perceived fairness and minimize conflict. In a downturn, they should avoid the temptation to spread the pain evenly across all units and instead disinvest from less promising operations to free resources for more promising ones. They can also use the current crisis to renew their processes for making portfolio decisions. Many executives centralize resource allocation in a crisis. Rather than decentralizing when the economy picks up again, senior executives can institutionalize processes to reallocate management talent and cash across units in order to preserve portfolio agility in the future.

Operational agility

An organization's ability to exploit both revenue-enhancing and cost-cutting opportunities within its core business more quickly, effectively, and consistently than rivals do is the source of operational ability. Managers cannot predict the form, magnitude, or timing of these opportunities in advance. They can, however, boost the odds of beating their rivals to them. While there are a number of important steps executives hoping to build operational agility can take, I focus here on two: putting in place systems to gather and share the information required to spot opportunities and building processes to translate corporate priorities into focused action.

Data to spot opportunities

Over the past few years, the Spanish retailer Zara, which overtook Gap in 2008 as the world's largest clothing retailer, has been a poster child for supply chain excellence because of its ability to deliver new items to stores quickly. Impressive as this supply chain is, the retailer's ability to spot trends as they emerge is equally important in serving its target customers—fashion-conscious young women in Europe. Zara consistently spots these opportunities because it has built-in systems to collect real-time market data, to supplement statistical reports with periodic exposure to raw market data, and to share information widely throughout the organization.

Zara's cross-functional design teams pore over daily sales and inventory reports to see what is selling and what is not, and they continually update their view of the market. Twice-weekly orders from store managers provide further real-time information on what might sell. Zara managers supplement these quantitative reports with regular visits to the field to collect firsthand data that standardized reports miss. In the summer of 2007, for instance, Zara introduced a line of slim-fit clothes, including "pencil" skirts in bright colors. Daily sales statistics revealed that the items were not selling but shed no light on why. Zara marketing managers visited the stores to explore the situation in person and learned that women loved how the slim-fit clothes looked but couldn't fit into their usual sizes when they tried on the garments. Armed with this insight, Zara recalled the items and replaced the labels with the next sizes down. Sales exploded.

To ensure that the data are widely shared, Zara locates designers, marketing managers, and buyers in the company's La Coruña headquarters, where they work in open-plan offices. Frequent discussions, serendipitous encounters, and visual inspection help teams diagnose the overall market situation, see how their work fits into the big picture, and spot opportunities that might otherwise fall between the cracks of organizational silos.

Recently, many companies have increased the frequency of their strategic and operational reviews and drawn, ad hoc, on different sources of data in order to understand the broader market context. They should not let these practices lapse as the economy recovers. Rather, companies ought to institutionalize the collection of real-time data, supplement these with periodic firsthand observations in the field, and disseminate information widely throughout the organization.

Translating corporate priorities into individual objectives

In many companies, agility stalls in the boardroom when top executives deluge the organization with multiple and often conflicting priorities. That's not the case at Banco Garantia and its affiliated companies, including the retailer Lojas Americanas, the logistics company América Latina Logistica, and, formerly, the brewer AmBev (which merged with Interbrew in 2004 and acquired Anheuser-Busch in 2008, creating Anheuser-Busch InBev). Garantia's companies operate in Brazil, traditionally one of the world's most turbulent markets, and have succeeded through operational agility.

Garantia companies avoid the proliferation of corporate priorities by capping their number at three to five in any year. Executives communicate them clearly throughout the organization to focus attention, resources, and effort on a handful of "must win" battles. Then managers translate corporate priorities into individual objectives. Subordinates negotiate with their bosses to set three to five individual objectives, when possible favoring quantitative targets and those that can be measured on an ongoing basis.

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To maintain focus on individual objectives, managers in each Garantia company work in an open office, with their individual objectives hanging behind their desks for all to see. A red, yellow, or green dot denotes progress on each objective. To ensure that individual objectives are aligned with one another and with overarching priorities, the CEO of America Latina Logistica spends one weekend each year reviewing performance targets for his top 200 executives, flagging inconsistencies and questions.

A downturn brings hard choices into stark relief, provides an external rationale to justify difficult decisions, and offers "air cover" with external stakeholders (including investors and directors) to reverse previous decisions. In the current market, senior executives should consolidate their major initiatives into a single list and make the hard choices needed to select a handful that are truly critical. To ensure that everyone gets the message, they should communicate the priorities throughout the entire organization, along with a list of initiatives that are no longer key objectives, to ensure that people do not waste resources on unimportant matters.

One final thought: economic crises can provide an ideal opportunity to invigorate the cultural transformation that is often needed to cultivate operational agility. For example, in the transition from good South Korean player to great global company, Samsung Electronics made most of its progress during the global recession of the early 1990s and the "Asian contagion" of 1997. Senior executives used these crises to renew a sense of urgency, justify unpopular decisions, and overcome complacency or resistance to change. Focusing on culture is critical because outexecuting rivals time and time again requires constant injections of urgency, effort, and enthusiasm.[3] A performance-oriented culture helps induce such effort.

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Traditionally, managers have been equated with ship captains, peering through a telescope deep into the future, setting a long-term vision, and proceeding steady as she goes. In the new normal, however, managers must proceed through an impenetrable fog that obscures any view of the future. By building the organization's strategic, portfolio, and operational agility, managers can position their companies to succeed, come what may.

[3] The importance of values and a performance culture to operational agility is a broader topic than space allows me to treat fully here. Chapter nine of my book *The Upside of Turbulence* (HarperBusiness, 2009) addresses the issue in more detail.