Rip the band-aid off quickly

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

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Too frequently, CEOs and management teams who face the daunting challenge of transforming their companies don't move far enough, fast enough, or broadly enough to truly reposition their businesses. Instead, they implement a series of half cures that can be worse than the disease: round after round of restructuring, strategic redirection, or layoffs, none of them sufficient to heal the wounds. In trying to minimize the pain of change, managers actually create more of it.

By contrast, companies that rip the band-aid off quickly – implementing change programs that are fast, focused, and simultaneous – have the chance to create enormous and long-lasting shareholder value.

Consider Optus Communications, a 1992 start-up and the number two telecommunications firm in Australia (with only one competitor). After a promising first few years, by the mid-1990s the company faced a host of problems, including the end of Australia's telephone duopoly, a cash-hemorrhaging subsidiary, 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 of 1997, shareholders came "within an inch of liquidating the company" (*Australian Financial Review*, 1997).

But instead of a line gone dead, investors soon heard the clear dial 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. Their change initiative, Project Breakeven, by targeting a variety of short-term opportunities, yielded $260 million in pretax earning improvements. Management completely 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.

Since then, Optus has turned in four consecutive years of profit growth and is among the top ten Australian companies in market capitalization. In September 2001, Singapore Telecom acquired Optus for more than double its IPO price, locking in more than $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. The stock prices of the companies in our sample rose on average 250 percent per year in the period during and after their transformations, and more than 1,000% 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 action principles in their approaches to change:

(1) Reward managers for hitting strategic targets not for constructing elaborate change management processes.

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(2) Remove underperforming senior managers, the burned out fuses.
(3) Challenge managers to achieve higher performance levels – turn up the voltage.
(4) Do it fast and all at once – rip the band-aid off quickly.

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 provide managers a simple and consistent framework for organizing and executing action.

The common threads of successful change

Beginning in 1997, a team of consultants began an investigation to identify the key principles common to the most successful corporate transformations. We studied in depth 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 corporate units undertaking major change initiatives includes:

(1) Pacific Bell;
(2) Citizens Bank;
(3) Ned Corp;
(4) Continental Airlines;
(5) General Dynamics;
(6) Accuride;
(7) Stage Stores;
(8) Cambridge;
(9) Vetco Gray;
(10) Gartner Group;
(11) Physio Control;
(12) Wessley Jessen;
(13) Neutraceutical;
(14) Duane Reade;
(15) Dade Pharmaceuticals;
(16) US West;
(17) Dell Computer;
(18) Power Financial;
(19) Hilti;
(20) Armstrong;
(21) Optus.

Across all 21 companies, four common themes emerged.

Reward managers for hitting strategic targets not for constructing elaborate change management processes

The best transformers are companies that focus first on developing a clear strategy. They establish non-negotiable goals (financial and nonfinancial) to support that strategy and incentives to reinforce those goals. Then they step back and let managers figure out how to get the results. What they don't do is dictate every step in the process or construct elaborate "change management programs."

Just ask Continental Airlines. When Greg Brenneman took over as president and chief operating officer of Continental in 1994, the company was about to crash-land. Legend had it that the company had never met a budget forecast. It had churned through ten presidents in ten 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.

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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.

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 percent 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: as of this writing, Continental has ranked first in on-time service for 13 months running.

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. And if you provide incentives, make sure they tie to short-term achievements, such as monthly or quarterly targets.

Says Brenneman, now CEO of Turnworks, a consulting firm specializing in corporate turnarounds, "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."

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Six years after the turnaround, Continental employees are still focused on results, and it shows: In Q1 2001, Continental and Southwest were the only two major American airlines to report a quarterly profit. More remarkably, Continental also celebrated 24 consecutive profitable quarters.

In the wake of the World Trade Center disaster, Continental faces very tough times, as do all airlines[1]. Yet, with the right principles in place, the dramatic results of Continental's turnaround should allow it to rise again.

Remove underperforming senior managers – the burned out fuses

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 – underperforming 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 percent 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 percent of their workforces actually performed significantly below average over three years. And companies that announced repeated rounds of layoffs did even worse[2].

This is not to say that management should never lay off employees. But it does suggest that who you let go matters more than how many. Indeed, our research of highly successful turnarounds reveals that nearly all the most successful transformers substantially replaced senior management who couldn't perform up to the new turnaround standards. The most meaningful replacement targets are the burned out "fuses" among those who channel strategic energy and direction to broad networks of employees – in other words, underperforming senior executives.

Of the top 15 executives at Optus, 14 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."

Replacing senior managers 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 harsh and confrontational policies. However competent the executives were, they would just never again be viewed by the workforce as trustworthy. We absolutely had to change them."

Making personnel changes can be extremely painful for the entire organization. Often, personal friends among senior management 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.

Challenge managers to achieve higher performance levels – turn up the voltage

The next challenge – and arguably a harder one – is to require the employees who remain to perform at a higher standard, or in other words, turn up the voltage. How does a leader inspire a workforce that most likely is severely demoralized to meet new stretch goals? Removing managers who are viewed by employees as incompetent or untrustworthy can provide a quick boost to employee morale.

But to successfully confront the risks the company faces, says Kevin Ryan of Wesley Jessen, you communicate a simple, powerful set of messages to employees about what you must accomplish together. This 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 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 percent 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, *Business Week* 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 returned its vision to 20/20 has everything to do with CEO Ryan's ability to challenge his employees to achieve higher performance.

He told the sales force that he understood the sales job – its loneliness and frustration. But then he told them to put all that aside.

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

The purpose of the performance, says Ryan, was 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 for personal wealth creation 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.

Ryan also repeatedly communicated a very concise set of messages to the employees who remained.

"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" near the cafeteria celebrated new ad campaigns and sales achievements and displayed pictures of Hollywood movie stars wearing Wesley Jessen contact lenses 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.

"Remove underperforming senior managers, the burned out fuses . . ."

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 programs or layoffs were starting, 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. This was not a practice that Ryan had to do (the company was privately held). But as it turned out, this policy quickly became a morale booster: from a $40 million annual loss, the company turned a profit in its first month under Ryan's stewardship and has never had a losing quarter since.

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. In my view, you can't have people who don't sign on. Everybody who comes to work wants to contribute and succeed. But you've got to give them something to believe in."

Rip the band-aid off quickly

In addition to focusing on results not process, culling unmotivated senior managers, and raising performance targets, the best transforming companies rip the band-aid off quickly. This means implementing change as fast as possible 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 an example of fast, focused, and simultaneous change, 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.

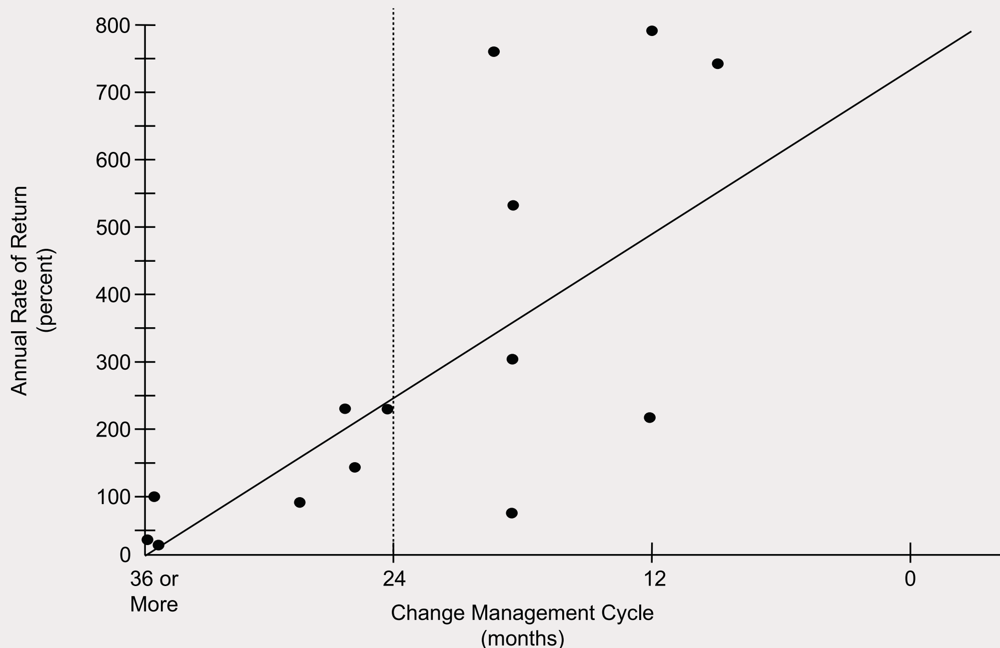
Having shored up the core business, Pellicioli next introduced a series of Internet-based initiatives, including an audio version of the “yellow pages” commercial phone directory. He also led several successful acquisitions, including the landmark purchase of Matrix, the leading Italian Internet portal/search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

The result? In less than three years, Pellicioli transformed SEAT from a sleepy paper-based monopoly to 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 our research shows, they are not alone. Exhibit 1 plots the annual share-price appreciation of the 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 percent, each completed its transformation in 20 months or less.

Exhibit 1 — Change management cycle time vs. return

Change efforts that take longer to execute generally result in lower returns



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Source: Bain Client Survey

BOS Rip the Band Aid Off Quickly1 1

This was true for companies in all types of industries and for all types of transformations, not just classic "turnarounds."

> **"Challenge managers to achieve higher performance levels – turn up the voltage."**

Let me be clear about what I am recommending. My call to rip the band-aid off quickly doesn't mean that managers should act recklessly, nor that moving faster will make a transformation easy. Our observations lead us to believe 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.

Why is this? By hesitating, you may miss important new market opportunities, critical acquisitions, the opportunity to achieve significant differentiation, or even the chance to play at all. In capital-intensive industries, for example, a competitor who 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. Your employees, too, are more likely to tolerate a brief interval of change than prolonged uncertainty. In contrast, a protracted period of restructuring is likely to result in a doom loop of deteriorating performance, plummeting morale, and dwindling talent.

Conclusion

Successful turnarounds require 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 that much sooner, and the cost will almost surely be less than that of prolonged indecision. And if you are right, our evidence shows that you're likely to speed the arrival of the rewards. ■

Notes

1 On September 11, 2001, two flights from Boston, hijacked by terrorists, made suicide crashes into the World Trade Center towers in Manhattan, exploding and toppling both skyscrapers. A third hijacked aircraft smashed into the Pentagon, and a fourth crashed in Pennsylvania. The disaster closed airports for up to five days and precipitated a falloff in air travel as the US government planned retaliation.

2 This information is available in Bain & Company's 1999 study, "Winning in turbulence: strategies for success in tumultuous times", by Darrell Rigby.

Reference

Australian Financial Review (1997), 4 July.