



Achieving Successful Strategic Transformation

Few companies decide to adopt new strategies without being forced to by financial trauma. What can we learn from those rare companies that achieve both successful major change and superior long-term financial performance?

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COMPANIES THAT ARE able to radically change their entrenched ways of doing things and then reclaim leading positions in their industries are the exception rather than the rule. Even less common are companies able to anticipate a new set of requirements and mobilize the internal and external resources necessary to meet them. Instead, the momentum of and commitment to the prevailing strategy usually prevents companies from spotting changes such as a shift in either the market or the technology, and leads to a financial downturn — often a crisis — that, in turn, reveals the need for change. Few companies make the transformation from their old model to a new one willingly. Typically, they begin to search for a new way forward only when they are pushed.

This raises two important questions for corporate managers. First, is decline inevitable? And second, do companies really need a financial downturn to galvanize change, or can they adopt new

?

THE LEADING QUESTION

How do some companies achieve successful strategic transformations?

FINDINGS

- ▶ Successful transformers build alternative coalitions internally.
- ▶ They create a tradition of constructively challenging the status quo.
- ▶ They exploit “happy accidents” to make needed strategic changes.

ways of doing things when not under pressure? Management theorists have observed that decline, while perhaps not inevitable, is at least very likely after a period of time.¹ For this reason, some say it's critical for organizations to develop new dynamic capabilities deliberately rather than relying entirely on their historic capabilities.²

In order to understand how some companies continue to perform at high levels even as they modify their strategies over time, we studied 215 of the United Kingdom's largest public companies. We measured performance by, among other things, profits and returns on shareholder funds and on total assets over the 20-year period from 1984 to 2003. Some of the consistent high performers operated in relatively safe and stable markets; such companies were therefore mostly able to maintain high levels of performance without making major strategic changes. Our goal, however, was to draw insights from the small subset of high performers that successfully transformed themselves. Among other things, we wanted to understand the role of history — for example, which management processes and capabilities do companies need to develop over time. (See "About the Research.")

ABOUT THE RESEARCH

In our search for exceptional companies, we studied 215 of the largest British public companies over the period 1984 to 2003 — starting around the time of the Thatcher government's reforms and continuing through the stock market meltdown of 1987 and the Internet bubble. The research period ended before the 2004 economic downturn and the 2008 recession. We started with the premise that companies that could sustain long periods of financial success and also make major transformations would be the exception; if such companies existed, there could be potentially valuable lessons in understanding how they did it. We compared the financial performance of each company with its domestic and international industry peers. As our main screen, we used five measures of performance: profit margin, return on shareholders' funds, return on total assets, return on capital employed and cash flow to operating revenues; 28 companies passed our long-term performance test. We then studied which of these companies had also made major strategic transformations, constructing 20-year timeline event histories for each. Most of the companies had not needed to make major strategic changes. Only four companies sustained superior performance consistently over 20 years and strategically transformed themselves. We paired each of them with a company from a similar industry (one with comparable performance that had not made as extensive strategic changes). We were able to obtain high-level access to the management of the three successful transformers discussed here. For our in-depth analysis, we chose to concentrate on these three companies and their counterparts. We conducted interviews with 46 former and current chairmen, chief executives, board-level executives and senior managers, covering up to 40 years of history. This research was funded primarily by the Advanced Institute of Management Research, an initiative established by the United Kingdom government to improve management research and practice.

As a result, we decided to focus on three companies that had made successful strategic transformations and compare them with three companies from similar industries that were also successful but hadn't been required to make a dramatic shift. The first pair, Cadbury Schweppes and Unilever, were longtime international leaders in packaged goods, both with roots extending back to the 19th century.³ The second pair, Tesco and J Sainsbury, were major players in the United Kingdom's supermarket industry and are among the largest grocery retailers in the world. The third pair, Smith & Nephew and SSL International, operated globally in the market for medical devices and related products.⁴

How did these companies perform relative to each other? Cadbury Schweppes was clearly dominant over Unilever; it outperformed Unilever every year except 1984, when its performance was only marginally weaker. In the second matchup, Tesco slightly underperformed Sainsbury during the first 10 years of the study before catching up in the middle years and then pulling ahead. Sainsbury had been the industry leader, with consistently high performance, but by the end of the 1990s its performance declined. Although its weak performance spurred Sainsbury's management to take action, Tesco continued to outperform Sainsbury after 2003. Finally, Smith & Nephew easily outperformed SSL International every year except 1995, when it was marginally weaker.

All six of these companies exhibited success factors of well-managed companies. Nevertheless, Cadbury Schweppes, Tesco and Smith & Nephew all displayed the rare combination of making strategic transformations and, at the same time, achieving strong performance year after year for 20 years relative to industry peers around the world. This prompted us to choose them to examine in depth. These companies, we found, had three fundamental advantages over their peers: They were able to build alternative coalitions with management, create a tradition of constructively challenging business as usual and exploit "happy accidents" to make strategic changes. Together, these advantages helped them establish the virtuous cycle of strategic transformation that their counterparts could not. (See "A Virtuous Cycle for Strategic Transformation")

A Tradition of Creating Alternative Coalitions

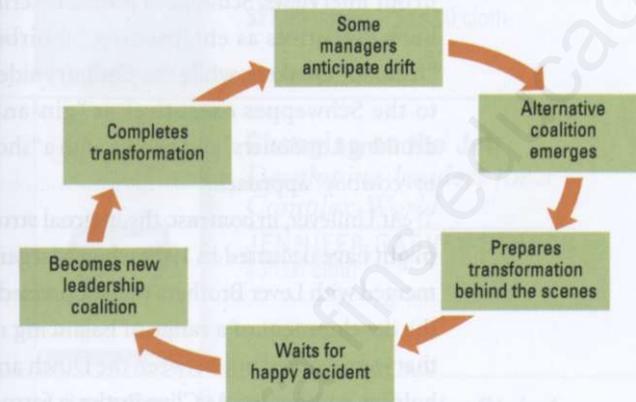
Although many executives recognize the need to exploit current capabilities while developing new ones, few are very effective at managing this conflicting set of activities. Moreover, most of the advice emanating from scholars who write about "organizational ambidexterity" lacks a historical dimension.⁷ The companies we studied that transformed themselves had an unusual ability to maintain steady performance while pursuing strategic change. They did this by creating parallel coalitions of senior executives. The first group, typically the more senior one, focused on reinforcing current capabilities, strengths and successes. The second group, usually younger but still senior, actively looked to develop new strategies and capabilities. This parallel system came to be an accepted part of how the company operated. It was encouraged and eventually institutionalized. In particular, the second group often anticipated strategic drift that would leave the company increasingly misaligned with a changing environment.

For instance, the original Tesco model was to "pile it [the merchandise] high, sell it cheap." Founder Jack Cohen instigated this and perpetuated it through a personal command-and-control management style. Nonetheless, in the 1960s an alternative coalition was created to pursue more modern logistical and operations practices. The new forces introduced Tesco to a corporate model of management control. During the 1970s, the alternative coalition acquired more and more nonfamily members, who receive credit for modernizing Tesco in the 1980s and 1990s. Ian MacLaurin and his team of operations-oriented managers developed their ideas over many years, and they were ready to take charge once the limitations of Cohen's approach become evident. They did away with the old business model featuring reward stamps when Cohen and his associates stepped down at the end of the 1970s.

In contrast, Sainsbury's was unable to find a way to go beyond the formula that had made it successful in the 1990s: store configurations that helped maximize sales per square foot, an emphasis on fresh produce, yearly growth of 20%, family control and heavy reliance on a CEO who was widely acknowledged as an intuitive retailer. While this recipe had served the company well, the deeply entrenched business model

A VIRTUOUS CYCLE FOR STRATEGIC TRANSFORMATION

Within organizations that achieve successful strategic transformations, some managers are able to anticipate strategic drift, form an alternative leadership coalition to resolve the problem, prepare for transformation, wait for a happy accident that allows them to act and eventually become the new leaders.



and management style were difficult to change.

Of the three companies that made successful transformations, none had to reach outside the organization for top leadership. In a sense, they grew their own "outsiders" by encouraging intrapreneurial talent and giving individuals space to comply with their formal job duties while they experimented with and refined their knowledge of alternative approaches to business.

A Tradition of Constructively Challenging Business as Usual

Most companies say they encourage challenges to business as usual or even to the core tenets of the business model. What is less clear is whether and how they actually do it. At companies that achieved major transformations, the development of alternative coalitions frequently occurred in the context of fundamental conflict. At both Tesco and Smith & Nephew, the conflicts were open. Tesco experienced boardroom battles between family members and, later, between the two coalitions of managers. Smith & Nephew endured a major showdown between the "textile traditionalists" and those who wanted to develop new business ideas. At both companies, over time the conflicts became less intense and more respectful.

Constructive challenging at Cadbury Schweppes had a much longer legacy. Cadbury was founded in the early 1820s by Quakers, and its leaders had long sought to foster a corporate culture in which "can-

dor, freedom of speech ... a spirit of toleration and liberty... (were) the dominant notes." This cultural tradition was strong, and the merger in 1969 with The Schweppes Co. reinforced it. The two corporate cultures clashed. As former executives reported to us in our interviews, Schweppes people described Cadbury executives as enterprising "choirboys" and "teetotal" Quakers, while the Cadbury side referred to the Schweppes executives as "gin-and-tonic-drinking Londoners" and people with a "short-term" or "cowboy" approach.

At Unilever, in contrast, the internal struggle that might have occurred in 1929 when Margarine Unie merged with Lever Brothers was suppressed through the development of a range of balancing measures that were worked out between the Dutch and British holding companies. As Clive Butler, a former Unilever director, noted, "From the merger in 1929, our strategy has suffered from the need to control the balance between the Dutch and British sides of the business." The ability to collaborate and innovate internally across corporate and business levels was hampered by equalization agreements and silo-creating resource allocation decisions — most notably about product and geographical responsibilities. At the same time, the company's legacy of engaging in a wide variety of businesses all over the world fostered a growing disconnect between any corporate strategy and what the business units did. As a result, Unilever units pursued all kinds of businesses and strategies that did not together make up a coherent companywide approach. For example, the company had literally thousands of brands applied inconsistently to products across countries. Hence, there was a widespread view that Unilever was "a fleet of ships doing all kinds of different things, all over the place." Although the need for British-Dutch balancing operations dwindled with the internationalization of the corporate executive and nonexecutive teams, the tendency to circumvent conflict remained.

At the companies that transformed themselves successfully, a tradition of open conflict had a way of evolving into constructive challenging. Over time, the vying for dominance became institutionalized. This was not just a matter of senior executives advocating different points of view; it also involved management systems that embedded such processes across the organization. In contrast,

the comparator companies we studied never established a tradition of constructive challenging.

A Tradition of Exploiting Happy Accidents

Not only did new ideas and alternative ideas continually surface in the companies that made successful strategic transformations, but they were aggressively pursued. Thus, the companies were well positioned to turn problems into opportunities. Significantly, we found that alternative leaders were able to accelerate the pace of transformation, not by forcing the issue but by leveraging what we call happy accidents to gain a broad platform of support. Happy accidents are unanticipated circumstances or events that ultimately support transformation in the direction favored by the leaders-in-waiting. For instance, at Smith & Nephew, Chris O'Donnell pressed hard for the articulation of a clearer strategic framework when he took over as CEO in 1997. It's likely that resistance to change would have won the day if not for a happy accident: O'Donnell's predecessor had invested heavily in the fast-growing Asian economies to placate disgruntled shareholders. The company started with a new division in Japan in 1990, and also invested in manufacturing plants in Malaysia and offices in China. Just as O'Donnell took over, the East Asian currency crisis hit, wiping out 40% of the company's profits in 18 months. O'Donnell reacted by initiating comprehensive reviews of strategy and manufacturing, which led to decisions to exit smaller businesses and focus resources on global medical sectors. In the face of the economic turmoil, most of the critics who had resisted O'Donnell's agenda came around, making possible the company's successful transformation in subsequent years.

At Cadbury Schweppes, the poor performance of the U.S. confectionery business triggered a hostile takeover bid by General Cinema in 1987. Ultimately, the episode turned out to be a happy accident. It resulted in an increase in the share price, which generated money for acquisitions and functioned as a poison pill that allowed the Cadburys to refine their long-term focus. It also spurred Dominic Cadbury to accelerate the pace of transformation — not just by divesting the food and hygiene businesses, but also by giving alternative leaders within Cadbury Schweppes the opportunity to initiate exciting new

developments. These included the Coca-Cola Schweppes Beverages joint venture, the relocation of the beverages headquarters from London to Stamford, Connecticut, and the refocusing of the confectionery division.

A similar situation occurred at Tesco. In June 1977, management launched Operation Checkout — across-the-board price cuts intended to generate volume and gain market share. The campaign was ridiculed in the press for having narrow operational objectives, and it proved so hard to manage that it almost destroyed the company. It turned out to be a blessing in disguise, however, because it forced the old guard to accept the need to change logistical, distributional and property investment processes. Tesco's board had approved Operation Checkout, which was led by Ian MacLaurin, under a narrow operational mandate. When the campaign turned out to have very strategic consequences, the old guard could not cope anymore and turned the strategic command over to MacLaurin and David Malpas. They and other alternative leaders, by force majeure, were granted the power to complete the ambitious strategic transformation plans they had envisioned years before. Family resistance to the new team's plans crumbled, and a decisive shift from family control to a process of distributed managerial engagement and change began.

Successive alternative coalitions at Cadbury Schweppes, Tesco and Smith & Nephew alike each took advantage of four major (different) happy accidents during the last four decades. Their counterparts Unilever, Sainsbury and SSL International, lacking a tradition of anticipation, were unable to convert problems and crises into happy accidents. They dealt narrowly with problems on their own rather than using them as triggers for broader changes. For example, Sainsbury steadily struggled with its increasing loss of market share to Tesco but did not change its business model or management approach. Similarly, Unilever gradually lost market position to Procter & Gamble but failed to develop a more aggressive strategy and style.

The Rewards of Tradition

We have already noted how the companies that successfully transformed themselves reaped financial benefits, but what about their strategic success? By the late 2000s, all three companies were in superb strategic and competitive positions, with well-defined management processes. Cadbury Schweppes had grown from a modest-sized national competitor into a global leader in two of the most competitive industries in the world, and it eventually became a keenly sought acquisition target.

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Grocery retailer Tesco established and integrated new ways of working that became a catalyst for continuous transformation.

Tesco, meanwhile, established and integrated new ways of working that became a catalyst for continuous transformation. It launched multiple retail formats, significantly reduced the size of its headquarters staff, streamlined management layers and began an international expansion, becoming one of the most successful multinational retailers. Tesco is widely regarded as one of the best-managed companies in the United Kingdom.

Smith & Nephew, for its part, has repeatedly made changes and explained them to investors in ways that retain their confidence. Its tradition of transformation has helped the company stay a step ahead of changes in the competitive environment, and engage in a self-paced rather than forced transformational process. This has resulted in more than 20 years of above-average growth and provided a buffer against the rapid changes in technology and the market that are inherent in the medical devices industry.



Developing Traditions for Transformation

If companies are to sustain high performance and transform their strategies, they need to foster alternative management coalitions and value constructive tension and challenges to the status quo. We have developed eight recommendations for accelerating these changes.

1. Build on history. The first thing to recognize is the importance of valuing history and building on it. In the cases of Tesco and Smith & Nephew, the contestation we saw was built on conflict, even emotional conflict, decades ago. Over time, consciously or not, the skirmishing evolved into a more respectful tug of war. In the case of Cadbury, a tradition rooted in the company's Quaker past was reinforced by a clash of cultures that followed the merger with Schweppes. Building on history requires managers to reflect on the evolution of their organization and the legacy they can draw on. Which traditions are present, at least in embryonic form, and which ones are absent? In the light of the answer, what new steps could be taken?

2. Select and develop a new generation of leaders. All good companies carry out succession and talent planning. But too often they focus too much on maintaining the current mold. In a company that's serious about transformation, succession planning requires building *different* capabilities. New generations of leaders need to be groomed and encouraged to develop alternative coalitions and business models. Of course, this is easier said than done. To make it happen, current leaders must nurture replacements who will question, modify or even be willing to reject the company's heritage. In the late 1990s, Tesco CEO Ian MacLaurin and managing director David Malpas recognized this quality in Terry Leahy, a young manager who would become a major change agent. Malpas explained to us his approach to management talent-spotting: "I used to categorize youngsters in two [groups]: those who believed the corporation was a corporation and they worked for it, and those who believed it was their business." As much as he valued the former group, it was the latter group that he looked to for the next generation of leaders.

3. Accept and encourage constructive mobility. In a similar vein, it's important to accept and en-



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courage constructive mobility in management. This does not necessarily mean bringing in outsiders to run the business: On the whole, the successful transformers developed their own managers and leaders internally. However, rather than appointing the most predictable successors, companies need to adopt a deliberate policy of cultivating internal talent. In other words, in addition to fostering alternative coalitions, welcoming challenge and encouraging divergent perspectives on the future of the business, managers should identify leaders who, while respecting the past, have a distinctively different view of the future.

4. Ensure that decision making allows for dissent. There's a fundamental difference between an organization built to maintain consensus around a dominant logic and one where managers naturally challenge it. Butler, the former Unilever director, recognized that Unilever "had many layers of people that were clever enough to think of many reasons why a new idea wouldn't work." Tesco's Malpas, on the other hand, described Tesco as an organization where new ideas took on momentum across different levels of managers: "You have bright people who have ideas and want to mold the business their way, so an initiative gets to the boss at the next level who embraces it, and it becomes his scheme; it gets to the next level and he embraces it, and it becomes his scheme. How the hell do you stop it?" A decision-making process that allows for dissent and challenge works only among people who can live with, and indeed welcome, challenge.

5. Create enabling structures that encourage tension. Creative tension between opposing views can also be fostered structurally. When Smith & Nephew bought an R&D facility from another company, and when Tesco gave responsibility for demographic profiling to the marketing department rather than the real estate department, the companies ensured that there would be new and different

perspectives. Such changes alone will not guarantee that alternative views will be heard and taken seriously — that will depend on the relevance of the views and who in the organization promotes them. But changing the structure can make a difference in how people see ideas internally.

6. Expect everyone to get behind decisions once they are made. Essential though constructive confrontation, contestation and experimentation are, there needs to be a point when leadership makes decisions and the different parties fall in line. This requires what we call "corporate maturity": having the confidence to see the value of dissent while accepting the need to move forward for the wider good. Taking this position is not an argument for suppressing dissent. Rather, it's an argument for appreciating the value of diversity and recognizing that there are times when top management needs to take charge. In our research, we found that failures occurred not so much when top management avoided making decisions but when management mishandled the internal debate, by stifling it, cutting it short or failing to build management teams with enough confidence to overcome doubts.

7. Develop an overarching rationale. Although the executives with whom we discussed our findings were wary of attempting to "create cultures," they agreed that managers needed to develop clear positions concerning "what we are about." At Tesco in the 1990s, for example, managers engaged in spirited discussions about how to balance the needs of customers with those of shareholders and employees. They concluded that success required focusing on customers. Dominic Cadbury noted that the starting point is the company's values: "These do not happen by chance, and they can't drift either. There has to be some management there." And values need to be more than words — they should be believable and evident in top managers' behavior.

The emphasis on a clear rationale supported by strong values must allow for the necessary diversity

of views and ideas. Sainsbury had in place a very clear rationale and set of values. Unfortunately, one of those values was that dissent is dangerous. This offers a lesson from complexity theory: Organizations need "order-generating" or "simple" rules that are few in number but sufficiently clear to provide overall direction while at the same time allowing for differences of views and ideas.

8. Beware of market size and dominance. Each of the successful strategic transformers we studied developed some of the characteristics that helped them succeed while competing against dominant players in their industries. Indeed, Cadbury Schweppes, Smith & Nephew and Tesco saw themselves as seriously threatened. This was not the case for Unilever or Sainsbury, both of which were major forces in their markets. As Dominic Cadbury, the retired chairman of Cadbury Schweppes, put it, "Unilever was such a different size that... it would be infinitely more difficult to galvanize [the company] to think of itself as an endangered species." Butler conceded, "Unilever has had to grow smaller to be like that." This raises an important question: As once-threatened companies such as Tesco become industry leaders, will management lose sight of the very qualities that helped create their success?

Butler's comment about the challenge of mobilizing an organization raises issues about both complexity and size. Tesco was always a retail business; Cadbury, while operating in a number of different businesses, was much less diverse than Unilever; Smith & Nephew was less diversified than SSL International. Complex, diversified organizations such as Unilever often try to reduce their complexity to realize a corporate strategy of having the right mix of businesses. We believe that there is a different reason for reducing complexity: Ongoing strategic transformation requires relatively focused businesses.

Institutionalizing traditions does not take place overnight. Therefore, our proposals are the antithesis of short-term management. The capabilities to avoid strategic drift must be nurtured over the long term. However, today's organizations have one important advantage: The exceptional organizations we studied developed their skills and traditions over many years — and without the benefit of the lessons we have drawn from them. Now that we have identified how traditions of transformation are developed, today's managers have the opportunity to build on

this experience to establish their own traditions more rapidly and also more deliberately.

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