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The organization that renews itself: Lasting value from lean management

Applying lean principles to management, rather than just operations, can help large organizations reimagine how they work and unlock value through continuous improvement.

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Executives at a financial institution wondered how to fight complacency as they watched competitors start to catch up to their most important product—one whose success the institution never quite matched.

A logistics company faced diminishing returns from years of cost cutting. Managing vendors now consumed many of the gains from outsourcing. Fixing talent and quality issues meant that "low cost" locations were no longer so low cost. And just keeping pace with the latest IT developments meant constant budgetary struggles. How could it get more out of the cost-cutting investments it had already made?

For an asset manager, the focus was on customer disappointment with how long it took to open and fund an account. Every day of delay meant lost revenue both for the company and, more important, for the customer. But regulatory constraints meant that speeding the process up seemed fraught with risk.

A government agency seemed to be in an enviable position, with demand higher than ever. But its budget was flat and it recently had to impose a hiring freeze. It needed to manage the influx while maintaining quality standards, without causing highly trained employees to burn out.

How often do you hear of these types of issues in your organization? How often do you confront them yourself?

Of course, questions that challenge how well large, modern organizations work are almost as old as management itself. But if it seems that questions are coming up more often, or more forcefully, there are good reasons.

The first is a rising sense of urgency, with large organizations recognizing that the pressures they face are unlikely to abate much in the short term, regardless of location or sector. In mature markets, slower growth, lingering debt burdens, and aging workforces are the chief concerns; in fast-growing countries, rapid expansion and urbanization are outpacing the ability of local infrastructure and talent pools to keep up. Everywhere, mismatches between worker skills and available jobs are growing, even as unemployment reaches new highs, especially among the young[1]—while those managers and workers who do find employment report high stress and low engagement. To respond to these forces, organizations need new capacity and energy, but instead they find both are in short supply, having been absorbed by internal complexity.

[1] For more information, see *The World at Work: Jobs, Pay, and Skills for 3.5 Billion People*, McKinsey Global Institute, June 2012, on mckinsey.com; as well as the sidebar "Filling the great labor gap."

Filling the great labor gap

In 2011, the McKinsey Global Institute estimated that for the United States to match the GDP growth and rising living standards to which it has long been accustomed, the country's labor productivity would have to rise by 34 percent, to a rate not seen since the 1960s.[1] A year later, a separate report suggested that rapidly aging advanced economies such as Germany and Japan face an even more daunting challenge: they will need to increase the pace of their productivity gains by about 60 percent in order to attain historical GDP growth.[2]

Those gains will be especially difficult to attain given pervasive mismatches between available work and employee skills, gaps that are already large and threaten to expand further. Across advanced economies, newly created jobs are much more likely to involve complex interactions that require employee flexibility and responsiveness; the routine, execution-oriented work that historically has provided employment for tens of millions of less educated workers will fade. By 2020, advanced economies may face a surplus of 32 million to 35 million workers with only a secondary education and a shortfall of 16 million to 18 million of their college-educated peers.

Organizations must therefore learn how to increase their productivity despite a scarcity of highly skilled workers—the sort of constraint that lean management helps resolve. One organization, Export Development Canada (EDC), illustrates the possibilities. In 2008 and 2009, demand for EDC's financing services surged by about 25 percent over three quarters. By better coordinating the work of its many highly trained specialists, EDC was able to find the needed flexibility to absorb the additional demand without increasing its financial risk.

[1] See *Growth and Renewal in the United States: Retooling America's Economic Engine*, McKinsey Global Institute, February 2011, on mckinsey.com.

[2] See *The World at Work: Jobs, Pay, and Skills for 3.5 Billion People*, McKinsey Global Institute, June 2012, on mckinsey.com.

What is it that makes these exceptional organizations so exceptional—and keeps them that way?

Thus, while the specific issues may differ, the broader themes are the same. Large organizations realize they must reimagine how they work so that their scale once again becomes an asset rather than a liability. And they must do so from within, because external conditions—the rising economic tides that formerly lifted so many boats, regardless of how well or badly they rowed—are not likely to make a lasting return any time soon.

The second reason for questions is, if anything, even more important. Leaders know that some organizations are transforming themselves, finding new value while becoming more resilient, effective, and efficient in ways that keep reinforcing themselves over time. These organizations, both in heavy industry and in service sectors as diverse as banking, telecommunications, and government, attain a state that is as valuable as it is rare: continuous improvement. Their performance increases both in the immediate term and over the long run, as the techniques people learn form a new culture centered on finding ways to do things better.

However, leaders also know that imitating an admired organization's best practices is hardly a reliable way to imitate its success. It takes more than a borrowed checklist. What is it that makes these exceptional organizations so exceptional—and keeps them that way?

Lean management's four disciplines

In working with large organizations, we have found that those that renew themselves all seek to execute four essential management disciplines exceptionally well. Every organization already follows these disciplines in one form or another. Accordingly, they are not a formula; they do not represent the whole universe of "good management." But when leaders design systems that enforce these disciplines effectively—and when they ensure they're followed every day, at every level of the organization—the disciplines reinforce one another to create what lean has long envisioned: an adaptive organization that consistently generates the most value possible for all stakeholders from all of the resources it can bring to bear.

Even more important, the disciplines correlate to tangible skills and ways of working that people and organizations can learn—which, over time, constitute culture—how people behave and think. The more the organization learns regarding each of the four disciplines, the more it can achieve and the faster it gets at learning and improving itself.

- Delivering value efficiently to the customer. The organization must start by understanding what customers truly value—and where, when, how, and why as well. It must then configure how it works so that it can deliver exactly that value, no more and no less, with the fewest resources possible, improving coordination, eliminating redundancy, and building quality into every process. The cycle of listening and responding never ends, as the customer's evolving needs reveal new opportunities to attack waste, create new worth, and build competitive advantage.

- Enabling people to lead and contribute to their fullest potential. The organizations that get the most from their people provide them with

The limits of 'scientific management'

Criticism of objective, top-down, metric-focused "scientific management" has a long pedigree, dating almost to the idea's origin at the turn of the 20th century in the "Taylorism" movement. As early as the 1920s, pioneering management theorist Mary Parker Follett endorsed a participatory vision of management, in which the manager's role was one of "power with," not "power over." In 1933, Harvard Business School professor Elton Mayo argued in *The Human Problems of an Industrial Civilization* that higher output depended more on group norms than on the physical conditions that Frederick Taylor emphasized. By midcentury, Peter Drucker and Douglas McGregor added their voices in favor of a more humanistic vocabulary for management, rather than strong control over the workforce, while future Nobel economics laureate Herbert A. Simon began publishing his work describing the limits of rational factors in management decision making.

Yet even as more organizations adopted policies for motivating or empowering employees, the gap between the policies and day-to-day reality grew. In 1990, employee stress had become a large enough problem to attract attention from labor scholar Robert Karasek. His research identified three main contributors to work-related stress: high professional demands, low decision latitude (that is, little ability to control how the work is done), and low social support. The combination of high professional demand and low control was found to be especially stressful.

Exhibit

Employees in large companies feel more stressed than those in small ones, and management is a significant problem.

Work-related stress is more prevalent in large and midsize companies than in small ones, notably because of management

People in large companies are more likely than those in small companies to see stress levels as increasing

Size of companies	**Causes of stress in the past year,** 2012, %: Job	Management	Customers	**Employee perception of stress increase in the past year,** 2012, %
Large	67	40	27	54
Midsize	60	41	29	50
Small	56	20	42	46

Source: Regus, *From Distressed to De-stressed*, September 2012 (regus.com); McKinsey analysis

Since then, at least some data suggest that employees' positions have gradually worsened. According to a 2009 EU report, workers reported steady erosion in control over their work between 1995 and 2005. And a 2012 study of 16,000 workers worldwide found that employees in large organizations were more stressed than those in small ones, particularly because of management issues (exhibit).

Lean management seeks to reconcile control and autonomy in large organizations by rethinking how organizational improvement should work. The lean-management system enables individuals to rely much more on themselves and much less on the top-down, external sources of control that so often become rigid, inefficient, and even counterproductive on a large scale.

Further reading

Pauline Graham, ed., *Mary Parker Follett: Prophet of Management—A Celebration of Writings from the 1920s*, revised edition, Frederick, MD: Beard Books, 2003.

Robert Karasek and Töres Theorell, *Healthy Work: Stress, Productivity, and the Reconstruction of Working Life*, New York, NY: Basic Books, 1990.

Herbert A. Simon, *Administrative Behavior: A Study of Decision-Making Processes in Administrative Organization*, fourth edition, New York, NY: The Free Press, 1997, and "A behavioral model of rational choice," *Quarterly Journal of Economics*, 1955, Volume 69, pp. 99–188.

support mechanisms so that they can truly master their work, whether at the front line or in the boardroom. Revamped physical space fosters collaboration, visual-management techniques let everyone see what needs to be done, targeted coaching builds capabilities, and simple "job aids" reinforce standards. These and other changes enable employees to own their own development, without leaving them to figure it out by themselves.

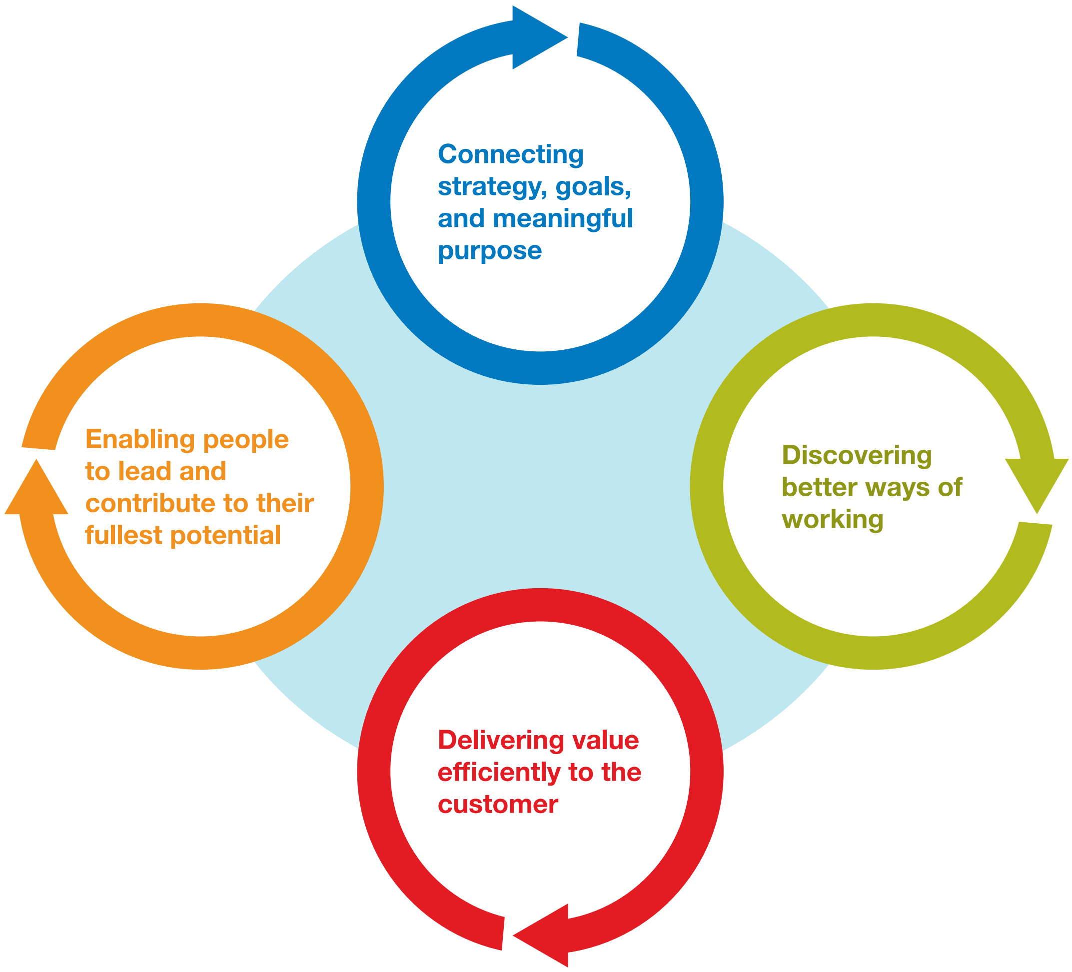
- Discovering better ways of working. As customers, competitors, and the broader economic and social context change, the whole enterprise must continually think about how today's ways of working and managing could improve. To guide the inquiry, people will need a clear sense of what "better" means—the ideal that the organization is reaching toward—as well as an unvarnished view of current conditions and the ability to work with others to close gaps without fear of reprisal. Problem identification and resolution must become a part of everyone's job description, supported by structures to ensure that problems flow to the people best able to solve them.

- Connecting strategy, goals, and meaningful purpose. Organizations that endure operate from a clear direction—a vision of what the organization is for, which in turn shapes their strategy and objectives in ways that give meaning to daily work. At every level, starting with the CEO, leaders articulate the strategy and objectives in ways that their people can understand and support. The final step aligns individual goals to the strategy and vision, with the result that people fully understand their role in the organization and why it matters.

The four build on one another. For example, to create new products that deliver better value to customers, the financial-data company cited at the beginning will need to convince its employees that their ideas matter, encourage them to find new ways to respond to customers, and clarify the company's purpose. To help its people manage the surge in inflow, the government agency will need to evaluate what matters to constituents, reassess how work gets done, and

Exhibit

The lean-management system is articulated through four integrated disciplines.



make sure that its strategy is consistent with its mission. Thus, while an organization's focus may naturally emphasize different disciplines at different times, it will need all four to keep renewing itself. Together, they form the lean-management system (exhibit).

As the organization's experience with the system deepens, its capabilities will naturally strengthen. At the same time, lean management fosters a culture that encourages continual reassessment. Gradually, that drive will come to apply to the system as well—the organization will seek to improve its application of lean management, to see how it could push the ideas (and its performance) further. Accordingly, the most committed organizations regularly conduct well-structured assessments of their maturity in lean management, giving them feedback on their progress in all four disciplines while identifying opportunities to reflect and improve. ○

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