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THE TRANSFORMATION TRAP

THE SMART AND SIMPLE WAY TO AVERT HR RISK

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The only constant in today's business environment is unrelenting change. Business models are in permanent flux, as companies swiftly adapt to cope with ever-intensifying globalization and the rapid digitization of industries, not to mention fast-changing customer needs. And there's no sign that these trends will be abating.

This turbulence, which is buffeting every industry and market, means that global corporations must undertake a growing number of increasingly complex cross-border transformations. And these transformations are different from those of the past. Rather than face a single organization-wide transformation every three or four years, companies must deal with an unpredictable number of such initiatives, both small and large, while still conducting their day-to-day business. These efforts usually make heavy demands on the HR function, which is frequently the "engine room" of the transformation program.

Complexity is increasing because, in many cases, companies run multiple transformation initiatives in parallel. These initiatives ultimately affect each other, with results that are not entirely foreseeable—but such interdependencies often are not sufficiently taken into account. Moreover, some parts of the organization may be involved in several consecutive transformations while others remain virtually untouched. This complexity significantly complicates codetermination processes, because in many cases employee representatives such as unions or works councils are not willing to sign off on a particular transformation concept when they're aware that several others might be under way at the same time—and multiple transformations inevitably unsettle and demotivate rank-and-file employees. Yet successful transformations, executed without unduly disrupting day-to-day business, are critical if companies are to stay competitive.

Transformations Are On the Rise

Our work with clients in every region and industry has taught us that the transformation game has changed. Amid mounting complexity, the old playbook no longer works. Although known concepts might appear from a distance to need just an update and a bit of adaptation, organizations that take this approach risk becoming wrapped up in a never-ending stream of change that soaks up management capacity and weakens the company.

The old procedures and approaches no longer work for a host of reasons:

- Increasing demands from top management and other stakeholders
- An increasingly complex regulatory environment, especially internationally, which often affects not just HR but also other parts of the company
- More cross-border coordination among social partners, as well as increased professional support for them
- Streamlined HR organizations that have no additional capacity to handle extra projects
- An increasing number of projects, with a correspondingly higher number of interdependencies

Data from the European Monitoring Centre on Change shows that the number of transformations in Europe continues to increase, rising by as much as 17 percent from 2010 through 2014. (See Exhibit 1.) Yet many experts argue that most transformations are not successful—a view supported by our own data. That's all the more reason to start thinking about how transformations can succeed.

Five Risks in Transformations—and How to Avert Them

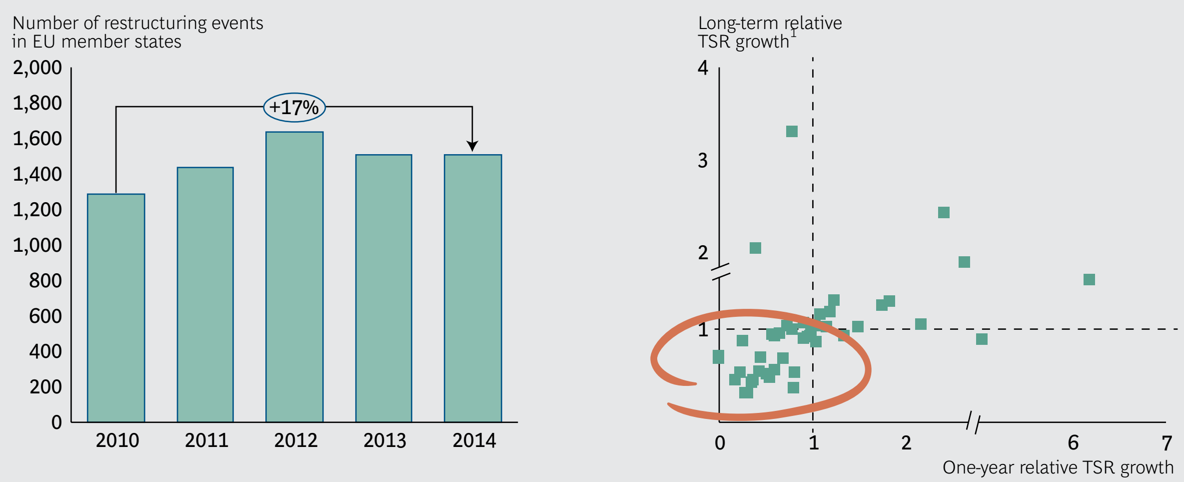
The ever-changing business environment demands innovative and technically advanced approaches to transformations in order to avoid the risk that they will absorb all available management capacity. Because these approaches require a significant amount of coordination and cooperation among employees, managers, and other stakeholders, applying smart rules for working together can dramatically improve a transformation's results.

It is especially important to address five common personnel risks that must be averted if a transformation is to succeed:

- Personnel cost savings are not fully realized.

EXHIBIT 1 | Transformations Are More Common but No More Successful

Transformations have increased strongly in Europe... **...but more than 60 percent of them fail**



Sources: European Monitoring Centre on Change, restructuring events database; BCG analysis of a sample of 48 companies.
Note: Total shareholder return (TSR) is adjusted by the relevant industry index growth (or the S&P 500); 1 = same growth rate as the industry index.
[1]Five years from start of transformation effort, or until today.

- Restructuring costs end up higher than expected.
- The organization has lost key employees, and those retained have the wrong skill set.
- The HR implementation process takes too long.
- Relations with employee representatives are severely damaged.

Personnel cost savings are not fully realized. Most transformations are aimed at least in part at reducing personnel costs. These savings are often not fully realized, however, because of insufficiently detailed preparation and the absence of strict tracking of the implementation process. In addition, managers responsible for achieving targets face no severe consequences for failing to meet them.

The following measures will help to realize personnel cost savings:

- Detail functional changes and accompanying cost savings as precisely as possible.
- Make responsible managers feel the "shadow of the future"—that is, make them feel today the urgency of taking actions whose consequences may not emerge for some time.
- Do not accept the excuse that the changing business environment makes it impossible to achieve targeted efficiency improvements.

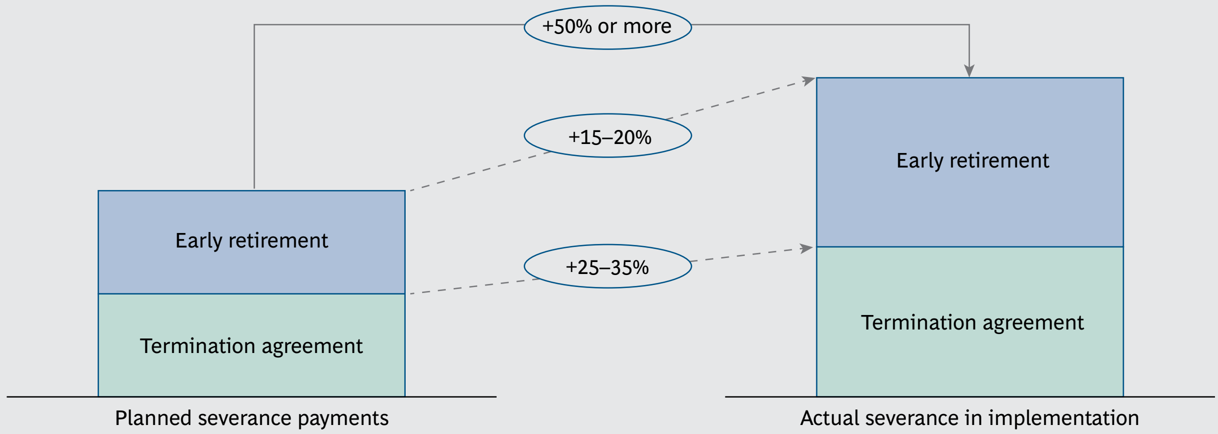
Restructuring costs end up higher than expected. In many failed transformations, restructuring costs considerably exceed the forecast amount. This overage is often the result of inappropriate or suboptimally applied HR instruments, such as negotiated severance and early retirement packages.

Even a well-designed transformation concept that includes clear rules for determining payments to employees does not assure predictable costs. Actual costs can exceed forecasts when timelines are tight and managers start offering employees ad hoc "sweeteners" to convince them to take voluntary severance. (See Exhibit 2.) It's important, therefore, to closely and continuously track actual costs against planned costs.

The following measures can help hold the line on restructuring costs:

- Carefully track actual costs against planned costs for each category of HR instrument.
- Establish target ratios for the mix of HR instruments that will be used during implementation.

EXHIBIT 2 | Actual Severance Payments Can Deviate Sharply from Planned Payments



Source: BCG analysis of a sample of financial institutions.

- Define a process for the case-by-case analysis of deviations from planned costs.

The organization has lost key employees, and those retained have the wrong skill set. After the dust from the transformation has settled, many managers discover that the loss of key employees has significantly weakened the organization—and that many of the employees who remain have the wrong skill set for their future tasks.

The following measures can help to preserve the right mix of employees:

- Determine the skill set needed for the transformed organization.
- Identify and pre-select key employees who will be needed in the transformed organization.
- Create a communications strategy with defined and differentiated messages for each target audience.

The HR implementation process takes too long. A long time can elapse between the creation of the initial transformation plan and the moment when the first HR measures actually take effect. The longer the process takes, the more pressure there is on the business case for the transformation—and on the people working in the organization.

The following measures can help keep the process on track:

- Develop centralized, rigorous steering of the implementation process.
- Establish an explicit mandate regarding results and timelines.
- Start the implementation phase early—even if all details are not yet in place.

Relations with employee representatives are severely damaged. Transformations inevitably heighten emotions, and when feelings are running high, people on both sides of the negotiating table can say and do things that are not easily undone. Talks and negotiations with employee representatives can be particularly difficult, with repercussions that stretch years into the future. Once-uncontroversial topics can suddenly come under heavy scrutiny and impair the conduct of day-to-day business.

Heated disputes are common in the commercial airline industry, for example, whose flight attendants' or pilots' unions often stage several strikes a year, disrupting the operations of multiple airlines and snarling global air travel. Entire countries are held hostage to their demands.

During these job actions, talks with representatives of airline management often break down, sometimes repeatedly, and require the intervention of board members to set negotiations back on track. But even when such extraordinary efforts produce an agreement, they almost never bring long-term labor peace. To the contrary, those agreements far more often are awkward compromises that merely postpone the cycle of disputes, strikes, and temporary truces rather than arrest it permanently.

The following measures can help to ensure good long-term relations with employee representatives:

- Define a clear communication and negotiation strategy well in advance.
- Manage the expectations of negotiating partners appropriately.
- Take an analytical approach to negotiation preparation with the aim of finding the optimal solution.

That last point merits further discussion. A well-prepared negotiating strategy, complete with scenario modeling and other analytical exercises, is critical if companies are to avoid collective bargaining agreements that include a high increase in personnel costs. Such agreements can set an unfortunate precedent for the next transformation, because high run rates put the cost structure under pressure.

In many cases, a detailed analysis can help negotiators structure agreements that satisfy both sides while holding run rates to moderate increases. For example, one client offered to pay one-time bonuses rather than raise hourly wages for the duration of its 24-month collective bargaining agreement, which enabled it to hold its run rate increase to 2.7 percent (calculated as of the end of the agreement), compared with a 3.5 percent increase had hourly wages been increased.

The success of any transformation requires the identification and assessment of personnel risks early in the process. An analytical approach that combines stable processes with innovative elements is critical to steering clear of the transformation trap. HR departments must also have all the tools and support they need in order to be able to function within the transformed company, test the efficacy of their current procedures, and set the stage for continuous improvement.

It is equally important that the core transformation team can manage the expectations of stakeholders clearly, consistently, and skillfully. Indeed, the success of the entire undertaking hinges on the core team's performance in this regard. The HR function in particular is the transformation team's key player and must be ready and able to lead the implementation process and see to it that savings are realized as planned.

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