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Organizational health is (still) the key to long-term performance

McKinsey's latest findings on organizational health demonstrate that it remains the best predictor of value creation and a sustainable source of competitive advantage in today's global marketplace.

by Alex Camp, Arne Gast, Drew Goldstein, and Brooke Weddle

February 2024

For decades we've seen companies' fortunes rise and fall based on their ability to react to, and recover quickly from, geopolitical shocks, technological advances, economic uncertainty, competitors' bold moves, and other disruptions. Amid this volatility, which these days is accelerating rather than abating, many have a hard time staying the course. But some continue to survive and thrive despite the challenges. Why do these companies manage to succeed, year after year—operationally, financially, and otherwise—while others don't?

Twenty-plus years of proprietary McKinsey research tells us that one of the main reasons is organizational health.

Organizational health refers to how effectively leaders "run the place"—that is, how they make decisions, allocate resources, operate day to day, and lead their teams with the goal of delivering high performance, both near term and over time. Organizational health comprises three elements: how well the entire organization rallies around a common vision and strategy, how well the organization executes its strategy, and how well the organization innovates and renews itself over time.

Our latest research on the topic reiterates the degree to which organizational health is not just nice to have; it's required for sustained performance and organizational success. McKinsey's Organizational Health Index (OHI) continues to show, for instance, that, over the long term, healthy organizations deliver three times the total shareholder returns (TSR) of unhealthy organizations, regardless of industry.[1] Other findings point to greater resilience and higher financial performance in healthy organizations, even as the world around them has become that much more complicated (see sidebar, "What is the Organizational Health Index?").

In this article, we look at the latest OHI results and highlight a few of the more compelling insights that the index reveals about leadership, data and technology, and talent management. We also identify several principles for building or maintaining organizational health over time—something that leaders often tell us they have limited time and resources to do.

It's important to make the time, however—not just to spin up new activities but rather to think about how to run the business differently and factor both health and performance into daily actions. The causes of, and conditions for, organizational health are always changing. Just as medical associations continually update their recommendations on diet and fitness, so must the business community regularly monitor its practices and performance. The companies that do can differentiate themselves from others in the marketplace. They can more readily identify the kind of talent they need and the specific behaviors it will take to achieve their organizational objectives.

Organizational health can put companies on a fast track to performance—and a commitment to sustained health can keep them there.

The staying power of organizational health

There is no one right path to sustained success, but the fact is, healthier organizations do tend to perform better than unhealthy ones, especially in times of uncertainty. And that performance advantage increases over time.[2] According to our research, organizational health is the strongest predictor of value creation and a critical factor in sustained competitive advantage. In one evaluation of 1,500 companies in 100 countries, for instance, we saw that companies that had improved their

[1] Aaron De Smet, Bill Schaninger, and Matthew Smith, "The hidden value of organizational health—and how to capture it," *McKinsey Quarterly*, April 1, 2014.
[2] "Where companies with a long-term view outperform their peers," McKinsey Global Institute, February 8, 2017.

What is the Organizational Health Index?

The Organizational Health Index (OHI) is a diagnostic that measures critical elements of a high-performing culture in an organization. The index draws from a proprietary database of more than eight million respondents across more than 2,500 organizations in a range of geographies and industries. The index aggregates employees' and managers' views on the management practices (and employee experiences) that inform an organization's performance across nine dimensions, or outcomes. An overall score is assigned so companies can see how they compare with others in the database. The result is a detailed view of the health and internal-network dynamics of an organization (exhibit).

Launched in 2003, the OHI model is updated regularly to reflect advances in organizational science and changes in the state of organizations more broadly.

The 2023 update includes factors—such as agility, resilience, inclusivity, and employee experience and well-being—that have become more pronounced in the wake of the global pandemic, macro-economic shifts, geopolitical unease, and other global trends.

Exhibit

The Organizational Health Index clarifies the link between organizational practice and performance.

The Organizational Health Index (OHI) aggregates employees' and managers' views on the behaviors that can affect an organization's outcomes across nine dimensions.

Accountability
Ensure that individuals understand what is expected of them, have sufficient authority, and feel accountable for delivering results.

Direction
Communicate a clear and compelling vision of where the organization is headed, how it will get there, and what it means for everyone.

Coordination and control
Consistently measure and manage the business and its risks, and address problems when they arise.

External orientation
Engage with customers, suppliers, partners, and other important external stakeholders to create and deliver value—now and in the future.

Leadership
Use different leadership styles to shape employees' actions and generate high performance.

Innovation and learning
Encourage and harness new ideas—from incremental improvements to radical innovation—so the organization can evolve and grow.

Capabilities
Ensure that institutional skills and talent are in place to execute strategy and create competitive advantage.

Work environment
Cultivate a clear, consistent set of values and working norms that foster effective workplace behaviors.

Motivation
Develop employee loyalty and enthusiasm and inspire people to exert extraordinary effort to perform at their very best.

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organizational health realized 18 percent increases in their EBITDA after one year.

Consider the following data points.

Health and M&A. In merger situations, healthy organizations—those that applied various health interventions during the integration phase and emphasized organizational health throughout the integration—gained a 5 percent median change in TSR compared with industry peers after two years. The change for unhealthy companies was −17 percent over the same period.

Health and transformations. In large transformations, companies that embedded organizational-health investments and initiatives in their change programs across an 18-month period saw 35 percent higher TSR than companies that did not invest in health.

Health and resiliency. Healthy organizations are not just higher performers, they are also more resilient and better able to manage downside risk. For instance, from 2020 to 2021, during the COVID-19 pandemic, healthy organizations were 59 percent less likely than unhealthy organizations to show signs of financial distress.

Health and safety. Companies with superior organizational health are better able than their peers to provide safe work environments, thereby limiting their exposure to financial, operational, and reputational risks. Indeed, companies in the top quartile in organizational health have six times fewer safety incidents than those in the bottom quartile.

The relationship between health and performance can be quantified in other ways, too, including in the areas of talent and culture. In our experience, employees and leaders in unhealthy cultures often focus on what made them successful in the past rather than on what may be required going forward —and their entrenched behaviors and ways of working can take on a life of their own. Consider the situation at one global company: employees had reported in company satisfaction and pulse surveys that they felt motivated to do their jobs—and yet, the company's performance remained stagnant. The CEO and executive team could not determine how to break through.

An organizational-health diagnostic revealed the problem: misaligned behaviors had dulled the company's performance edge. Employees were producing day to day—but not in the areas that mattered most for meeting the organization's long-term strategic goals. They were engaged but comfortable—"like being in a warm bath." To change the energy, the CEO and executive team embarked on a multiyear transformation in which they reengineered business processes, instituted different working norms for leadership teams, changed their protocols for meetings and communications, activated change agents across the organization, and pushed more decisions down to those on the front lines. Over time, employees' enthusiasm increased, and descriptions of "what it felt like to work there" became livelier and more focused on achieving great things together. Performance was on the upswing.

A pulse check: How should leaders think about organizational health?

Clearly, organizational health matters as much now as it ever has. The latest OHI results reiterate what we know from McKinsey's 2023 State of Organizations research about how companies are faring in an era of unprecedented change. But in these latest OHI findings, three trends in particular

stand out: how leaders are leading; the links between technology, data, and innovation; and the value of talent mobility.

1. Leadership is undergoing a generational transformation

It's fair to say that few—if any—executives anticipated the deeply disruptive business (and societal) changes that would emerge because of the 2020 global pandemic and the speed at which organizations needed to transform themselves. As they have reckoned with changes in where and how work gets done, leaders are learning that they need to be both decisive and empowering.

To that point, the OHI research indicates that decisive leadership is now one of the best predictors of organizational health. Unlike authoritative leadership, in which leaders use influence and authority to get things done, decisive leadership reflects leaders' quick decisions and their commitment to act on them. During the COVID-19 pandemic, senior leaders at Amazon made quick commitments—within days and weeks, not months—to prioritize essential supplies, protect customers from price gouging, raise the minimum wage for hourly workers, and increase overtime pay. They allowed unlimited paid time off, as well as two weeks of sick pay to those affected by COVID-19. The company also rapidly expanded the capacity in its data center to meet the surge in demand for cloud computing services, which resulted in increased operational efficiency and growth for Amazon Web Services.[3]

Decisive leadership is not just for times of crisis, however; it's a requirement for any business that just wants to keep up.[4] To that end, a number of organizations have taken steps to empower frontline workers. Senior leaders at TJ Maxx, for instance, have empowered more than 1,200 buyers across all stores, each of whom controls millions of dollars, to cut deals on the spot with manufacturers. By committing to a system of delegated decision making, leaders have ensured that items get into stores quicker—within a week, in most cases—than they would have under a more traditional, hierarchical review process.[5] Leaders at Southwest Airlines have made a concerted effort to put critical customer information in frontline employees' hands: "Not only are [employees] able to work more quickly, but they are also providing a more tailored experience to customers," James Ashworth, vice president for customer support and services, told *Forbes* magazine. The end result has been "a lift in our customer satisfaction scores, as well as a decrease in our call handle times," he says.[6]

According to the OHI research, companies with leaders who take decisive actions—and who commit to those decisions once they are made—are 4.2 times more likely to be healthy, as compared with their peers.

But it's not enough just to be fast with those decisions; our OHI research shows that decisive leaders who empower their employees (giving those closest to the work the autonomy to make their own decisions) are 85 percent more likely to improve the quality of organizational decisions, as compared with their peers. This supports previous McKinsey research pointing to a paradigm shift in leadership and, among other new requirements, the need for executives to shift from being controllers to becoming coaches who engage employees and help foster in them a bold mindset of testing, learning, and fast adaptation.[7]

Bank Mandiri, for instance, is using digital tools to ensure that individuals across all parts of the company have access to data analytics. Previously, information requests and report generation at the bank could take weeks, and critical business information had to be pulled from a tangle of

[3] Karen Weise, "Amazon's profit soars 220 percent as pandemic drives shopping online," *New York Times*, April 29, 2021.
[4] Aaron De Smet, Gerald Lackey, and Leigh M. Weiss, "Untangling your organization's decision making," *McKinsey Quarterly*, June 21, 2017.
[5] "The Economics of T.J. Maxx's recession-proof pricing strategy, explained," *Wall Street Journal*, June 1, 2023.
[6] Tiffani Bova, "Southwest on the importance of employee experience," *Forbes*, November 17, 2020.
[7] Aaron De Smet, Arne Gast, Johanne Lavoie, and Michael Lurie, "New leadership for a new era of thriving organizations," *McKinsey Quarterly*, May 4, 2023.

systems. Through a new self-service system, employees can now access the data that are most relevant to them in a timelier manner—in a matter of days rather than weeks—allowing employees to make better, faster decisions.

2. Data is the fuel for everyday innovation
Leaders have traditionally thought of innovation as a process for bringing "the next big idea" to life. But our latest OHI data reveal that companies are more likely to succeed with innovation initiatives if "big bang ideas" are supported by data-driven insights and supplemented with smaller, more frequent ideas that target improvements in everyday processes or ways of working.

In many organizations, the ideas for "little i" innovation often come from the people closest to customers—frontline employees.[8] And, as it turns out, it pays to listen to them: the OHI data show that organizations that actively listen and act on recommendations from frontline employees are 80 percent more likely than others to consistently implement new and better ways of doing things.

The research also reiterates that *all* forms of innovation are more likely to succeed when decisions are grounded in data and facts. According to the research, organizations that emphasize data-driven decision making are 63 percent more likely than others to adapt to a changing business environment.

One of the best recent examples of data-informed innovation comes from Major League Baseball. The rise of data analytics prompted significant changes in many teams' operations; managers built their rosters and managed their lineups according to batting percentages, probabilities, and other data captured across the league. The downside of that data-driven innovation, however, was longer games (more pitching changes and a product that was

less appealing to younger viewers. Again, the league turned to data—this time conducting surveys, focus groups, and spending time with younger fans—to learn what was important to them. Based on that feedback, the league engaged in some experiments. It implemented rule changes in 2023 (pitch clocks, larger bases, pitching-change limits, and so on) that fundamentally altered the pace and action of the game. The league continues to embrace innovation and technology, not only to improve the game but the overall fan experience.[9]

3. The dynamic deployment of talent is becoming even more of a competitive advantage
Workforce dynamics have been completely upended over the past few years, which has left organizations with an increasingly difficult HR-related task: ensuring that they have the right talent on board to tackle the highest-value-creating activities and successfully execute on their strategies.[10] Our OHI research shows that the dynamic deployment of talent can be a powerful lever for both employee attraction and retention. It can also help organizations pivot quickly as markets change or new technologies and global trends emerge.

Companies that encourage and even facilitate internal role changes can sharpen employees' skills, maximize their versatility, and provide avenues for growth. According to our OHI findings, employees that experience more mobility at work are 27 percent less likely to report feeling burned out, 47 percent less likely to report intentions to leave their organization, and 2.3 times more likely to recommend their companies to others.

Employee rotations and upskilling became core components of one Latin American bank's digital transformation. When HR leaders realized that 62 percent of the company's technology workforce needed to be upskilled to meet the bank's

8 *People & Organization Blog*, "Empower the front line for a thriving organization," blog entry by Kelli Moles and Michael Park, McKinsey, August 28, 2023.
9 Erik Roth, "The Committed Innovator: How Major League Baseball built an innovation machine," McKinsey, October 27, 2023.
10 Patrick Guggenberger, Dana Maor, Michael Park, and Patrick Simon, "The State of Organizations 2023: Ten shifts transforming organizations," McKinsey, April 26, 2023.

transformation goals, they launched a large training initiative, which involved more than 1,500 courses focused on about 820 technology skills, 60 boot camps, and countless individual, on-the-job coaching sessions. The HR organization embedded this focus on technology coaching and capability building into all performance management discussions.

As a result of this effort, about 60 percent of the total technology workforce is engaged in upskilling, attrition is low, and what started as a "special transformation program" is now considered business as usual and a cornerstone of the bank's learning and development efforts.[11]

It's worth noting that more and more organizations are following the bank's lead and exploring the move to skills-based hiring—in part to address shortages in certain skill areas like technology but also to create pathways for "nontraditional" job candidates, or those who might not have a college degree or a formal certificate of expertise.[12]

Getting and staying healthy

Sustained organizational success really comes down to leaders gathering the data that will help them understand which behaviors can help them to meet their performance goals as well as the type and scale of health improvements their organization should target.

It's critical for leaders to establish a baseline of the organization's current strengths as well as the strengths it is targeting. With that baseline in mind, leaders can set clear behavioral priorities and begin to act—but it's also critical to remember that context matters. Organizations will need to launch health interventions that are specific to the business, their performance goals, and their

customer value proposition. Two hotel chains—one luxury, one economy—may offer similar services in the market, but each requires different kinds of behaviors to deliver on their value propositions and meet their performance targets. Regardless of their starting points, each will need to track progress against goals and adapt as needed along the way.

McKinsey research points to four foundational behaviors, what we call *power practices*, that can have disproportionate effects on organizational performance—and whose absence can create a significant drag on organizations: strategic clarity, role clarity, personal ownership, and competitive insights.[13]

— *Strategic clarity*. Healthy organizations effectively translate vision and strategy into actionable and measurable objectives that are clearly articulated and shared with employees at all levels.

— *Role clarity*. Healthy organizations tend to have structures, processes, and working norms that speed up decision making, remove layers of bureaucracy, and make it easy for employees to get things done—even when situations are new or ambiguous.

— *Personal ownership*. Healthy organizations hire and develop managers who have a deep sense of personal ownership for their work and who foster that same sense of ownership in their teams and employees.

— *Competitive insights*. Healthy organizations tend to have a clear view of where and how they fit in the competitive landscape and of their value propositions; they use these insights to set strategic priorities, make decisions, and allocate resources.

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[11] Vincent Bérubé, Dana Maor, Maria Ocampo, and Alex Sukharevsky, "HR rewired: An end-to-end approach to attracting and retaining top tech talent," McKinsey, June 27, 2023.

[12] Bryan Hancock and Brooke Weddle, "Right skills, right person, right role," McKinsey, October 25, 2023.

[13] It is worth noting that the list of power practices has changed over time, and likely will again, but three practices routinely show up: strategic clarity, role clarity, and personal ownership.

If any of these power practices are missing or at risk, organizations should take steps to address them; it's a no-regrets move for achieving good organizational health.

In addition to this list, companies also need to identify which kinds of talent and behaviors are required for them to truly differentiate themselves from competitors—the organizations' so-called "secret sauce." Industry insights and benchmarks can provide some direction, but the final list of behaviors that convey competitive advantage to one company and not others can only be identified by an organization's senior leaders.

The "born remote" technology company GitLab provides a good example. Long before these days of remote and hybrid workplaces, the company established foundational norms to get the most out of its distributed workforce. Ways of working were designed to be independent of time and place. Employees are encouraged to "write things down," for instance, and playbooks are readily available online. GitLab's operating model emphasizes a shared reality, equal contributions, decision velocity, and measurement clarity. The central behaviors at the company's core have given it an advantage as other companies continue to try to define remote and hybrid working models. And GitLab has demonstrated top-decile performance against OHI benchmarks.

As this and many other examples show, leaders in outperforming companies always have a plan to be "good enough" at everything and "truly excellent" at the handful of things that matter for them and the organization. And when it comes to how they run the place, they emphasize cultural consistency across the organization.[14]

The leadership imperative

Our research makes a clear and compelling case that organizational health is the foundation for companies' ability to successfully create value, attain profitability, build resilience, and thrive in so many other areas.

So why don't more senior executives make it a priority?

In our experience, there are several common obstacles. The first is inconsistency in how leaders think and talk about organizational health: conversations about organizational health often anchor on employee engagement as the default, and executives often consider organizational health as being separate from performance. In fact, they are actually one and the same. Leaders should be asking themselves, "How do I run the place each and every day—in each and every meeting—in ways that are both healthy and conducive to creating high performance?"

Related, senior leaders may not see the trees for the forest; many will discuss organizational health as a top-level theme but are much less often involved in the interventions and implementation required to achieve and sustain organizational health. Third, realizing improvements in organizational health takes time—and executives often need to move fast. The default here is to focus on putting out fires rather than fixing the system.

And finally, there's a sense that bad health implies bad leadership. C-suite leaders must make organizational health a central component of their leadership styles and manage it as rigorously as they do their P&L. Otherwise, they may not actually recognize unhealthy actions when they see them. For this reason, leaders may need to spend extra

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[14] Carolyn Dewar and Scott Keller, "Three steps to a high-performance culture," *Harvard Business Review*, January 26, 2012.

time, attention, and resources on health interventions. They may need to reframe quarterly discussions and incentives and other elements of performance management around the idea of maintaining organizational health.

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Even for those companies that are seemingly in great shape, it's important to continue to monitor the organization for symptoms of upset or disruption. Just as top athletes can lose time or distance or skill if they skip workouts for an extended period, so can companies fall behind competitors if they take a break and rest on their laurels. Commitment is crucial.