THE BOARD–CEO PARTNERSHIP IN A TRANSFORMATION

By Gerry Hansell and Lars Fæste

Many executives have opinions about transformation, but only a few have succeeded at multiple transformation initiatives across a range of companies and industries. Raj Gupta is one of them. Over three decades, Gupta has served as CEO, chair, and director at several companies undergoing transformations that unlocked significant value. Currently, he is chair at two companies: Aptiv, a supplier of auto parts and technology, and Avantor, a manufacturer of specialty materials and equipment for the health care industry. He has a wealth of insights that CEOs, board directors, and chairs at other organizations can apply.

"Successful transformations require more than just running operations leaner and incrementally raising profit margins," says Gupta. "Companies need to align around a clear point of view and take more ambitious steps—innovation, reshaping the portfolio, and repositioning how the company goes to market. That's a different mindset, and it requires a different style of leadership." His experience points to five strategic imperatives for companies that want to design and implement a successful transformation.

Ensure Board and Executive Team Alignment

The board has a critical role in growth transformations. First, it needs to ensure that the right CEO is in place—someone who can question the status quo, outline a vision for the future, and implement a program to get there. If any of these elements is missing, the board may need to replace the top person. "Selecting a new CEO is the most critical thing the board does," says Gupta. "You need someone who's curious and challenges the status quo, someone who's open-minded, listens to and engages with the board, communicates candidly, and doesn't feel like they already have all the answers. Complacency and arrogance can really limit successful companies—and successful individuals."

BCG research has found that new CEOs tend to have better long-term results in transformations, measured by long-term total shareholder return, but companies with new CEOS also show a bigger spread between top performers and laggards. That reinforces a similar, earlier analysis, which found that a new CEO is one of three factors that correlate with long-term transformation success. (See the sidebar "The Transformations That Work—and Why.") "Boards sometimes get it wrong and hire the wrong CEO," says Gupta. "In those cases, it's important not to linger. Realize the problem, fix it, and move on." (See the sidebar "Choosing the Right CEO at Avantor.")

Focus on Execution

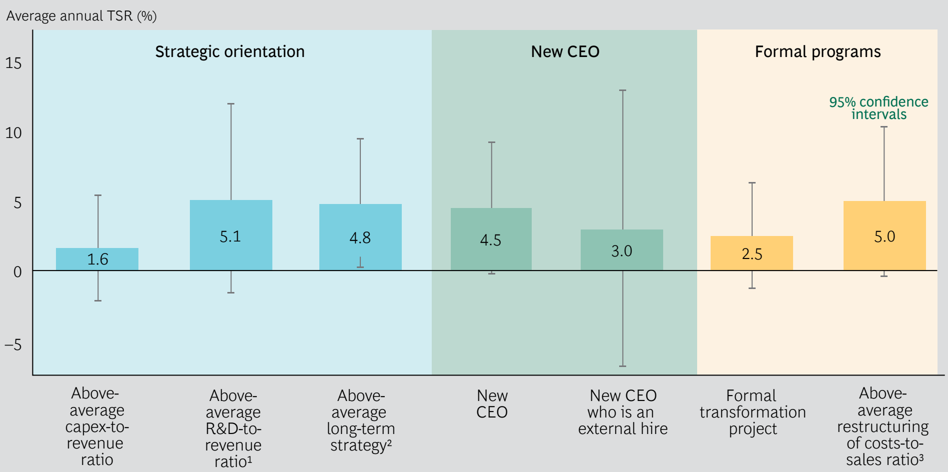
The second major strategic imperative is execution, starting with prioritization of change efforts. Some organizations have 30 or more initiatives running at the same time. Each may be worthy in its own right, but senior leaders—not to mention the company's workforce—cannot possibly focus on such a broad mandate. Instead, companies must narrow down the list of strategic priorities to the three or four that are most important, coordinate them through a single transformation program, and then allocate the capital, talent, and

THE TRANSFORMATIONS THAT WORK—AND WHY

A BCG analysis of transformations identified three critical factors that can improve a company's odds of success. (See the exhibit below.)

- A strategic orientation, with sufficient investment in the critical areas of capex and R&D
- A new CEO, with a slight improvement in performance for new CEOs hired from outside the organization rather than promoted from within
- A formal transformation program that the company invests in sufficiently (measured by restructuring costs as a percentage of revenue)

Three Factors That Lead to Long-Term Transformation Success



Sources: Capital IQ; Thomson; Edgar; BCG Henderson Institute analysis.
Note: Results are based on a multivariate regression analysis that looks at the five-year change in TSR for companies with two preceding years of severely declining performance. The sample includes U.S. public companies (excluding the energy sector) from 2004 through 2011 with market capitalization of at least $10 billion. Capex and R&D are benchmarked to industry averages.
[1]Of companies reporting R&D.
[2]Based on a proprietary BCG analysis of 10-K filings.
[3]Of companies conducting a formal transformation.

CHOOSING THE RIGHT CEO AT AVANTOR

Avantor provides mission-critical products and services to the biopharma, health care, education, and technology industries. The company was formed in 2010 from an orphaned specialty-chemical business. Gupta became chairman of the company's board that same year, when New Mountain Capital, a private equity firm where Gupta is a senior advisor, invested in Avantor. Over the past decade, the company has grown through a series of strategic acquisitions that gave it global scale, differentiated technology, increased access to distribution channels, and world-class manufacturing capabilities.

Leadership has also been a key aspect as well. "We had a bumpy start and went through two CEOs in the first few years," Gupta says, "until we recruited Michael Stubblefield in the spring 2014." Stubblefield set three priorities:

- Accelerating growth by pivoting to the attractive biopharma market and increasing R&D investments
- Enhancing profitability by improving pricing, reducing the product line, scaling back the manufacturing footprint, and other measures
- Expanding into Europe and Asia to capitalize on scale efficiencies and gain new capabilities

Within two years, Avantor's revenue started to grow at double-digit rates, and profit margins doubled. The company built on this momentum by making several bold acquisitions and has continued to grow. In May 2019, Avantor went public on the New York Stock Exchange at $14 a share—the largest health care IPO in US history—and its stock price was about $30 as of early 2021. From the initial $280 million required to launch the business, Avantor's market cap is now approximately $17 billion, and the company recently joined the Fortune 500.

other resources—such as marketing and R&D investment—needed to succeed.

In addition, companies need to relentlessly track results, with clear metrics and a timeline of key milestones and objectives. Tracking of results should happen on a shorter timeline than some leadership teams might like. Rather than monthly or quarterly, leaders need to see results weekly—or even daily in some cases. (Many companies' response to the COVID-19 pandemic featured this kind of close oversight, with good results.) Some leaders develop a medium-term vision and then break that into a series of short-term targets, the idea being that you have to win in the short term in order to win in the medium term. Quick wins early on can build credibility—among both internal and external stakeholders—and generate momentum for bolder measures later on in the transformation. "People can handle a lot of volatility if they know that you're focused on a long-term goal," says Gupta.

Hand in hand with tracking results goes real candor. Organizations need a culture in which people are empowered to speak the truth, particularly when something isn't working.

Actively Manage the Portfolio

As noted above, growth doesn't simply mean doing the same thing more efficiently. It means identifying promising markets to exploit and contracting markets to exit. "You have to be brutal about getting out of businesses that are commoditized or where you just don't have a future," says Gupta.

In addition to simplifying the portfolio of products and services, companies can focus on a different customer segment, a different geographic market, or a different business model. The decision to sell off a particular business unit or product line can be particularly challenging if it is performing well but no longer fits with the transformation agenda. In those cases, companies need to be disciplined about how the components come together to unlock value and which pieces no longer fit. (See the sidebar "Reshaping the Portfolio at Rohm and Haas.")

Identify and Mitigate Risks

Any transformation raises the risk profile of the company, both during the initiative and afterward. Changes in business units, talent, digitization, and other aspects of the organization all potentially introduce new risks that the board must identify and mitigate. That is an ongoing process. As Gupta notes, "Things rarely play out according to the plan, so you'll likely have to pivot at key junctures, all while reassuring key stakeholders, including investors."

During the transformation, directors and chairs need to work with management to ensure that the implementation process stays on schedule and the organization hits its key milestones: cost reductions, synergies, growth, or other metrics. And in the post-transformation state, the board needs to understand the company's new risk profile and ensure that leaders are addressing manageable risks. (See the sidebar "Identifying Market Risks at Aptiv.")

Engage Key Stakeholders

Transformations require a consistent vision and the willingness to ride out short-term disruptions. Without a long-term objective that the board and leadership team can communicate, analysts, investors, employees, and other stakeholders may see their faith shaken.

In addition, boards and leadership teams need enough flexibility in the short term to adjust how the company will achieve its vision. "This is not a straight-line journey,

RESHAPING THE PORTFOLIO AT ROHM AND HAAS

A maker of specialty chemicals, Rohm and Haas has a long history of innovation in products for the construction, automotive, and agriculture markets. The company named Gupta CEO and chairman in 1998, and he added the title of president in 2005. At that time, several of the company's key product lines were at risk of being commoditized. Others did not have the scale to succeed. Margins were strong and the company had no debt, but annual sales were essentially stagnant at around $4 billion (with after-tax earnings of $400 million).

Gupta immediately launched a transformation aimed at reshaping the portfolio to capitalize on fast-growing markets. In a six-month period spanning 1998 and 1999, the company made $6 billion worth of acquisitions, including two in electronic materials. Those deals nearly doubled the company's revenue and employee count and gave it $4 billion in debt. At that point, the dot-com bust was about to hit, reducing the company's sales in key segments.

In 2000, Rohm and Hass set four strategic goals: strengthen the leadership team, build state-of-the-art information systems, invest in Asia, and differentiate through technology. That effort took about three years, but the work paid off when the company resumed its growth trajectory. In 2009, Gupta navigated a successful and highly public sale of the business to Dow Chemical for $15.3 billion. From 1998 to 2009, the company's total shareholder return was the second-highest on the S&P 500.

IDENTIFYING MARKET RISKS AT APTIV

In 1999, GM spun out its components supplier, a company called Delphi, into a separate business. Over the past two decades, Delphi has had significant ups and downs, including a bankruptcy restructuring in 2004, being taken private, and then going public again in 2011. (Gupta has been a director since 2009 and chair since 2015.) By the mid-2010s, it was clear that focusing on traditional gas and diesel powertrains carried significant risk. Hybrids were gaining market share, and fully battery-powered vehicles were becoming technologically feasible. Autonomous vehicles, car sharing, and decreased car sales to younger people, among other shifts, were threatening automakers' established business models—which, in turn, created risks for Delphi.

In response, CEO Kevin Clark (who took the top role in 2015, the same year that Gupta became chair) engaged with the board and external advisors to understand the scope of these risks and to formulate a response. The transformation involved acquisitions and divestitures, culminating in a split into two companies. One, called Delphi Technologies, would focus on gas and diesel powertrains. A second company, called Aptiv, would focus on advanced automotive technologies such as electrification, hybrids, autonomous driving, and safety. Since that split, Aptiv has continued to thrive and invest. For example, in March 2020, Aptiv formed a joint venture with Hyundai called Motional, which develops autonomous-vehicle technology.

Aptiv's financial performance has been extremely strong. Revenue is growing, and the company's stock increased nearly sevenfold since the IPO in November 2011, pushing the company's market cap to approximately $40 billion.

and there's no single path," says Gupta. "If you have a short-term mindset and you only think about what analysts say and what's going to move the stock price tomorrow, you're not going to make it. You need the confidence of your board and investors to ride out the ups and downs over a time period of at least two to three years. For them to stick with you, you need to be clear in your communications and focus on the long term."

Finally, organizations increasingly need to consider environmental, social, and governance factors as part of their performance metrics. ESG issues are getting more attention from shareholders—an advantage for companies that take a proactive approach but a disadvantage for those that drag their feet. In fact, BCG research has found that total societal impact—which incorporates both societal and business value—can be a better lens for strategy than traditional shareholder return.

TRANSFORMATION IS NOT easy, but boards—in partnership with the CEO—can play a critical role in the process. By following the principles described here, boards can effectively partner with management teams and flip the odds of successful transformation decisively in a company's favor.

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