How Extraordinary Leaders Double Profits

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Decoding leadership reveals patterns that can be used to develop leaders that inspire and motivate employees to higher levels of productivity, and deliver profits as a result.

Observe a print by M.C. Escher long enough and a mysterious pattern becomes apparent throughout the piece. Not unlike deciphering an Escher work, decoding leadership trends reveals a pattern that's likely to pique your interest: Extraordinary leaders can double profits.

This is a bold statement that will undoubtedly bring to mind a few questions, including:

- How does leadership drive profit?
- How do organizations and leaders maximize, if not double, profit opportunity?
- How do we capitalize on leadership as a means to profit and growth?
- What issues can leaders impact that will most effectively drive profit?
- What data supports the claim that extraordinary leaders double profits?
- How do we identify and develop extraordinary leaders?

The connection between leadership and the bottom line has to an extent been made. Yet, most of what we've seen is the result of closed-door boardroom brainstorming sessions and personal treatises of famous, successful executives. While interesting, we're left confused by the variety of opinions on key issues involving leadership and the slew of contradicting leadership development models.

There is a growing body of research that supports the claim that leaders, good and bad, directly affect the bottom line of the organization. 360-degree feedback reports offer a useful tool. If you want to find out the effectiveness of a leader, ask those who are led.

Analyzing a database of 300,000 360-degree feedback reports on approximately 30,000 managers collected within hundreds of companies around the world, the authors identified concrete performance metrics that allowed them to compare measurable business results with leadership effectiveness. This data-driven approach revealed how we can identify extraordinary leaders and how such leaders develop.

Impact of Leadership Effectiveness on Net Income

In a study of a Fortune 500 commercial bank, the authors discovered evidence of the impact that leadership effectiveness has on net income. Fortunately, this was an organization in which the profit analysis was relatively easy. In this instance, they were able to isolate many of the exogenous factors that exist for most of its leaders and reveal the impact leadership had on its bottom line.

Starting with a 360-degree assessment of the leadership competencies that quantitatively make a significant difference in the effectiveness of a leader, the next step was to divide the leaders into three groups: The top 10 percent were the best leaders, the bottom 10 percent were the worst leaders, and the leftover 80 percent of leaders fell somewhere in the middle. This division revealed the significant contrast between poor and great leaders and the impact that leadership has when performed at its highest level.

By cross-referencing this data with operating profit results of each of the offices those leaders were responsible for managing, the results show the bottom 10 percent did poorly and the top 10 percent did exceptionally well, but it's striking to see just how significant the differences were.

Figure 1 shows the results of the study. The vertical axis shows the total net income as $1.2 million in losses for the bottom 10 percent of leaders, a total net

FIGURE 1: IMPACT OF LEADERSHIP EFFECTIVENESS ON NET INCOME

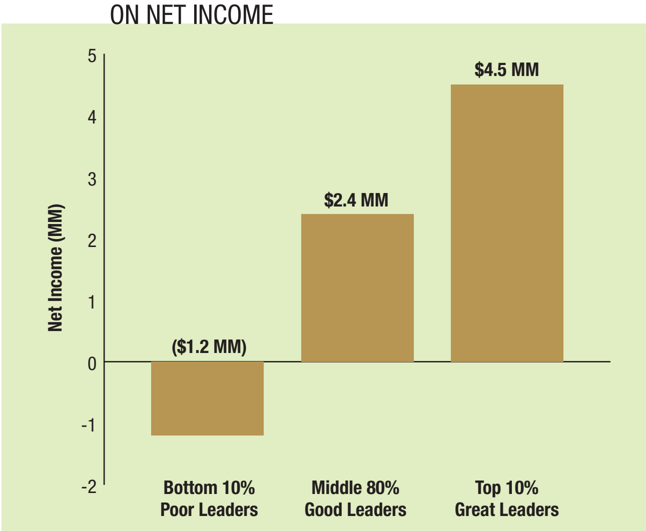

FIGURE 2: THE TREND LINE

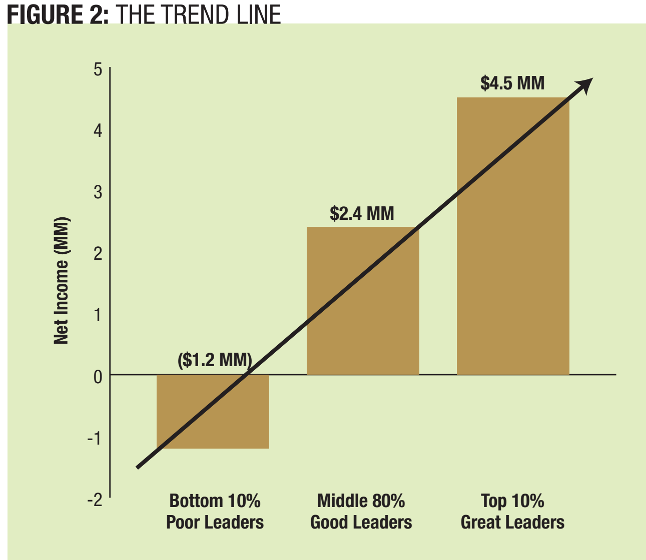

FIGURE 3: LEADERSHIP EFFECTIVENESS VS. EMPLOYEE SATISFACTION/COMMITMENT

FIGURE 4: LEADERSHIP EFFECTIVENESS VS. PERCENT OF EMPLOYEES WHO "THINK ABOUT QUITTING"

FIGURE 5: LEADERSHIP EFFECTIVENESS VS. SATISFACTION WITH PAY

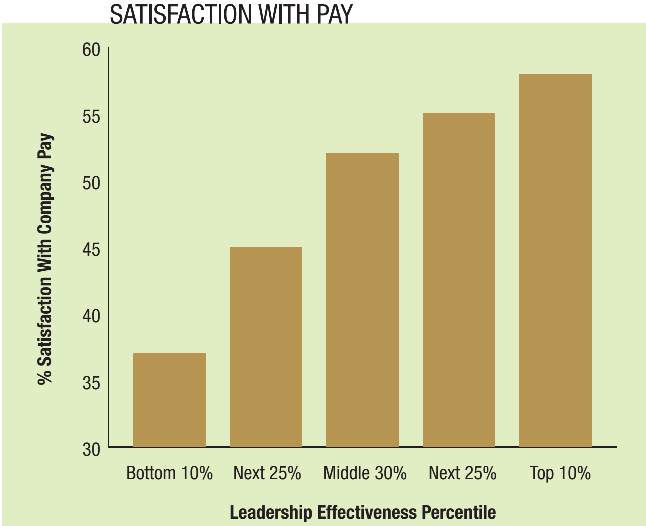

FIGURE 6: IMPACT OF PRODUCTIVITY GAINS ON PROFIT

And productivity improvement is...

If people costs are...	5%	10%	20%	40%
20%	20%	40%	60%	260%
30%	30%	60%	120%	240%
40%	40%	80%	160%	320%
50%	50%	100%	200%	500%

Then % increase in pre-tax profit is...

> There is enormous potential for organizations to improve their bottom lines by developing leaders who, for example, inspire people to perform at higher levels and who can recognize and remove obstacles to employee productivity.

income of $2.4 million for the middle 80 percent and nearly $4.5 million for the top 10 percent. Poor leaders lose money, good leaders make profit, and extraordinary leaders more than double profits in comparison to the other 90 percent.

The Trend Line

Do extraordinary leaders double the organization's profit in every case? While they did in the previous case study, the answer is probably not. Isolating the variety of factors involved in measuring profit is incredibly difficult.

However, data does show that the trend line will likely look the same regardless of whether the raw numbers or percentages show a poor leader losing $1 million or breaking even, or an excellent leader doubling profits or increasing them by 20 percent. The contention remains the same: Good leaders create more economic value than poor leaders, and extraordinary leaders create significantly more economic value than the rest.

We can consistently measure the performance of leaders on the issues that have the most powerful impact in driving profit. Because of this ability to measure, we have a strong proxy for how to draw hard measures on leadership's effect on the bottom line. These factors often include retention and turnover, employee commitment/morale, customer satisfaction and productivity. And because these issues can be objectively and empirically measured and the trend line remains the same every time, we can say with strong conviction that this is how extraordinary leaders double profits.

How Leadership Drives Profit

It's not always possible to measure profitability directly, but there has been some research about what drives profit. For instance, a study highlighted in "The Employee-Customer-Profit Chain at Sears," published by the *Harvard Business Review* in 1998, showed that for every 5-point increase in employee attitude toward their jobs and the company at a specific Sears store, customer satisfaction typically went up 1.3 percent, which ultimately increased revenue growth of the organization by 0.5 percent. This trend also appears to be true at other retailers. Starbucks has indicated that a strong correlation exists between profitability at a particular location and employee commitment.

Though we may not be able to determine an organization's raw profit, we can measure the factors that lead to profitability with consistent results. These indirect influences of leadership effectiveness include:

1. Employee satisfaction/commitment.
2. Employee turnover.
3. Percent of employees who think about quitting.
4. Satisfaction with pay.
5. High commitment.

The results are dramatic. For instance, in the case of the impact of leadership effectiveness on employee satisfaction/commitment, the bottom 10 percent of leaders were below the 25th percentile on employee satisfaction/commitment, as compared to employees being at the 75th percentile who had leaders at the 90th to 100th percentile.

Here's another example: More than 50 percent of employees who think about quitting their jobs report to leaders in the bottom 10 percent versus just slightly more than 15 percent who think about quitting their positions reporting to leaders in the top 10 percent. (About half of the people in an organization who are thinking about quitting actually quit within a year.)

Even satisfaction with pay shows a dramatic disparity, with less than 37 percent of employees satisfied at organizations led by the bottom 10 percent of leaders versus nearly 60 percent of employees satisfied with their pay at organization led by the top 10 percent.

FIGURE 7: DIFFERENTIATING COMPETENCIES

Focus on Results	Leading Change	Character	Interpersonal Skills	Personal Capability
• Drives for results • Establishes stretch goals • Takes initiative	• Develops strategic perspectives • Champions change • Connects the group to the outside world	• Displays high integrity and honesty	• Communicates powerfully and proficiently • Inspires and motivates others to high performance • Builds relationships • Develops others • Collaboration and teamwork	• Technical professional expertise • Solves problems and analyzes Issues • Innovates • Practices self-development

What is interesting about this statistic is that employees are not necessarily being paid more by leaders in the top 10 percent than they are by leaders in the bottom 10 percent. They are in reality often living proof of the saying, "You can't pay me enough to work for that person."

How Do Organizations Develop Leaders Who Can Double Profits?

There is enormous potential for organizations to improve their bottom lines by developing leaders who, for example, inspire people to perform at higher levels and who can recognize and remove obstacles to employee productivity.

This isn't an entirely new concept. In 1976, Robert Sibson researched and published his findings about the impact that improving productivity has on increasing profits, in his book *Increasing Employee Productivity*. This new research confirms Sibson's findings and carries it into the 21st century. If people costs are 50 percent (as a percentage of sales) and productivity improvement is 10 percent, then the increase in pretax profit is 100 percent. Even if productivity improvement is just 5 percent and people costs are 50 percent, that's still an increase in pretax profit of 50 percent.

Is a Gain of 10 Percent Productivity Reasonable?

Affecting such issues as employee satisfaction and commitment, turnover and retention may directly influence the organization's bottom line, but is a gain of 10 percent productivity reasonable? According to research by Hunter, Schmidt and Judiesch, there is ample opportunity for leaders to develop the higher levels of commitment necessary to impact productivity by 10 percent.

For instance, Hunter, Schmidt and Judiesch found that in medium-complexity jobs, a person in the top 1 percent was 85 percent more productive than a person in the 50th percentile. In high-complexity jobs, it found that a person in the top 1 percent was 127 percent more productive than a person in the 50th percentile.

Gallup found that 55 percent of employees are not engaged at work as compared to 29 percent of employees who are engaged. The remaining 16 percent are actively disengaged, costing the U.S. economy upward of $350 billion. These studies reveal room for gains in productivity across the board. So the next logical step is to develop extraordinary leaders.

Developing Extraordinary Leaders

We can develop leaders who inspire people to perform at a higher level and thus increase organizational productivity. There are many organizations that show consistent improvement in productivity over time as a direct result of their leadership development programs. General Electric had 5 percent per annum growth in employee productivity at a time when many organizations were languishing with 1 or 2 percent productivity improvement.

In order to realize substantial increases in productivity and sustain these gains over time, the organization must rely on a leadership development model that defines the competencies that will make a difference to it and use development methods that really work. There are 16 competencies that separate the best companies from the rest (Figure 7).

Although the focus will vary by company and industry, these 16 competencies were the most consistent ones for all of the companies in our studies. Building and developing these leadership competencies or strengths become the clear path to extraordinary leadership, increasing productivity and maximizing profits for the organization.

The 16 competencies of extraordinary leadership can be categorized into five clusters of behavior:

1. Focus on results.
2. Leading change.

3. Character.
4. Interpersonal skills.
5. Personal capability.

The 16 competencies that fall into these categories most frequently and consistently separate the highest-scoring leaders from the others.

Differentiating Competencies and Performance: What's the Link?

The links between these behaviors and performance may seem subtle, but they are critical. For instance, the leader who focuses on results learns that what gets focused on gets better: Seeing improvement, people respond to this focus and follow it. The leader's focus then creates a cycle of success.

Another interesting observation is that first-rate, talented people are attracted to honesty and integrity and to leaders who are technically competent and good problem solvers. What better way to attract the best talent than to display fair ethics, character and personal capability?

As another example, leaders with interpersonal skills build cultures that inspire employees to want to work harder and care more about their jobs. People feel cared for and respected as the leader clears away obstacles; this in turn creates a culture that encourages teams to flourish. As for leading change, this behavior is a vital, long-term function to the organization and its people because it ensures the organization stays abreast of the world about it, thus maintaining competitive advantage.

Not everyone is exceptional in every area, but this is not a problem. The highest-performing leaders are strong in three or four areas; however, these need to be spread out and not clumped in one area. A leader can be exceptional in just a few of the 16 competencies and be an extremely good leader who increases the productivity of the company.

Interestingly, the person who does not have glaring weaknesses or extraordinary strengths — who isn't really good at anything, but isn't really bad at anything — will fall into the bottom third of the leadership distribution in the company. So although the person

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isn't necessarily taking the company into bankruptcy, this person isn't doing anything for productivity either.

One strength can work wonders in the overall perception of leadership, raising the leader to the 64th percentile. Three strengths will raise the perception of leadership effectiveness to the 81st percentile, and four and five strengths to near or above the 90th percentile.

One Pivotal Competency

Interestingly enough, there is one pivotal competency that is most powerful in distinguishing the top 10th percentile from the rest: inspiring and motivating others to high performance.

Falling in the interpersonal skills cluster of behaviors, this competency was voted by direct reports as the most important competency for leaders to possess. It was most correlated with employee engagement, and for many people, it intuitively has the most obvious link to productivity.

If this competency doesn't come naturally, which for many leaders it does not, it can be overwhelming — even a burden. Not only are leaders expected to fulfill the duties of their positions, they need to inspire and motivate people if the company is to succeed. However, contrary to popular belief, motivating others to high performance is relatively simple. It's a process of developing in leaders the competencies that support the behavior of inspiring and motivating people.

What leaders learn in any leadership program will have to be repeated if there is a lack of follow-up. New skills and behaviors will rapidly evaporate if there are not follow-up mechanisms in place.

How Can We Help Leaders Be More Inspiring?

Traditional thinking is that we can make leaders be more inspiring by teaching them to use deliberate motivational tactics, such as applying pressure on employees to perform at higher levels, giving motivating pep talks, implementing new compensation systems, creating competition, invoking peer pressure, tossing out challenges or comparing their teams to other high-performing groups.

However, empirical analysis revealed that each of the 16 differentiating competencies, including inspiring and motivating others, has several companion behaviors or "competency companions." These competency companions are the handful of behaviors statistically correlated to the differentiating competency, and often they are not intuitive.

Enhancing these companion behaviors strengthens the behavior. It's like cross-training in the world of sports. Think, for example, of the runner who lifts weights along with a running program, or swims longs distance or engages in aerobic exercise.

If an organization wants more inspiring and motivational leaders, one promising approach is to develop in its leaders the competency companions to this behavior. These include:

- Setting stretch goals for employees.
- Establishing a clear vision.
- Developing others.
- Practicing greater teamwork collaboration.
- Demonstrating greater initiative.
- Being a role model.

Sustaining Change

Leadership development isn't a new concept. There are many approaches to developing leaders, and each organization has to decide for itself which process will serve it best. One thing that is certain: What leaders learn in any leadership program will have to be repeated if there is a lack of follow-up. New skills and behaviors will rapidly evaporate if there are not follow-up mechanisms in place. To put it in statistical terms, 87 percent of what a person learns in a leadership program will be gone within 30 days if there is no follow-up, according to Neil Rackham in his book *SPIN Selling*.

Follow-up can be as simple as asking for monthly progress reports from team members, colleagues, employees or peers. Specific suggestions for improvement can be requested. Mini surveys can be part of the follow-up process. Conducted every four to six months, these mini surveys reveal areas for improvement before and after the individual takes part in the leadership program.

There is no substitute for measurement and feedback, and there is an assortment of follow-up metrics and tools that work with customized leadership development, as well as more traditional programs. These types of internal mechanisms keep leadership development at the forefront of the leader's awareness and show progress.

It is possible to measure leadership in dollars. Boiling it down to the simplest of terms, good leaders create more economic value than poor leaders, and extraordinary leaders create far more value than good ones. That being the case, you may wisely choose to develop great leaders in your organization. CLO

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