



# HOW EXTRAORDINARY LEADERS DOUBLE PROFITS: Decoding Leadership Trends to Discover the Patterns

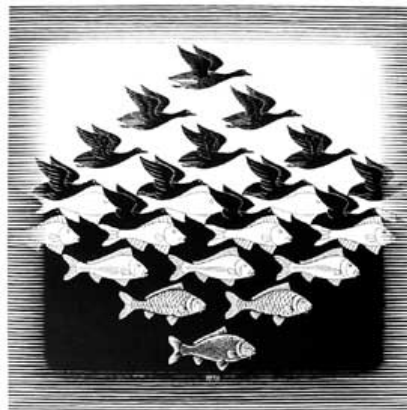
*by Jack Zenger, Joe Folkman and Scott K. Edinger*

## A PATTERN EMERGES

Observe the print by M.C. Escher at right long enough, and a mysterious pattern (of a duck morphing into a fish) becomes apparent throughout the piece. Not unlike deciphering an Escher work, we've spent years decoding leadership trends and we've discovered 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 that we'll answer in this article, 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 recounted in the mountains of materials published on the subject of leadership 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. That is until now.

## Discovery vs. Creation

Zenger | Folkman has answered the call to provide a more scientific approach to the study of leadership. As a result, we have gathered research that supports the dramatic claim that leaders, good and bad, directly affect the bottom line of the organization.

In recent years, one of the authors, Dr. Folkman, has led a team that has analyzed a substantial database of some 300,000 feedback instruments (commonly called 360-degree feedback reports) that pertain to approximately 30,000 managers. Our premise was simply if you want to find out the effectiveness of a leader, ask those who are led.

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These questionnaires were collected within hundreds of companies, around the world. In addition, some concrete performance metrics on these same managers have allowed us to compare their measurable business results with their leadership effectiveness.

This data-driven approach has furthered our understanding of leadership, revealing how we can identify extraordinary leaders and how such leaders develop. As a result, our leadership model provides our clients with practical and tactical methods for both determining a leadership focus as well as the means for developing strengths. We'll discuss more on this concept later in this white paper.

Most of all, our work in developing leadership is focused on the business outcomes that leadership creates. In other words, our process is proven to convert leadership development into business results—or “how extraordinary leaders double profits.”

### THE IMPACT OF LEADERSHIP EFFECTIVENESS ON NET INCOME

In a study we were commissioned to do for a division of a Fortune 500 commercial bank, we discovered strong and compelling evidence of the dramatic impact that leadership effectiveness has on net income.

Fortunately, this was an organization in which the profit analysis was relatively easy. In general this is not the case,

*Poor leaders lose money;*  
*good leaders make profit;*  
*extraordinary leaders*  
*double profit!*

which has made measuring actual profit a difficult process. In this instance, we were able to isolate many of the exogenous factors that exist for most of its leaders, thus clearly revealing the significant impact leadership had on its bottom line.

We started with a 360-degree assessment of the leadership competencies that quantitatively make a significant difference in the effectiveness of a leader. Our next step was to divide the leaders into three groups: the top 10% were the best leaders, the bottom 10% were the worst leaders, and the middle 80% were the rest of the leaders. This division revealed the significant contrast between poor and great leaders and helped us to understand the impact that leadership has when performed at its highest level.

We then cross-referenced this data with the operating profit results of each of the offices those leaders were responsible for managing. As you might expect, the results

show the bottom 10% did poorly and the top 10% did exceptionally well, but it's striking to see just how significant the differences are.

The graph below shows the definitive results of our study of the impact of extraordinary leaders on the bottom line of the organization: the vertical axis shows the total net income as \$1.2M in losses for the bottom 10% of leaders, a total net income of \$2.4M for the middle 80% of leaders, and nearly \$4.5M in gains for the top 10%. These astonishing results can be summed up in a simple conclusion: poor leaders lose money; good leaders make profit; extraordinary leaders more than double profits in comparison to the other 90%!

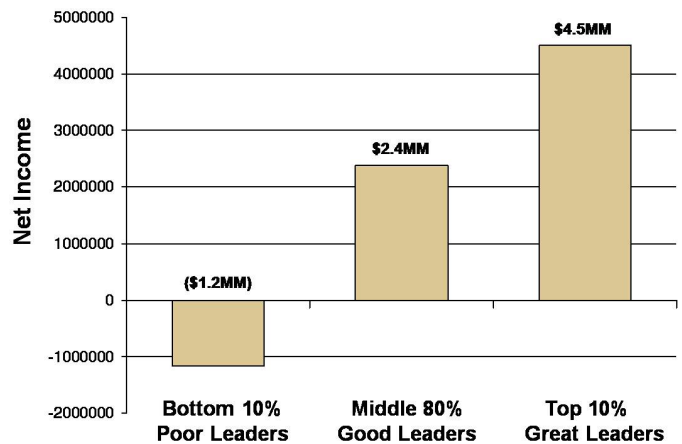


Figure 1: The Impact of Leadership Effectiveness on Net Income

### The Trend Line

Do extraordinary leaders double the organization's profit in every case? While they did in the previous case study we acknowledge that the answer to that question is “probably not.” We don't have the definitive answer to this question, because isolating the variety of factors involved in measuring profit is incredibly difficult.

However, we do have the data to show that the trend line will likely look the same regardless of whether the raw numbers or percentages show a poor leader losing \$1M or breaking even or an excellent leader doubling profits or increasing them by 20%, 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 which 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 leader-

ship's affect on the bottom line. These factors often include retention and turnover; employee commitment/morale; customer satisfaction; and productivity. And, because we can objectively and empirically measure these issues, and the trend line remains the same every single time, we can say with strong conviction: This is how extraordinary leaders double profits!

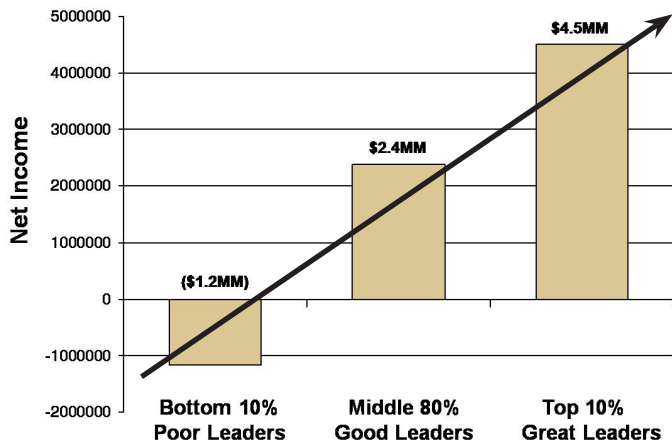


Figure 2: The Trend Line

### How Leadership Drives Profit

It's not always possible to measure profitability directly, but there has been some research about the issues that drive profit. For instance, as the Sears Study<sup>1</sup> has shown that at a given Sears store, for every five-point increase in employee attitude toward their job and the company, typically customer satisfaction typically goes up 1.3%, which ultimately increases revenue growth of the organization by 0.5%. This trend also appears to be true at other retailers. Our colleagues at Starbucks have 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

<sup>1</sup> "The Employee-Customer-Profit Chain at Sears," Rucci, A.J., Kim, S.P., Quinn, R.T., Harvard Business Review, January 1998, pages 82-97.

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

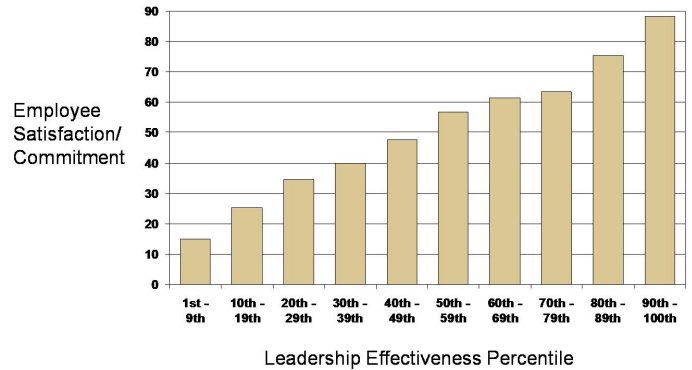


Figure 3: Leadership Effectiveness vs. Employee Satisfaction/Commitment

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

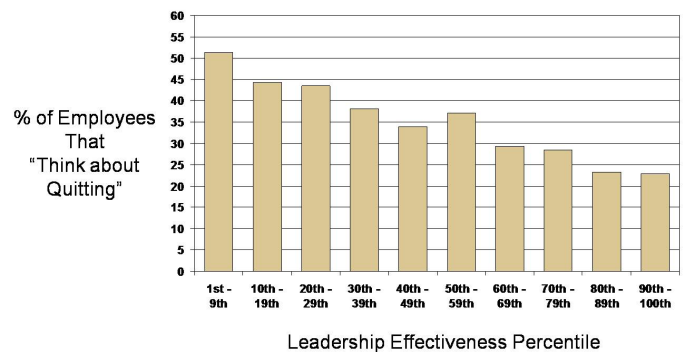


Figure 4: Leadership Effectiveness vs. Percent of Employees Who "Think about Quitting"

Even satisfaction with pay shows a dramatic disparity, with less than 37% of employees satisfied at organizations led by the bottom 10% of leaders versus nearly 60% of employees satisfied with their pay at organization led by the top 10%. What is interesting about this statistic is that employees are not necessarily being paid more by leaders in the top 10% than they are by leaders in the bottom 10%; they are in reality often living proof of the old saying, "You can't pay me enough to work for that person."

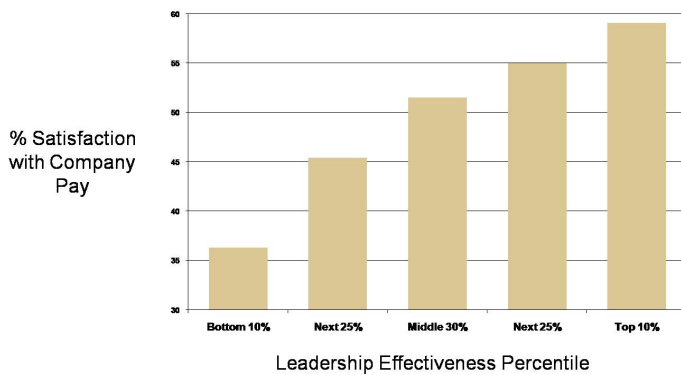


Figure 5: Leadership Effectiveness vs. Satisfaction with Pay

Having established the dramatic and measurable impact that leadership has on the bottom line, let's now look at the obvious question this raises.

### HOW DO ORGANIZATIONS DEVELOP LEADERS WHO CAN DOUBLE PROFITS?

There is enormous potential for organizations to improve their bottom line by developing leaders who, for instance, 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.<sup>2</sup> Our research confirms Sibson's findings and carries it into the 21<sup>st</sup> century. As a matter of fact, we've found that if people costs are 50%\* and productivity improvement is 10%, then the increase in pre-tax profit is 100%. Even if productivity improvement is just 5% and people costs are 50%, that's still an increase in pre-tax profit of 50%!

		And productivity improvement is...			
		5%	10%	20%	40%
If People costs* are...	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...

Figure 6: Impact of Productivity Gains on Profit

<sup>2</sup> Sibson, Robert E. Increasing Employee Productivity, AMACOM: New York. 1976. p. 12.

\* as % of sales

### Is a Gain of 10% Productivity Reasonable?

Affecting such issues as employee satisfaction and commitment, turnover, and retention, may directly and significantly influence the organization's bottom line, but is a gain of 10% productivity reasonable?

According to research by Hunter, Schmidt, and Judiesch, as well as Gallup and Zenger | Folkman, there is ample opportunity for leaders to develop the higher levels of commitment necessary to impact productivity by 10%.

For instance, Hunter, Schmidt, and Judiesch found that in medium complexity jobs, the person at the top 1% was 85% more productive than the person in the 50<sup>th</sup> percentile. In high complexity jobs, they found that the person at the top 1% was 127% more productive than the person at the 50<sup>th</sup> percentile.

Gallup found that an astounding 55% of employees are not engaged at work as compared to 29% of employees who are engaged. The remaining 16% are actively disengaged, costing the US economy upwards of \$350 billion!

At Zenger | Folkman we found that a mere 14% of employees have high satisfaction and commitment in their positions, 40% are moderately satisfied and committed, and nearly half, 46%, have lower satisfaction and commitment.

These studies reveal plenty of room for gains in productivity across the board. So, the next logical step is to develop extraordinary leaders. Sounds great, but how?

### DEVELOPING EXTRAORDINARY LEADERS

The first question you might have is: can we develop extraordinary leaders? The simple answer is yes; 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. For instance, General Electric had a 5% per annum growth in employee productivity at a time when many organizations were languishing with 1% and 2% productivity improvement.

In order to realize substantial increases in productivity and to 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. This doesn't bode well for a trendy leadership program that has no evidence of changing behavior and fails to focus on those behaviors that truly make a difference.

By emulating “evidence-based” medicine—gathering the aggregate data from 300,000 360-degree feedback instruments of 30,000 managers to produce a leadership development model that will have real value to the organization—we have identified 16 competencies that separate the best companies from the rest.

Although the focus will vary by company as well as from industry to industry, we have found that these 16 competencies were the most consistent ones for all of the companies in our studies. Building and developing these leadership competencies, or strengths, then becomes the clear path to extraordinary leadership, to increasing productivity, and finally to the maximization of profits for the organization.

### A Proven Model for Leadership

Our data-driven approach to understanding leadership has led to an empirically derived, scientifically grounded, proven model for developing leaders with 16 competencies of extraordinary leadership that can be categorized into five clusters of behavior:

1. Focus on results
2. Leading change
3. Character
4. Interpersonal skills
5. Personal capability

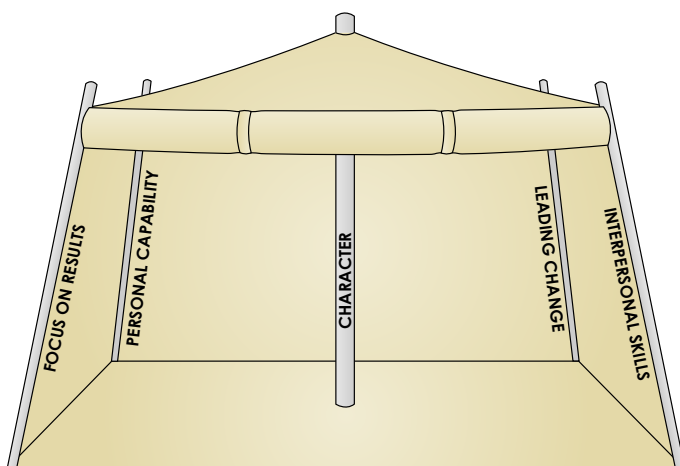


Figure 7: Zenger | Folkman Model for Leadership

The 16 competencies that fall into these categories, for instance displays high integrity and honesty and takes initiative, most frequently and consistently separate the highest scoring leaders from the others. (See Figure 8.)

### 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?

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, that 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 that the organization stays abreast of the world about it—thus maintaining competitive advantage.

Not everyone is exceptional in every area, and we find this not to be a problem. Our research shows that 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.

Another interesting finding is that the person who does not have any glaring weaknesses nor any extraordinary strengths (that is the person who isn't really good at anything nor is he or she really bad at anything,) will fall into the bottom third of the leadership distribution in the company. So, though the person isn't necessarily taking the company into bankruptcy, this person isn't doing anything for productivity either. The impact of one strength works wonders in the overall perception of leadership, raising the leader to the 64<sup>th</sup> percentile. Three strengths will raise the perception of leadership effectiveness to the 81<sup>st</sup> percentile and four and five strengths to near or above the 90<sup>th</sup> percentile.

Focus on Results	Leading Change	Character	Interpersonal Skills	Personal Capability
<ul style="list-style-type: none"> <li>• Drives for Results</li> <li>• Establishes Stretch Goals</li> <li>• Takes Initiative</li> </ul>	<ul style="list-style-type: none"> <li>• Develops Strategic Perspectives</li> <li>• Champions Change</li> <li>• Connects the Group to the Outside World</li> </ul>	<ul style="list-style-type: none"> <li>• Displays High Integrity and Honesty</li> </ul>	<ul style="list-style-type: none"> <li>• Communicates Powerfully and Prolifically</li> <li>• Inspires and Motivates Others to High Performance</li> <li>• Builds Relationships</li> <li>• Develops Others</li> <li>• Collaboration and Teamwork</li> </ul>	<ul style="list-style-type: none"> <li>• Technical/Professional Expertise</li> <li>• Solves Problems and Analyzes Issues</li> <li>• Innovates</li> <li>• Practices Self-Development</li> </ul>

Figure 8: Differentiating Competencies

### One Pivotal Competency

Interestingly enough, we did find that there is one pivotal competency that is most powerful in distinguishing the top 10<sup>th</sup> percentile from the rest: **inspires and motivates 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, now, in addition to the responsibilities outlined in their job descriptions, 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.

### How Can We Help Leaders to Be More Inspiring?

Traditional thinking is that we can make leaders be more inspiring by teaching them to use deliberate motivational tactics, such as: apply pressure on employees to perform at higher levels, give motivating pep talks, implement new compensation systems, create competition, invoke peer pressure, toss out challenges, or compare their teams to other high-performing groups.

However, our research points to some promising new approaches.

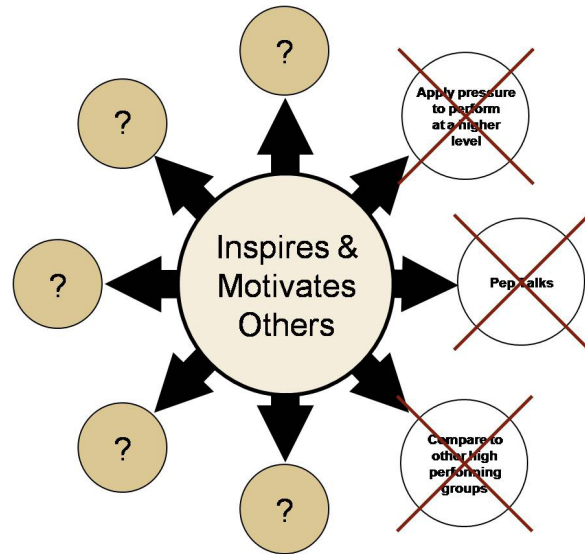


Figure 9: One Pivotal Competency

Our empirical analysis revealed that each of the 16 differentiating competencies, including inspiring and motivating others, has several companion behaviors or competency companions.<sup>3</sup>

These competency companions are the handful of behaviors statistically correlated to the differentiating competency, and they are often not intuitive. However, enhancing these companion behaviors strengthens the behavior. We liken it to cross-training in the world of sports. Think, for example, of the runner who lifts weights along with her running program, or swims long distance or engages in aerobic exercise.

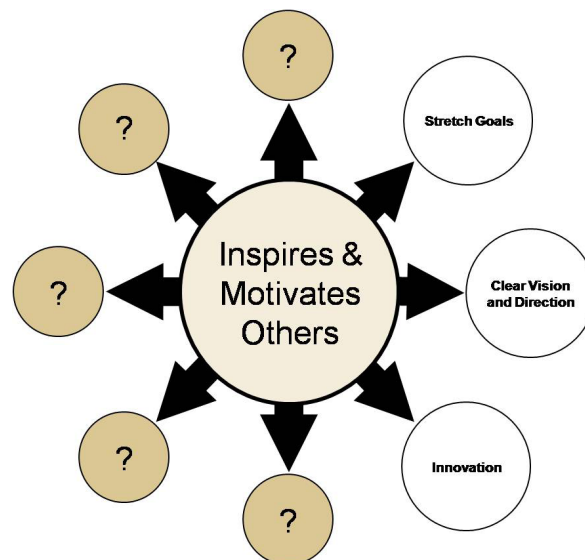


Figure 10: Example of Companion Behaviors

<sup>3</sup> Please contact Zenger | Folkman for more information about differentiating competencies and competency companions.

So, if an organization desires 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 and direction for the organization
- being more innovative and risk taking
- developing others
- practicing greater teamwork and 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 for certain, however, 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% of what a person learns in a leadership program will be gone within 30 days if there is no follow-up.<sup>4</sup>

Follow up can be as simple as asking for monthly progress reports from team members, colleagues, employees, and/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.<sup>5</sup>

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. For instance, Zenger | Folkman's leadership development solutions include the ActionPlan Mapper™ online tool that records accomplishments and milestones. It delivers routine progress and completion reminders, and asks specifically what the leader has done and plans to do to achieve his/her goals.

This type of internal mechanism keeps leadership development at the forefront of the leader's awareness and shows progress. Progress which leads to improved productivity, which takes us full circle back to how leaders can double profits!

## PARTING THOUGHTS

Most of us intuitively know that leadership affects the bottom line and we have presented a variety of evidence to support that assertion.

In our Extraordinary Leader research we have decoded what it takes to develop extraordinary leaders and confirmed that 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.

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<sup>4</sup> Rackham, Neil. SPIN Selling New York: McGraw-Hill. 1988.

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<sup>5</sup> Goldsmith, Marshall, Lyons, Laurence, Freas, Alyssa. “Teambuilding Without Time Wasting” Coaching for Leadership: How the World's Greatest Coaches Help Leaders Learn. Jossey-Bass/Pfeiffer: San Francisco. 2000.

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## ZENGER | FOLKMAN

*Extraordinary Performance. Delivered.*

We specialize in leadership and performance development that directly drives an organization's profitability. Founded on pioneering, empirical research using 360-degree assessments and other surveys, we've built one of the world's largest collections of leadership research data – hundreds of thousands of feedback surveys on tens of thousands of managers.

Using powerful techniques that focus on building strengths using implementation tools and personalized coaching, our approach lifts the performance of leaders, coaches and individual contributors in the differentiating competencies shared by those who are among the world's most successful people. Our proven, practical methods create a clear picture of how leadership drives profit and the ways to put it to work within organizations.

If you are interested in discussing how your organization can increase profit through extraordinary leadership, please contact Zenger | Folkman. We welcome the opportunity to talk with you about how your organization can develop extraordinary leaders who have the competencies to maximize profits for your organization!

**John H. “Jack” Zenger, D.B.A.**, was inducted into the Human Resources Development Hall of Fame in 1994 and received the Thought Leader Award from his industry colleagues in 2005. He is the author or co-author of seven books on leadership and teams, and is considered one of the most authoritative voices on improving organizational performance and developing leadership.

**Joseph Folkman, Ph.D.**, is a frequent keynote speaker and conference presenter, a consultant to some of the world's most successful organizations, and the author or co-author of six books. His research has been published in The Wall Street Journal's National Business Employment Weekly, Training and Development, and Executive Excellence.

**Scott K. Edinger** works with hundreds of leaders each year on developing leadership talent in their business and addressing the challenges of organizational change. He is a frequent keynote speaker at national meetings, and has contributed to publications such as Selling Power and Sales and Marketing Management.

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