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How Extraordinary Leaders Double Profits

by Jack Zenger and Joe Folkman

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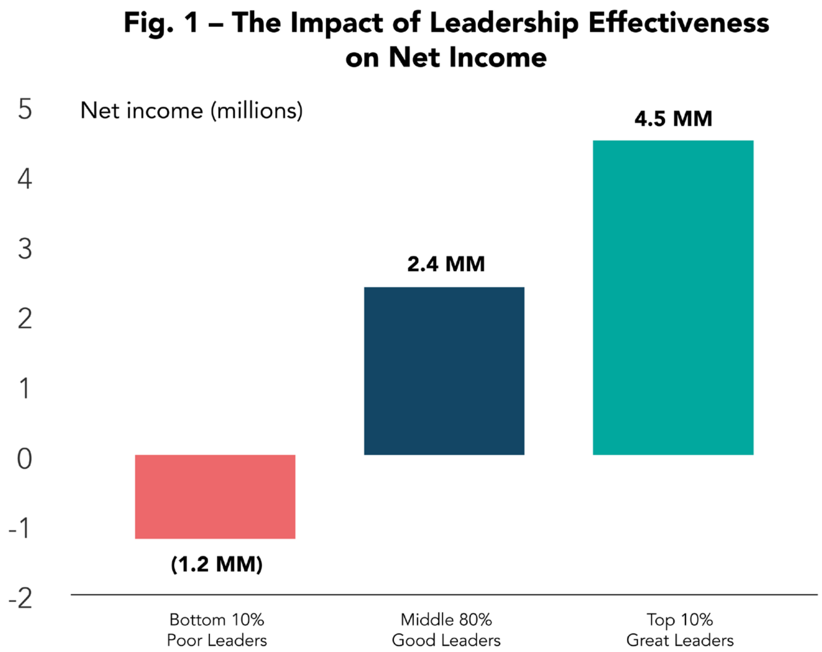
Overwhelming evidence proves that extraordinary leaders create far more economic value for an organization than leaders that are good.

Business success can be attributed to many causes. These range from the industry you are in, a dramatic new technology that you've discovered, an unusually well-designed product, a brilliant strategy, the timing of beginning your enterprise, and yes, plain old good luck. We acknowledge that all of these can account for an organization's success.

There is one factor, however, that is consistent and predictable in its impact on the success of every business. That is the quality of leadership inside the organization. This paper addresses the evidence we have for the relationship between leadership and business outcomes and explores the likely reasons for that occurring. Finally, it describes what organizations can do to develop excellent leaders.

Can extraordinary leaders double profits?

They can. It doesn't always happen, nor does it happen in the short run. But let



us review an example of where it did. We were commissioned to conduct a study for a division of a Fortune 500 mortgage lending organization. In doing so, we discovered compelling evidence that leadership effectiveness has a direct impact on net income.

Fortunately, this was an organization in which the profit was easy to measure on a granular, branch by branch level. In this instance, we were able to isolate many of the external factors that influence business results, thus clearly revealing the significant impact leadership had on its bottom line. The organization included more than a hundred offices in cities scattered across North America. They provided mortgage loans to home buyers. Interest rates were consistent between offices. Policies and procedures were generally alike. Profitability metrics were readily available with no added or burdensome cost.

Each branch had 25–35 people reporting to a branch manager. To assess the leadership effectiveness of each branch manager, we used a 360-degree assessment to measure their leadership competencies. This process included a self-assessment by the branch manager, a rating by that person's manager, ratings by the peers within the organization (i.e. other branch managers and corporate or regional staff), plus a number of direct reports. We arbitrarily divided the branch managers into three groups based on their 360-degree feedback scores. We defined the top 10 percent as the best leaders, the bottom 10 percent as the worst leaders, and the middle 80 percent comprised the rest of the leaders. This division provided dramatic contrast about the impact of poor and extraordinary leaders.

We then cross-referenced this data with the operating profits of each of the offices those leaders managed. As you might expect, 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:

- Net loss of $1.2 million for the bottom 10 percent of branch managers.
- Profit per branch of $2.4 million for the middle 80 percent of leaders.
- Profit of $4.5 million for the branches managed by the top 10 percent of branch managers.

The middle group actually triples profits per branch in comparison to the bottom 10 percent. The top 10 percent more than doubled the average profit per branch of the other 90 percent.

In recent years, one of the authors, Dr. Folkman, led a team that has analyzed a substantial database of over 750,000 multi-rater feedback instruments (commonly called 360-degree feedback reports) that pertain to approximately 56,000 managers. He was an early pioneer in the development and use of 360-degree feedback instruments and wrote a doctoral dissertation on the subject. He believes that if you want to discover the effectiveness of a leader, ask those who are led by and interact as peers with a leader. These questionnaires were collected within hundreds of companies around the world. In addition, some concrete performance metrics on these same managers 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.

Most of all, our work in leadership development is focused on the positive business outcomes that great leadership creates. In other words, our process promises to convert leadership development into business results. It shows “how extraordinary leaders double profits,” and why that occurs.

The Trend Line

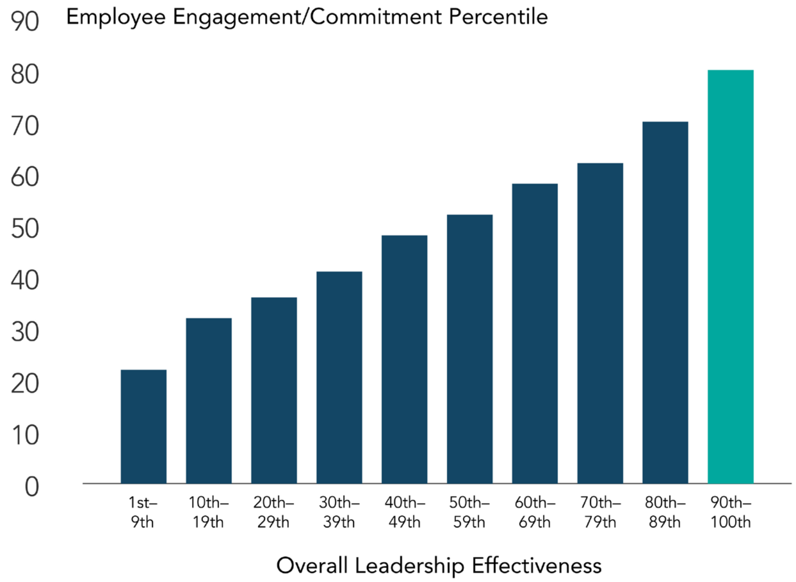
Do extraordinary leaders double the organization’s profit in every case? While they did in the previous case study, we acknowledge that the answer to that question is “probably not.”

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 $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.

How leadership drives profit

It’s not always possible to measure the link between leadership and profitability directly, but there has been much research about the various elements that drive profit. We can measure the factors that consistently lead to profitability. These indirect influences, or what some would call intervening variables on profitability, include:

Fig. 2 – Leadership Effectiveness vs. Employee Satisfaction/Commitment



- Ability to recruit good talent.
- Employee satisfaction/commitment.
- Employee turnover.
- Percent of employees who “think about quitting.”
- Satisfaction with pay.
- Sales effectiveness.
- Customer satisfaction.
- Corporate image.
- Corporate culture.
- Innovation.
- Workforce productivity.

The link between leadership effectiveness and each of these business outcomes is often easier to determine than the single ultimate outcome of profitability.

Employee commitment

For example, much has been written lately about the importance of employee commitment. When looking at the impact of leadership effectiveness on employee satisfaction and commitment, note that employees reporting to managers in the bottom 10 percent of leaders had employee commitment scores at the 23rd percentile. Then compare that to employees reporting to leaders in the top 10 percent. These employees had satisfaction and commitment scores at the 80th percentile. (This study is based on 30,661 leaders from all over the globe.)

Retention and Turnover

More than 80 percent of employees “think about quitting” their jobs if they report to leaders in the bottom 10 percent, versus the 4 percent who “think about quitting” if they report to leaders in the top 10 percent. It’s worth noting that in normal economic times, about half of the people in the organization who say they are thinking about quitting actually quit within a year! (These results are from over 2,500 leaders in a financial services company.)

Sales Growth

In 2014, the economy in Mexico struggled because of political problems and lower than expected growth. Every sector of the economy was impacted. The executives of a retail store chain, however, believed that effective store managers would deliver improved sales even in a difficult economy.

To verify their hypothesis, we analyzed the leadership effectiveness of 95 retail store managers. Assessments were completed by managers, peers, direct reports, and internal customers on each store manager. Because the size of stores varied, along with some locations being more favorable than others, we used as our primary measure the percentage increase in sales of each store compared to the

Fig. 3 – Leadership Effectiveness vs. Percent of Employees Who "Think About Quitting"

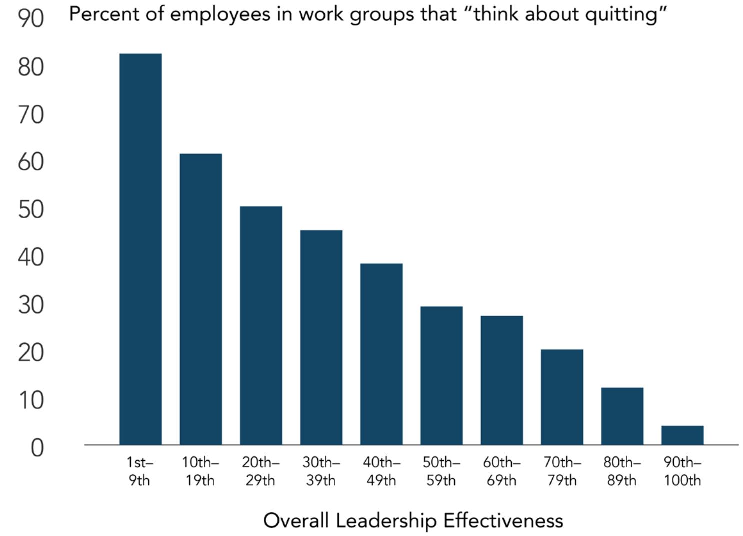
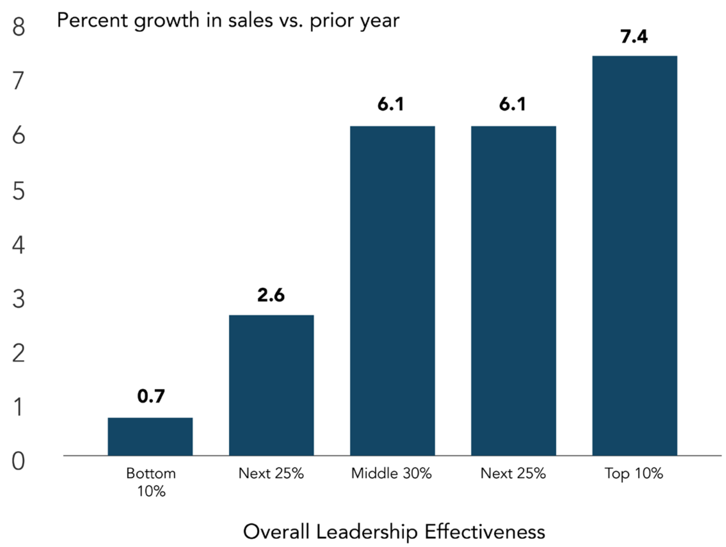


Fig. 4 – Growth in Sales Over Prior Year

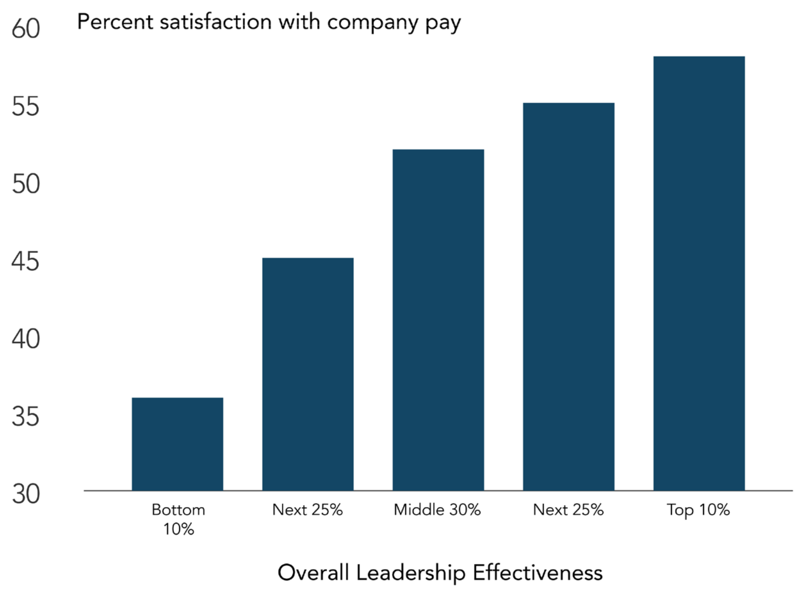


previous year. Figure 4 shows the results. The worst leaders, defined as those in the bottom 10 percent, showed a 0.7 percent improvement from the prior year. The best leaders, defined as those at the top 10 percent, showed a 7.4 percent improvement in year over year sales.

Pay

Even satisfaction with pay shows a dramatic disparity, with less than 37 percent of employees satisfied with their pay if they reported to a leader in the bottom 10

Fig. 5 – Leadership Effectiveness vs. Satisfaction with Pay



percent. Contrast that with nearly 60 percent of employees satisfied with their pay at organizations led by the top 10 percent. What is especially interesting about this statistic is that employees were not being paid more by leaders in the top 10 percent in comparison to those who worked for leaders in the bottom 10 percent. They are living proof of the sentiment underlying the old saying, "You can't pay me enough to work for that person."

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

Why does better leadership improve profitability?

We hope it is obvious to every reader that the business outcomes described above are really the key intervening variables that ultimately translate into profits for the firm. But let's dig a bit deeper to see if we can better understand why this happens.

When people come to work they have the option of putting forth a minimal amount of effort—just enough to get by and not get fired—or they can put forth an extreme amount of effort and energy to accomplish what they can see as the high priority tasks that would benefit the organization. That combination of choosing high leverage tasks to work on, along with a focused, efficient execution, enable those people to be far more productive.

Most of us can identify with coming into work knowing that we're leaving on a week-long business trip or a vacation the next day. It is amazing what can be accomplished with intense focus and effort, all in the face of a clear deadline. How variable is discretionary effort? It is gigantic. We've all experienced it.

However, is an immediate trip or impending event the only force to influence discretionary behavior? Our research confirms that the immediate manager also has a profound effect on whether direct reports put forth the maximum or the minimum effort. Figure 6 describes that relationship.

In a global pharmaceutical company, the impact of leadership on discretionary effort was even more pronounced, as shown in Figure 7.

Discretionary effort is one of the major influences on worker productivity. There are others, of course, including having adequate tools and resources, efficient systems and procedures, and appropriate

Fig. 6 – Percent of Employees Willing to Go the Extra Mile

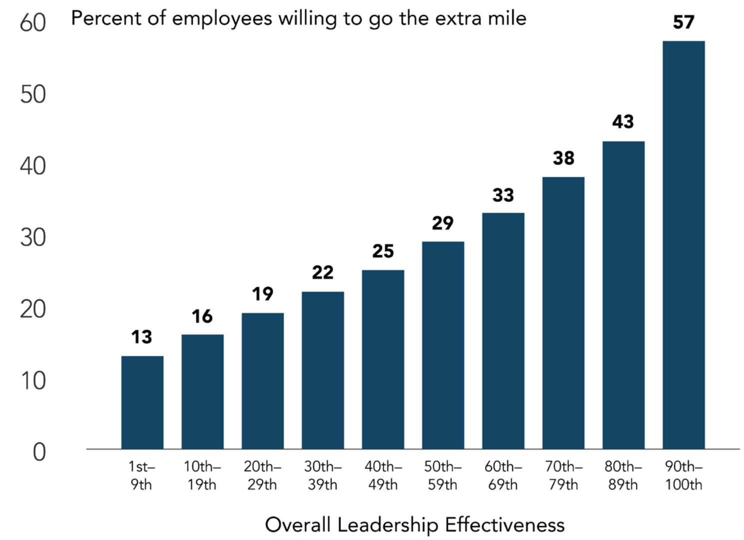
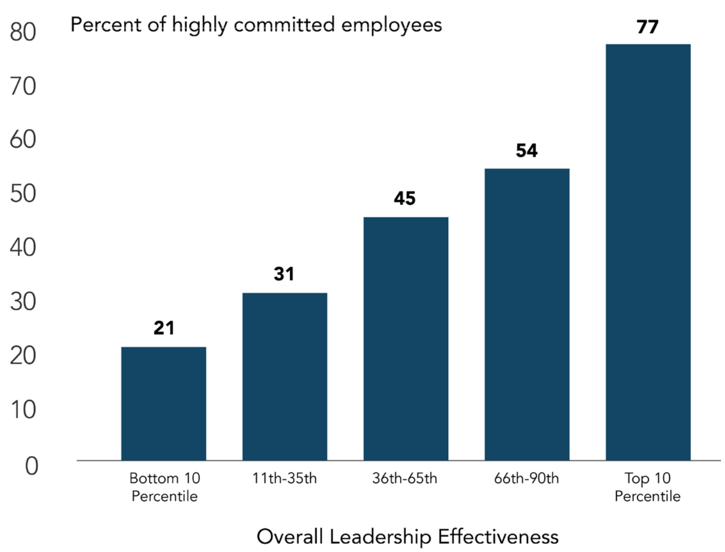


Fig. 7 – Percent of Highly Committed Employees



rewards and incentive systems. Given those, however, a huge factor determining worker productivity is the decision within the worker about how much they will produce on a given day. The late Peter Drucker observed that for most companies in which labor costs amounted to roughly half of their total expense, that a 10 percent increase in productivity would double most organizations' profits.

This isn't an entirely new concept. In 1976, Robert Sibson researched and pub-

Fig 8. Impact of Productivity Gains

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 percent increase in pre-tax profit is...

lished his findings about the impact that improving productivity had on increasing profits.[1] Our research confirms Sibson's findings and carries it into the 21st century. As a matter of fact, we've found that if people costs are 50 percent (as a percent of sales) and productivity improvement is 10 percent, then the increase in pre-tax profit is 100%. Even if productivity improvement is just 5 percent and people costs are 50 percent, that's still an increase in pre-tax profit of 50 percent!

Figures 8 and 9 summarize why we think there is ample room for productivity improvement in most organizations.

In a study at Zenger Folkman based on over 235,000 employees, we found that 20 percent of employees have high satisfaction and commitment scores, and that 37 percent are moderately satisfied and committed. But that leaves 43 percent who have lower satisfaction and commitment. Ponder that. Just under one-half of the employee workforce would have significantly higher productivity if their levels of engagement and commitment could be improved—a factor that is strongly influenced by leadership effectiveness.

Gallup claims that 16 percent of the workforce are actively disengaged, 55 percent of employees are not engaged at work, and that only 29 percent of employees are engaged. They claim this costs the US economy upwards of $350 billion. The difference between these research findings is probably in the definition of engagement. It is obvious, however, that if 71 percent of your workforce is actively disengaged or not engaged, there is easily room for a 10 percent increase in productivity from the overall workforce.

[1]Sibson, Robert E. Increasing Employee Productivity, AMACOM: New York. 1976. p. 12.

Fig 9. Compiled Research on employee satisfaction, commitment, productivity, and engagement

Research by Zenger Folkman	Research by Hunter, Schmidt & Judiesch	Research by Gallup
20% with high satisfaction and commitment	Medium complexity job: person at top 1% was 85% more productive than person at 50th percentile	20% of employees engaged
37% with moderate satisfaction and commitment	High complexity job: person at top 1% was 127% more productive than person at 50th percentile	55% not engaged
43% with low satisfaction and commitment	*Meta-analysis of 80 studies on productivity*	16% actively disengaged, costing the US economy $350 billion

Hunter, Schmidt, and Judiesch approached the productivity question by looking at the dramatic differences in productivity from those people doing exactly the same work. They broke out their data by various levels of job complexity. The greater the job complexity, the greater the difference between the top performers and the middle or lower performers. For example, they showed that for medium-complexity jobs, the person in the top 1 percent was 85 percent more productive than the person in the 50th percentile. In high-complexity jobs, they found that the person in the top 1 percent was 127 percent more productive than the person at the 50th percentile. Again, assuming that many of the low performers were reporting to the least effective bosses, an improvement in leadership effectiveness could be predicted to have significant impact on productivity.

Developing Extraordinary Leaders Who Can Double Profits

The next question you might logically ask 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 percent per annum growth in employee productivity at a time when many organizations were languishing with 1– 2 percent productivity improvement.

We have found that the most sure-footed way to accomplish this is to follow a process combining the following elements:

1. **Create a competency model based on hard data and analysis, versus the pooled opinions of a few executives.** The organization must rely on a leadership development model that defines the competencies which will make a difference. Competency models define the key leadership behaviors that will lead to organizational success. 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 help the organization to create value.

   By emulating "evidence-based" medicine—gathering the aggregate data from 750,000 360-degree feedback instruments describing 56,000 managers—you can then produce a leadership development model that will have real value for the organization. We have identified specific items that are most effective at differentiating great leaders from average and poor leaders. These items have been validated to predict engagement, turnover, profitability, sales, and customer satisfaction. These items also have a normative base to compare individual leaders to those who score at the 75th and 90th percentile across the globe.

   About half of our clients utilize our standard assessment, while the other half utilizes their organization's customized competency model. In some case, clients use both their own competency model and their own 360-degree feedback instrument. Regardless of which competency model and 360-degree feedback instrument is used, we have been able to demonstrate that leaders who have higher scores on the assessment also have more positive scores on key factors that leverage the success of the organization.

   When an organization has an evidence-based competency model and measurement tools that can accurately predict a leader's effectiveness, they can begin building and developing these leadership competencies, or strengths. These become the clear path to extraordinary leadership, to increasing productivity, and finally to the maximization of profits for the organization.

2. **Provide leaders with insightful awareness about how well they currently perform against this model.** Any journey begins by knowing where you're starting from. This self-awareness first illuminates the strengths that the individual possesses. It also needs to call attention to any serious failings that detract from the leader's performance. We think it wise to utilize a world-class 360-degree feedback instrument that is easily understood and digested by the participant.

3. **Make feedback motivational.** Telling everyone in the organization

where they fall on a bell-shaped curve of IQ scores or performance measurements is virtually guaranteed to be demotivating and discouraging to 95 percent of the population. Only those few at the very top will have positive feelings. Everyone else is deflated. But feedback can be enormously motivational when delivered in a caring and constructive way. When the feedback emphasizes strengths and is translated into specific actions it becomes a positive experience. This allows participants to translate this new awareness into a self-development plan to which they are committed.

We often hear of organizations who send leaders their 360-degree feedback report by email or regular mail. Data is dumped on the leader without regard for its impact on their motivation to improve.

4. **Assist in creating personal development plans.** Most participants have not, and probably will not, create a personal plan of development without some organizational support. Motivation and confidence increase when a practical and actionable plan is created.

   Our research has shown that magnifying a competency to the point at which it becomes a strength is not the same as curing a weakness. Non-linear development, akin to an athlete engaging in cross training, gives participants a fresh, new approach for developing themselves.

5. **Provide appropriate skill development.** Greater self-awareness helps most leaders identify areas in which they can be far better. Often it is in the skill of coaching. Most leaders acknowledge that giving colleagues corrective feedback is something they postpone and duck. Other managers benefit from presentation skills training or developing greater comfort in the strategic thinking process.

   This development does not always need to be formal training conducted in a classroom. A perfect "classroom" in which to learn leadership skills is very often a person's current job. For example, could there be a better situation in which to learn the skills of building relationships than your current position?

6. **Involve the manager.** Our research forcibly points out the huge differences in the outcomes of any leader's development process when the manager is intimately involved versus not being engaged. Clearly the manager's involvement greatly elevates the participant's motivation, not to mention the practical contributions that the manager can make to a direct report's development efforts.

7. **Create sustainment.** Leadership development isn't a new concept. There are many approaches to developing leaders and each organization has to decide which process will serve it best. If there is a lack of follow-up on a leadership program, basic principles will have to be repeated over and over again. New skills and behaviors rapidly evaporate if there are no sustainment 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.[2] 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.[3]

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.

Parting Thoughts

Many of us intuitively know that leadership affects the bottom line. We have presented a variety of evidence to support that assertion. Through our *Extraordinary Leader* research, we have detected 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 invest in developing exceptional leaders in your organization.

[2]Rackham, Neil. SPIN Selling New York: McGraw-Hill. 1988.
[3]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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About Us

Zenger Folkman relentlessly seeks to rise above the inconsistent, and sometimes misleading, nature of popular leadership philosophies and beliefs brought on by opinion. The discipline of leadership and those who pursue it deserve better. Our most valuable asset is the expertise of combining hard data and statistical analysis with logical explanations and actionable application that help individual leaders thrive and organizations succeed.