

Return on Leadership – Competencies that Generate Growth



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Growth is the Holy Grail of corporate strategy. Not only do high-growth companies deliver significantly greater shareholder returns than the average, they are also five times more likely to survive as independent entities than their low-growth counterparts.¹ There is little doubt that leadership quality is a key determinant of a company's growth, but the specifics are frustratingly elusive. What matters more – analytics or people leadership? Is growth driven by a small group of stars or a broad leadership cadre? Should executives conform to one corporate leadership profile, or does diversity deliver faster growth?

Few studies have been able to provide analytically rigorous answers to these questions – or quantify the impact of leadership on growth. As a result, companies struggle to focus their leadership development efforts and budgets on creating value for the business. To solve this problem, McKinsey & Company and Egon Zehnder International have carried out thorough statistical analyses of the relationship between managerial quality and revenue growth, across a global sample of more than 5,000 leaders in 47 listed companies (see box, “Quantifying the link between leadership talent and revenue growth”).

The study confirms that talent matters: executives of high-growth companies have a higher level of competency than those of low-performing firms. But the study also makes it clear that having good leaders is not good enough; only excellence makes the difference. Companies with outstanding leadership teams have a high correlation with revenue growth, while those with solid but unexceptional leaders have no correlation at all. The study also shows that several commonly held beliefs are mistaken. For example, it is not true that a solid talent bench can pull off any strategy: leadership is always contextual, and competencies for success vary greatly by strategy.

Indeed, the study makes it clear that companies must accurately target their efforts to develop and recruit leaders – building true excellence in the most critical roles and competencies – if these are to translate into vigorous revenue growth. This report discusses these findings, and their implications for companies, as three principles for action:

- Focus on the leadership competencies that matter most for growth
- Build a critical mass of excellent leaders
- Celebrate the extremes – develop and promote “spiky” leaders

The report concludes with a set of “Monday morning actions” that companies can take to build excellent leaders who deliver outstanding growth.

¹ Mehrdad Baghai, Sven Smit, and S. Patrick Viguerie, “The granularity of growth,” *McKinsey Quarterly*, May 2007

Quantifying the link between leadership talent and revenue growth

The study, a knowledge joint venture between the two firms, matched Egon Zehnder's in-depth appraisals of individual leaders with McKinsey's extensive analysis of company growth. This generated a global sample of 5,560 leaders across 47 listed companies from all major industry sectors. Each company's performance and leadership strength was analyzed for a period of at least five years up to 2007. For the subsequent analyses, we distinguished between the top team, i.e., n and n-1 executives (880 of our sample fell into this category) and the remaining senior managers, i.e., n-2 and n-3 executives.

Egon Zehnder has conducted management appraisals of more than 100,000 executives and senior managers across the world. Every appraisal is conducted in line with globally consistent standards, which include in-depth behavioral interviews as well as 360° reference-taking from the executive's peers, reports, and supervisor. Appraisal results are calibrated across appraisees and are benchmarked with the market. For the study sample, each manager was appraised from 1 (low) to 7 (high) across eight scaled leadership competencies, covering thought leadership, business leadership, and people and organizational leadership (Exhibit 1). Executives at levels 1 or 2 in a particular competency typically show reactive behaviors, while at levels 3 to 5 they show active behaviors; levels 6 and 7 of each competency denote proactive, transformational leadership competency.

EZI assesses leadership competencies in its standardized Management Appraisals

Egon Zehnder International

	Competency	Description	Competency	Description
Business leadership	Results Orientation	Driving improvement of business results	Customer Impact	Thinking about serving the customer
	Collaboration and Influencing	Effectiveness in working with peers or partners not in line of command	Change Leadership	Driving change through people, transforming and aligning an organization in a new direction
People and organization leadership	Team Leadership	Focusing, aligning, and building effective groups	Developing Organizational Capability	Developing competencies of the organization by attracting top talents and developing the team
	Strategic Orientation	Thinking beyond own area and showing complex analytical and conceptual thinking abilities	Market Insight	Strong understanding of the market and how it affects the business
Thought leadership				

SOURCE: Egon Zehnder International

Exhibit 1

McKinsey's Granularity of Growth data originates from an extensive analysis of more than 750 leading companies worldwide. With McKinsey's proprietary growth decomposition methodology, each company's growth was then disaggregated into three categories:

- **Portfolio momentum** – the organic revenue growth that a company achieves through the market growth of the segments represented in its portfolio
- **Market share gain** – the organic growth a company records by gaining or losing a share of the market in the segments where it competes
- **Mergers and acquisitions (M&A)** – the inorganic growth a company achieves when it buys or sells revenues through acquisition or divestment

Recognizing that growth rates for top-performing companies differ substantially between industries, the analysis determined growth thresholds for each industry in order to identify the top-quartile growth companies across the sample.

Matching these two databases created a powerful sample and revealed the links between leadership competency levels and corporate growth performance over time. Multiple statistical methods were used to explore the sample, including:

- T-tests, to determine differences in competency scores between fast- and slow-growing companies per growth category
- Pearson correlations, to identify linear relationships between competencies and growth
- Tipping points, to identify thresholds of leadership competency that distinguish growing from non-growing companies

FOCUS ON THE LEADERSHIP COMPETENCIES THAT MATTER MOST FOR GROWTH

Outstanding leadership correlates strongly with growth, but truly excellent leaders are few and far between. Only 1% of the executives in the study sample achieved an average competency score of 6 or 7 (on a scale of 1 to 7), and only 11% were scaled 5 or higher. Further, it is no easy matter to develop leaders. In Egon Zehnder's experience, high-potential executives who receive intensive coaching and development support from their employers can improve their appraisal scores by no more than +2 in one competency, or +1 in two competencies, in one year. And no one can repeat this kind of improvement year after year.

What this means is that companies can build leadership excellence in only a few selected competencies – and even then, this requires considerable time and investment. The companies with executives that excel at the competencies most relevant for growth therefore enjoy a significant competitive advantage that is difficult for others to replicate.

Nothing matters more than Customer Impact

The analysis shows that no leadership competency matters more than Customer Impact – that is, the capacity to understand the evolving needs of customers in detail. In the sample, there was a strong correlation (coefficient of 0.64) between companies' revenue growth and their top executives' effectiveness at Customer Impact. This correlation was true across most growth situations, and also for senior managers below the top team. How, then, can companies develop this capacity?

Swiss-based engineering giant ABB provides a good example of deliberate and effective focus on Customer Impact. In rebuilding profitable growth after its near-bankruptcy in 2002, ABB realized that its state-of-the-art products were not enough. To achieve profitable growth, the company would need to go beyond excellence in engineering and really understand customers' needs. In the leadership assessment and development program ABB created for its senior managers across the world, customer orientation was a key leadership competency targeted for improvement (along with people development and Change Leadership). Further, the company focused on embedding itself in the countries where it operates – so much so that customers in some Asian countries are surprised to learn that ABB is not headquartered in their country. As a key enabler for serving a global customer base effectively, ABB has also made a concerted effort to build diversity and intercultural sensitivity among its leadership.

There is no standard skill set for success

Beyond a focus on Customer Impact, the analysis shows that the leadership competencies needed to achieve breakout growth vary greatly depending on a company's strategy. Indeed, there is no standard skill set for success.

Consider **portfolio momentum growth** – the organic revenue growth a company achieves by capitalizing on the market growth of its existing segments. Such growth requires outstanding, consistent execution across the organization and often across the globe; this is driven by a strong cadre of senior managers (i.e., not the top team) who excel at business and people leadership. In the study sample, the senior management of companies with top-quartile portfolio momentum growth excelled in three key leadership competencies (in addition to Customer Impact):

- **Developing Organizational Capability** – a systematic focus on developing critical skills throughout the organization
- **Team Leadership** – the ability to focus, align, and build high-performing teams
- **Change Leadership** – the ability to drive large-scale, coordinated change across the entire organization.

A major pharmaceutical company provides an example of a leadership development program that strengthened managers' ability to drive rapid organic growth in an environment of changing customer needs and expiring patents. The company developed a four-month leadership program for cohorts of 40 managers at a time, around a "forum and field" design. The forums – three intensive workshops – focused on building the skills the managers would need to lead teams in delivering ambitious growth targets, including structured problem-solving, Team Leadership, and better understanding their own leadership strengths and challenges.

In the fieldwork, the pharmaceutical company's managers put this learning into practice by shaping real projects to increase revenue by better meeting customer needs. The projects, worth hundreds of millions of dollars in incremental profit, included a plan to relaunch a key product in emerging markets; proposals for diversifying "beyond pills and research skills" into new services; and a recommendation to reshape the company's customer interaction model by cutting the sales force by 25% and reinvesting the savings in other marketing channels. This practical focus on leadership development had a profound impact: within 18 months after the program, more than 90% of the participants had been promoted.

While such organic growth is driven by excellence across a broad cadre of senior managers, the study's analysis suggests that **inorganic (M&A) growth** is driven primarily by top teams. The key competencies for M&A differ too: top executives must have mastered the ability to shape sophisticated, integrated strategies that address customer needs and market trends (Exhibit 2). To be within the top-quartile inorganic growth bracket, executive teams of the respective companies had to excel in a broad range of competencies; along with Customer Impact, two additional key competencies came out very prominently:

- **Market Insight** – the ability to look beyond the company's current context to discern future growth opportunities
- **Results Orientation** – the ability to lead and transform a business for high performance.

IBM, which has made more than 100 acquisitions over the past decade, provides an example of the kind of leadership focus required to power successful inorganic growth. Thought leadership is deeply embedded in IBM's culture; indeed, the slogan "THINK" was coined by Thomas J. Watson Jr., son of the legendary general manager, nearly 100 years ago. Not only does IBM file more patents each year than almost any company, it is also exceptionally skilled at anticipating and actively shaping future market and technology trends (such as "cloud" computing) to fuel revenue growth. Acquisitions are a core enabler of this growth, and IBM is able to integrate smaller firms quickly and profitably thanks to its high degree of Results Orientation. For example, it accelerates the sales growth of its software acquisitions by giving them ambitious targets and integrating them quickly with IBM's massive global sales force. An intensive coaching program for senior leaders, plus frequent rotation across businesses and geographies, underpins both IBM's thought leadership and its Results Orientation.

A key implication of the study findings is that the focus of leadership development must shift as leaders rise through the organization. In particular, managers of large teams need to be great people leaders; but this is not enough when they reach the boardroom, where they need to excel at thinking ahead and shaping strategy. Managing a leader's transition from senior to top team is therefore crucial – only those individuals with the potential to develop the capabilities required for the next step should be promoted, and they should then be fully prepared for the top jobs. This will often require individualized support and coaching to further develop their thought leadership competencies.

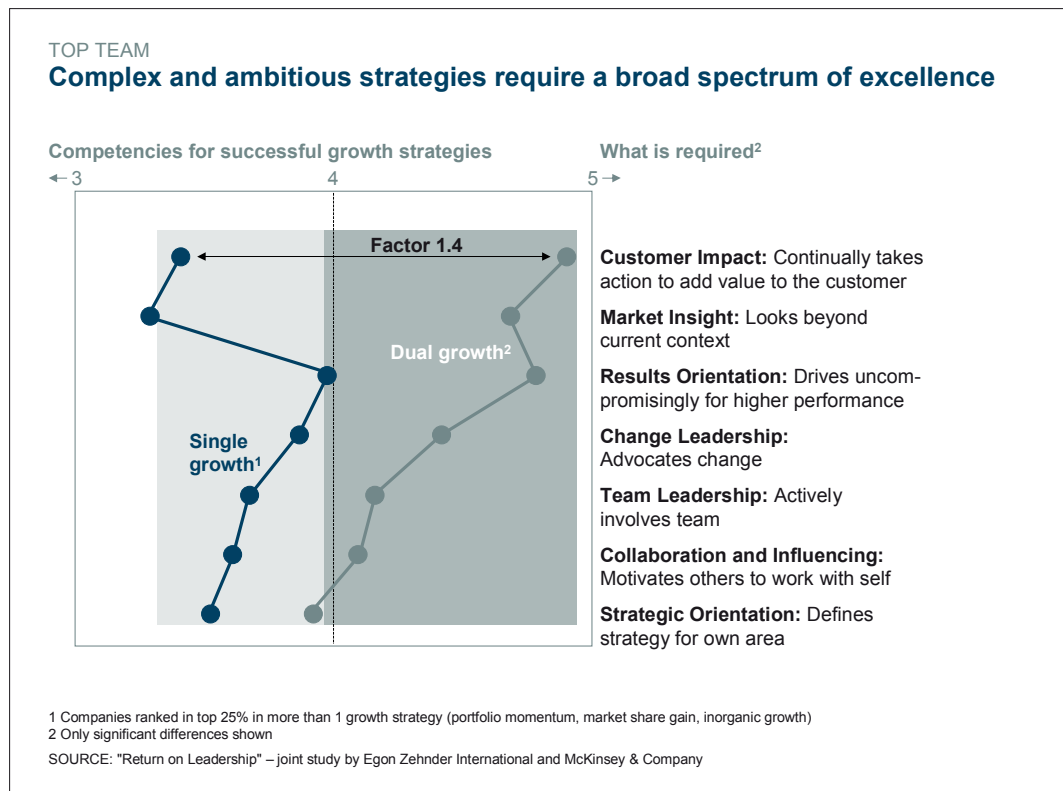
Exhibit 2



Complex growth strategies require outstanding leaders

Lastly, several companies in the study sample were in the top quartile of more than one category of growth – portfolio momentum, market share gain, or inorganic growth. The analysis shows that the top teams of such “dual growth” companies, which drive complex and ambitious strategies, have significantly stronger leadership quality than companies that focus primarily on one source of growth. For key competencies such as Customer Impact and Market Insight, the competency level of “dual growth” top teams was almost one-and-a-half times higher than that of their “single growth” counterparts (Exhibit 3).

Exhibit 3



BUILD A CRITICAL MASS OF EXCELLENT LEADERS

A further key finding disproves the myth that a small group of high-potentials – or just a star CEO – can drive business success. Rather, the study shows that a critical mass of excellent leaders is needed to trigger and sustain corporate growth. This finding was particularly marked for the Customer Impact competency discussed above. At companies in the top quartile of revenue growth, at least 40% of senior executives were scored 5 or above for Customer Impact on Egon Zehnder's 7-level scale (Exhibit 4). There is also evidence of a link between achieving above-average growth and having a critical mass of highly qualified talent, i.e., to belong to the top 50% growth companies, at least 20% of the leaders had to excel in Customer Impact.

How do companies build such critical mass? The best of them create clear, measurable leadership development targets across thousands of senior and middle managers, and hardwire leadership development into the company's performance management, recruitment, succession, and reward processes. In this way, they systematically build the quantities of excellent leaders – with business-relevant skills – needed to drive consistent revenue growth.

Exhibit 4

SENIOR EXECUTIVES			
For above-average growth, companies need a critical mass of senior executives with superior competency levels			
To be among the ...	Growth type	Competency (example)	Critical mass (minimum share of excellent senior executives) ¹
... top 50% growth companies	Revenues	Customer impact	19%
	Portfolio momentum	Collaboration and influencing	22%
... top 25% growth companies	Revenues	Customer impact	40%
	Portfolio momentum	Collaboration and influencing	22%

- A certain competency level among leaders of a given organization is needed to make a positive impact
- Required share of managers ("critical mass") differs by competency and growth strategy

¹ Appraisal score of 5 or higher; based on tipping point analyses with quality of 73 to 87%
SOURCE: "Return on Leadership" – joint study by Egon Zehnder International and McKinsey & Company

Consider again the case of ABB. To support the company's strategy of rebuilding profitable growth, a competency-based leadership assessment and development program was created in 2004 for thousands of the company's senior managers across the world. Required competency levels were defined for each "family" of roles, and each manager received regular, standardized assessments based on those competencies – assessments that included 360° feedback from supervisors, peers, and reports. The assessments themselves signaled the company's seriousness about leadership development: one executive noted it was the first formal feedback he had received on his leadership effectiveness in 27 years. Beyond this, though, the results of the assessments were integrated into ABB's annual performance reviews and influenced managers' year-end bonuses. Two major leadership interventions – the Senior Leadership Development Program and the Leadership Challenge Program for middle managers – were rolled out to strengthen leadership competencies in a systematic way.

For ABB, the impact in building a critical mass of leadership skill has been tremendous: in 2004, for example, only 30% of vacancies in the company's top 200 roles were filled by internal candidates; today the figure is 85%, a marker of the breadth of leadership available within the organization.

As the ABB example suggests, including leadership effectiveness in a company's performance management system will take root only if leadership excellence is clearly defined, for each key competency and each group of roles. This can be a challenge: it is often hard to identify crisp metrics to measure leadership skills. For one financial services company, the solution was to split its managers into ten population clusters (according to their level, division, and role) and define a simple set of actions for putting excellent leadership into practice for each cluster. One such action, focused on building Organizational Capability, was: "In the past two weeks, this manager has had a coaching session or one-on-one discussion with each of his or her direct reports." Again, the performance management system linked managers' record on such metrics with their annual bonus – a powerful catalyst for building leadership across the cohort, given that the bonus had traditionally been linked solely to financial performance.

There are times when a radical approach is needed to create a critical mass of business-relevant leadership competencies. An international media company was facing bankruptcy when a new CEO was appointed in early 2009. To lead the company's turnaround, he replaced half the top team, specifically recruiting a diverse group of leaders with a proven track record of performance focus and Results Orientation. Many of these new recruits were from outside the media industry, as was the CEO himself, prompting observers to doubt their capacity to rescue the company. Nonetheless, the new leadership's ability to set and drive bold performance targets has seen the company return rapidly to profitability.

CELEBRATE THE EXTREMES – DEVELOP AND PROMOTE “SPIKY” LEADERS

What do the study findings say about the kind of individuals companies should develop and recruit as leaders? The leaders most likely to drive growth are those who have real “spikes” on some competencies – even if they show underperformance in other fields.

The research shows a clear connection between revenue growth and leadership spikes (defined as score 5 or higher out of 7 for a competency). Companies with high performance, as measured in overall or inorganic revenue growth, also have a high share of managers with spikes in two or three competencies. There is, however, a clear differentiator between second and top-quartile revenue growth companies. The latter have twice the share of “spiky leaders”, i.e., senior managers that score 5 or higher in at least four competencies and show average performance or even deficiencies in others.²

As noted above, outstanding leaders are hard to find – and strengthening even one or two leadership competencies in an individual takes considerable time and investment. It is not surprising, then, that the leaders who drive high-growth companies are “spiky” – their brilliance is evident in key competencies, rather than being uniform across all competencies. Though these spiky leaders have a solid grounding in all aspects of leadership, they have invested in becoming best-in-the-world in their areas of strength, even if this means they are average at other leadership competencies.

This finding could be a wake-up call to corporations tempted to “clone” their leaders according to one rigid leadership model. For example, it need not be an obstacle to corporate success if a brilliant strategic thinker at the helm is solid rather than outstanding at people leadership – provided there are other great people leaders in the senior team.

Creating a platform for “spiky leaders” to develop and shine starts with the recognition that a leader’s spike, or outstanding area of leadership competency, will be in an area where he or she is naturally strong. The company must therefore help such leaders “build on brilliance” just as much as it must help them address deficiencies. This insight is counter to common practice: for example, in perhaps 80% of all cases, coaches are called in to address managers’ problems rather than to develop their strengths.

How can companies shift the balance towards building on the leadership strengths that matter most for sustained growth? One striking example is of Jeff Immelt, CEO of GE, who once introduced a “failure award” for ambitious growth projects that had failed. His logic was that entrepreneurial leadership, rather than a culture of safe bets, was essential to drive the company’s expansion; natural risk-takers needed to be encouraged and rewarded.

A European telecoms company faced a similar challenge. It had been through a major turnaround and cost-cutting, and its management culture was characterized by tough performance discussions weighted heavily towards addressing deficiencies. The problem was that this approach limited the development of high-potential future leaders. As a solution, the company created a mentoring program in which members of the top team coached high-potentials one-on-one. To impress upon the top team how this mentoring would need to differ from their accustomed performance discussions, the HR director made a three-minute video in which the future leaders spelled out “what I expect

² Among top-quartile growth companies, 26% of senior managers score 5 or higher in at least four competencies. For the second quartile of growth companies, the share is 13%.

from a really good mentor” – including listening, asking questions, and, most importantly, encouraging these up-and-coming leaders to pursue areas of passion.

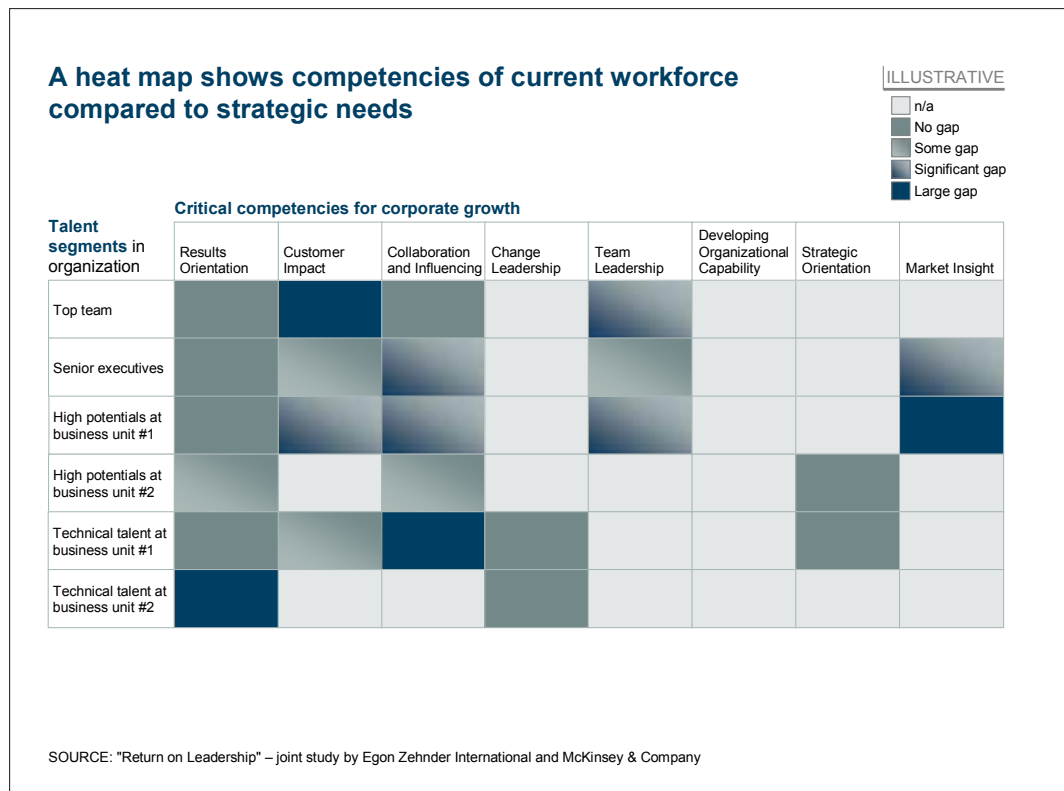
ACTION STEPS TO CONFIGURE LEADERSHIP FOR GROWTH

These findings show that great leaders make all the difference in powering corporate growth – but efforts to develop and hire executives need to be targeted and systematic if they are to have meaningful impact on the bottom line. In summary, then, what are the steps that companies should take to configure their leadership for growth?

The first set of actions is about aligning corporate strategy and leadership competencies. To identify and foster those leadership qualities that matter most for their specific growth challenges, companies should:

- Identify the required set of competencies for actual and future corporate strategy, detailing these for business units and geographies, and determine the number and quality of leaders their strategies need.

Exhibit 5



- Assess managers and compare current talent bench with required standards. Deriving competency gaps is easily done by “heat maps” that show available leaders cross-matrixed against the requirements of each business unit and geography (Exhibit 5 provides an example).
- Optimize talent deployment by matching strategic opportunities and competencies and develop measures to close competency gaps. Adjusting recruiting and selection processes as well as intensifying capability building in relevant competencies are both key in achieving the full potential of complex growth strategies.

In addition to these context-specific measures, companies should strengthen their customer focus both in existing business systems and talent practices. This might mean building the sales process around customer needs, ensuring touchpoints between customers and R&D, or developing a customer-oriented knowledge management that is linked to existing customer research. In addition, companies will need to adapt their talent management instruments to not only include, but stress Customer Impact in, e.g., selection criteria, performance management, or the competency model.

To generate growth, all companies need to build a critical mass of excellent leaders. Setting the bar high does not suffice but must be complemented with adaptations of business systems, talent management processes and high-impact capability building. Hence, companies should:

- Sharpen leadership development, by defining required competencies and skill levels for each job family and hierarchy level; anchoring critical competencies in all talent management processes, including recruiting, deployment, and assessment; and providing targeted support for the transition between senior management and top team roles given their differing skill sets.
- Innovate competency building, by building a “competency factory” to focus existing business processes and talent management practices on critical competencies; using “field and forum” approaches and “action learning” for sustainable change; and embedding leadership development in the company’s talent culture.
- Develop and promote “spiky” leaders by assessing the competency spikes of the current leadership team and talent bench; review the company’s existing leadership model and talent management practices for tolerance of spikes; and adapt the leadership model, talent practices, and internal communication to recognize the value added by the more unusual profiles. In addition, the utmost importance should be given to the composition of top and senior management teams. Our findings call for diverse teams with individuals of complementary leadership spikes.

* * *

Investing in leadership excellence can unlock rapid revenue growth, both organic and inorganic. But this leadership investment must be just as strategically focused, and its returns just as rigorously measured, as any other investment. It is not a matter best left to HR but requires a joining of forces and sustained attention from the company’s senior leadership. Those who get it right – and so develop a critical mass of spiky, business-relevant leaders – stand to create an enduring advantage that competitors will find very difficult to replicate.

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