

## Chapter 2

# Leadership Effectiveness and Business Performance

### *The Primary Competitive Advantage*

We will only seek a better model of leadership and make the Leadership Development Agenda a strategic priority if we believe that more effective leaders achieve higher performance and that we can develop effective leaders at a faster pace.

The fourth Promise of Leadership is that we lead effectively and *continue* to become more effective. When asked, leaders always agree that the effectiveness of leadership (both individual and collective) is a primary contributor to business performance and success. Yet, developing leadership effectiveness is rarely a leadership priority. In fact, it is often relegated to a staff function that struggles for attention and relevance amid competing priorities. Furthermore, most organizations, if they are focused on leadership development, focus on individual effectiveness and ignore the huge potential of collective leadership effectiveness.

#### WHAT THE RESEARCH SHOWS

The entire arch of leadership inquiry and research is rooted in the premise that *leadership effectiveness matters*. At The Leadership Circle, we are adding to this research. We developed a business performance metric by asking leaders to evaluate the performance of a business (or business unit) compared to industry standards on a series of performance criteria, including revenue, market share, sales, profitability, quality of



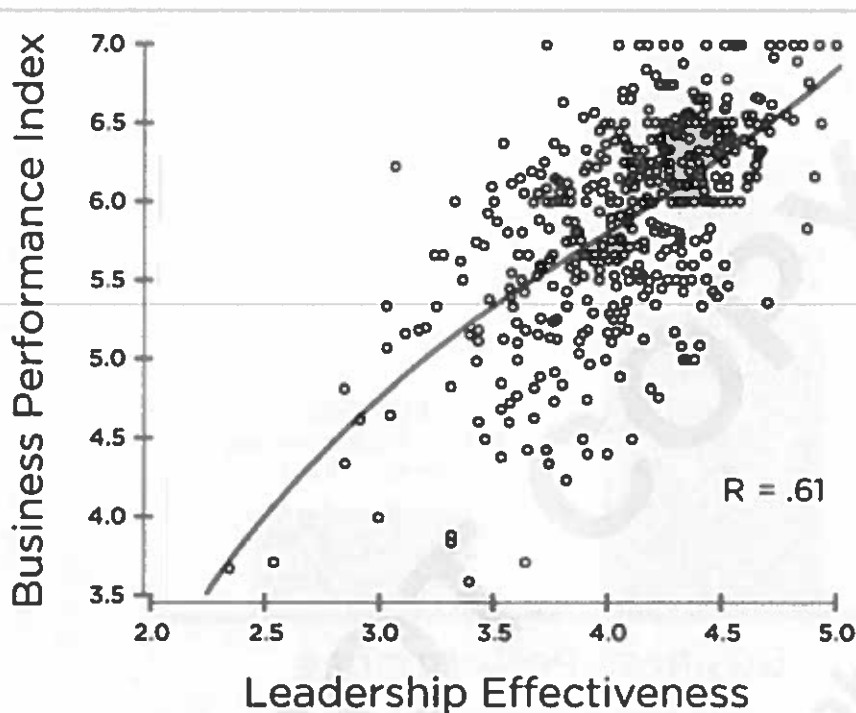


FIGURE 2.1 Leadership Effectiveness and business performance

products and services, new product development, and overall business performance. We then used these criteria to construct a Business Performance Index and correlated that index with a measure of Leadership Effectiveness on our Leadership Circle Profile (LCP) 360 assessment, and we found the pattern shown in Figure 2.1.

This study shows a strong correlation between *Leadership Effectiveness* and the *Business Performance Index*. It was originally conducted with about 500 businesses and has since been expanded to include over 2,000. The results are the same: *Leadership Effectiveness is a primary contributor to business performance*. In fact, this data strongly suggests that if you can improve leadership effectiveness, you have a 38% probability of seeing that improvement translate into higher business performance. In other words, leadership effectiveness is a 38% lever, contributing heavily to the organization's overall performance. Since 38% is well beyond most companies' profit margin, developing effective leaders clearly deserves investment.



FIGURE 2.2 Leadership Effectiveness in the highest/lowest performing businesses

This study became even more provocative when we computed the average Leadership Effectiveness scores for leaders in the highest performing business—the top 10%. We also compared that to the average Leadership Effectiveness scores of leaders in the lowest performing businesses—the bottom 10%. We found the following (see Figure 2.2):

In businesses evaluated as highest performing—top 10%—the average Leadership Effectiveness score was at the 80th percentile. Thus, those leaders in the highest performing business had Effectiveness scores higher than 80% of our norm base (over a half-million rater surveys). In the lowest performing businesses (bottom 10%), the leaders' Effectiveness scores averaged at the 30th percentile—lower than 70% of our norm base.

This research is consistent with the Zenger-Folkman research that shows leadership becomes extraordinary when effectiveness scores go beyond the 80th percentile. In their book, *Extraordinary Leaders*, Jack Zenger and Joe Folkman report an extensive survey of the leadership

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competency literature, including their database of over 250,000 surveys (Zenger, 2009). They make an astonishing conclusion: those leaders who are rated on a good 360° competency assessment at or above the 80th percentile (compared to a robust norm base) will produce twice the results of those in the middle 60 percentile range.

When we do the math on Zenger's research, we see that there are only two out of ten leaders beyond the 80th percentile and six out of ten in the middle ranges. So, there are three times more leaders in the middle range who are being outperformed two-fold. This means that each 80th percentile leader is *six-fold* outperforming those in the middle zone!

In *Good to Great*, researcher and author, Jim Collins, set out to discover what great organizations do that allows them to sustain high performance over time. He writes:

We systematically scoured a list of 1,435 established companies to find every extraordinary case that made a leap from no-better-than-average results to great results. How great? After the leap, a company had to generate cumulative stock returns that exceeded the general stock market by at least three times over 15 years—and it had to be a leap independent of its industry. In fact, the 11 good-to-great companies that we found averaged returns 6.9 times greater than the market's (Collins, September 2001).

Collins actually set out on this line of research with the specific goal of *not* looking at leadership. He did not want to write another book about the primacy of great leadership on business performance. However, as his research progressed, he could not ignore the impact of great leadership on the success of organizations. He called this *Level Five Leadership*—a unique blend of fierce resolve with humility (Collins, 2001).

The conclusion from the research is obvious: leadership effectiveness is a primary contributor to business performance, and it provides a competitive advantage, especially in times of increasing complexity (see Chapter 3). The best organizations are the best led, but this is not something that just happens on its own. Developing effective leaders deserves to be a key strategic priority, owned by top leadership.

## WHAT IS YOUR LEADERSHIP QUOTIENT?

Is leadership a competitive advantage in your organization, or is it costly? To measure this question, we created a metric called the Leadership Quotient (LQ). The math is simple.

$$\begin{aligned} \text{LQ} &= \text{LE}/\text{LI} \\ \text{Leadership Quotient} &= \frac{\text{Leadership Effectiveness}}{\text{Leadership Ineffectiveness}} \end{aligned}$$

For example, let's assume that the average Leadership Effectiveness score for an organization is at the 50th percentile (meaning they have an *average* level of effectiveness compared to their industry). Therefore, it is likely that they will have ineffectiveness scores at the 50th percentile as well. This gives them a collective Leadership Quotient of one (1).

$$\begin{aligned} \text{LQ} &= \text{LE}/\text{LI} \\ 1.0 &= 50\%/50\% \end{aligned}$$

A LQ score of 1.0 means neutral impact (one times anything results in the same number). Therefore, when we see a LQ score of 1.0, we can assume that leadership is competitive, but it is not yet a competitive *advantage* (or competitive disadvantage). However, an LQ of 1.0 also means that you are vulnerable to being outcompeted by organizations with higher LQ scores.

Let's recall the highest and lowest performing organization research (Figure 2.2) and calculate their associated LQ scores. Leadership Effectiveness (LE) in the highest performing organizations averaged at the 80th percentile. This means that by default, keeping the math simple for now (it will get a little more sophisticated as we develop the Universal Model), Leadership Ineffectiveness (LI) is at the 20th percentile (100 minus 80). Therefore, the LQ for the highest performing businesses, those evaluated in the top 10%, is 4.0.

$$\begin{aligned} \text{LQ} &= \text{LE}/\text{LI} \\ 4.0 &= 80\%/20\% \end{aligned}$$

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In the lowest performing businesses, or those in the bottom 10%, the average LQ score is 0.4.

$$\begin{aligned} \text{LQ} &= \text{LE}/\text{LI} \\ 0.4 &= 30\%/70\% \end{aligned}$$

There is a *10-fold difference* between the LQ of the highest and lowest performing businesses. Ten-fold may seem like a huge difference, but it makes sense because we are measuring the top and bottom 10% of business performance. Consequently, we think the LQ score for an organization measures the degree to which leadership is a competitive advantage or disadvantage. In organizations with LQ scores less than one (1.0), leadership is a costly competitive disadvantage. Organizations with LQ scores above one (1.0) are moving into the range where leadership effectiveness is a distinct competitive advantage. As you can see, scores as high as four (4.0) indicate that leadership is a serious competitive advantage.

### PROVOCATIVE QUESTIONS

We invite you to ask yourself these six provocative questions:

- Are you in the group of extraordinary performers with LQ scores well above one?
- Are your key leaders functioning at or beyond the 80th percentile?
- How effective is your personal and collective leadership? How do you know?
- How does your leadership effectiveness compare to that of your competition?
- Are you tracking the effectiveness of leadership over time to gauge improvement?
- Is your leadership a competitive advantage or disadvantage?

If you do not know the answers to these questions, you probably are not serious enough about the effectiveness of leadership—you are not making leadership a business imperative and a key strategic priority.

We have worked with Jim McGrane for over a decade in three different companies. When we got involved with his most recent company in 2006, he took the LCP, and his Leadership Effectiveness score, as evaluated by the key leaders on his team, averaged at the 80th percentile—putting him in the top 20% of effective leaders. We will present Jim's story in an extensive case study in Chapter 7. In that case, using the more sophisticated measure of LQ, Jim had an LQ of 2.0. This is quite high, making his leadership a big competitive advantage. Given his profile results and his high LQ, it is not surprising that he was leading a company that was a rising star in the industry. He made the Leadership Development Agenda a strategic priority. For the entire period of our engagement, he and his team could answer all the questions outlined above and they could correlate how they were performing as leaders, individually and collectively, with the business results they were getting.

## COLLECTIVE EFFECTIVENESS

In business, *collective leadership effectiveness* is underutilized and rarely capitalized upon. Most development focuses on *individual* leaders, ignoring collective effectiveness and the leadership system—all leaders and managers in formal leadership positions.

We focus our work primarily on the top four levels of leadership—the CEO (L1), their direct reports (L2: C-Team and EVPs/SVPs), that level's direct reports (L3: primarily VPs), and in some cases the next level down (L4: primarily Senior Directors). This *Extended Leadership Team* (ELT) makes up the organization's Leadership System. While leadership is required at every level, a reference to collective leadership or the Leadership System throughout this book indicates a discussion of the Extended Leadership Team.

The number of leaders on the ELT varies depending on a company's size. In large organizations, there are several hundred people within these ranks. In smaller enterprises, this group might be fewer than 20. Regardless of its size, the Extended Leadership Team is responsible for providing leadership to the entire organization. This group has more impact on how the organization performs than any other group.

The bulleted provocative questions mentioned above apply equally to individual leaders and the ELT. Since the ELT determines the organization's direction and execution, collective leadership effectiveness

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is impacted by how well the ELT sets direction; aligns around vision and mission; agrees on key strategies and initiatives; develops a clear shared understanding of strategy; translates strategy into execution; understands each other's roles; collaborates together; makes decisions; creates an accountable, engaged, performance-based culture; focuses on achieving results; mobilizes and engages all stakeholders to achieve those results; and develops leadership that can do all the above.

The level and consistency of collective effectiveness of the leadership system makes the difference between organizations that perform optimally and those that do not. It is not merely *individual leadership effectiveness* that results in high organizational performance. Individual effectiveness is necessary, but insufficient, for extraordinary business performance. Individual leadership effectiveness catalyzes collective effectiveness. *Collective effectiveness* carries the day. The organization cannot perform at a level higher than the collective effectiveness of its leadership.

Over the last 30 years, we have worked with hundreds of top and extended leadership teams. We have seen many examples of effective and ineffective collective leadership in businesses ranging from small start-ups to large multi-nationals. Regardless of size or maturity, we have found some common traits that impact the collective effectiveness of leaders, and the results they produce.

Start-ups in particular offer an interesting case study of collective leadership where its effectiveness, or a lack thereof, is immediately on display. Unlike a mature company, where it takes time to see the impact of change, a start-up experiences it very rapidly. The learning that takes place in a start-up is accelerated and amplified both on the upside, when there is rapid growth, and on the downside, when the start-up struggles.

Initially, a start-up is dependent upon its founders for vision, leadership, direction, and management. It requires their guidance on a daily basis. As the start-up begins to realize some order of success, or begins to struggle, its future quickly moves beyond the brilliance of its founding leadership. It now requires the capability and capacity of its collective leadership. When present and functioning effectively, collective leadership removes the single point of failure—dependency on the founder—that many start-ups experience and expands the capacity and capability of the organization to lead its growth.

Often, we can point to a lack of collective leadership effectiveness in start-ups that struggle, or fail outright. We have worked with a few leadership teams at start-ups that faced the need to fundamentally shift strategy and transform their businesses. Using the LCP at these companies, we found that those with a collective LQ of less than 1.0 simply lacked the capability or capacity to execute on strategy, much less transform. This finding has proven to be true with clients that have experienced successful double-digit growth reaching revenues in excess of \$1 billion, as well as those who were well funded but simply could not get out of their own way.

We once worked with a mortgage start-up in the southeast U.S. that was intended to be the standalone mortgage banking arm of a small regional bank. The bank had recently been acquired by a manufacturing company that was seeking to diversify its business portfolio. The acquiring company sent one of their financial officers to join the top team of the start-up as its CFO. The other team members consisted of a group who had a long history of working together running the mortgage division of the bank that had been acquired.

We began working with the top team at the end of their first year. Already, a significant number of issues had surfaced both within the team, and about the fundamentals of the business. As we began our work, we conducted interviews with the 8 leadership team members to identify what was working and not working. One question we posed in the interviews was, "How confident are you that the business will succeed with the strategy and team currently in place?" Each of the 8 members of the leadership team, including the CEO, expressed "little" or "no" confidence. All 8 leaders were handicapping their chance of success at 25%. The team was not in alignment on the vision or key strategies, and had energetically, collectively and individually, come to believe that the business would fail.

We immediately worked to get the team on the same page—to establish alignment and effective collective execution. Unfortunately, they had run out of runway and within the next 12 months, the owner sold off the servicing portfolio and exited the business. When we interviewed the owners, they shared that the top team had never provided them with the confidence that the business would succeed. Obviously that was no surprise, given the lack of alignment and the low quality of the

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leadership conversation that was taking place within the company. In less than 2 years, the leadership team went from being acquired and fully funded for success to being sold and out of work. What was most fascinating about this leadership team was that each individual believed they knew what needed to happen, both strategically and operationally, to be successful. Yet, the team was unable to reach collective agreement and alignment on these issues. Consequently, it was over before it even started.

Simply put, our success as a leadership team is tied directly to our level of alignment on vision and direction, our agreement on key strategies, and how well we execute together. Our ability to do this depends on the quality of our interaction, communication, honesty, and trust. This is what we call the “leadership conversation.” This conversation largely determines our collective leadership effectiveness, and the capability and capacity we provide to the business.

The importance of collective leadership effectiveness, driven by the quality of the leadership conversation, cannot be underestimated. The organization simply cannot outperform the collective effectiveness of its leaders. When the leadership conversation is overlooked, collective leadership becomes ineffective and a less than optimal outcome is likely to follow.

### COLLECTIVE EFFECTIVENESS AND INTELLIGENCE

Leadership is a conversation. Leaders spend most of their days in conversation—meetings, phone calls, emails, and strategic communications. How *you* show up in these conversations determines your level of effectiveness. How *we* show up together in these conversations drives our collective effectiveness. The quality of our collective conversation largely determines our collective leadership effectiveness and business performance.

We work with an extraordinary female leader of a large professional service firm who consistently leverages the best out of her Extended Leadership Team because of how she deploys herself in leadership conversations. She told us that in every conversation she has three objectives: 1) increase understanding and buy-in, 2) achieve the desired outcome, and 3) improve the relationship. For instance, she told of having a difficult performance review with a key executive. With this framework

in mind, she ensured that the content was clearly understood, outcomes were achieved, and the relationship improved. She consistently is seen as being clear, direct, fair, and compassionate. Her people know where they stand with her, and she outperforms her peers in this business at a multiple of *three times* their results. She is highly effective, in no small measure, because of how she models and orchestrates individual and collective leadership conversations.

Collective leadership effectiveness and intelligence represent huge untapped potential in most organizations. Management expert, Peter Senge, notes that the collective intelligence and performance of most groups is well below the average intelligence and performance of the members (Senge, 1990). We usually *dumb down* when we come together. We act at the lowest common denominator. The dynamics played out in most groups—overly aggressive advocacy of positions, poor listening, reactive responsiveness, political caution, ambitious self-interest, mistrust, withholding of opinions—subvert collective effectiveness. Consequently, most leadership teams function collectively well below their members' average intelligence. This results in an LQ of less than one, and most organizations with such a low LQ lose market share and end up on the auction block.

Collective intelligence is required for breakthroughs. Senge talked of finding *leverage points* within the system (Senge, 1990). A leverage point is an action taken or a change made that has a magnified positive and lasting impact on intended results. If you have a long lever, you can move a very heavy object with little effort. In financial language, this is the equivalent of getting a *multiple*. Businesses invest to get a multiple return on investment. Finding leverage means discovering an innovation, initiative, change, or action that, when taken, has a large, lasting, positive impact well beyond the energy of input.

The collective effectiveness of the ELT is often overlooked as leverage. We ask leaders to find leverage here by evaluating the return on their time spent in two ways. First, are you increasing the creative capacity and capability of your organization at a multiple? If you are not getting a 5-to-1 ratio of return on your time spent, your ROI is sub-par. Far too many leaders spend their time on the areas that provide a 1-to-1 return (or worse). These areas are low leverage and need to be upgraded or eliminated. Expanding capacity and capability depends on this ratio of return. Second, are you developing effective leadership at all levels within