Starring roles

Good leaders don't grow on trees. All the more reason to nurture them carefully, say partners at **Bain & Co**

Who says investment in people doesn't pay? Businesses that groom their leaders as carefully as they husband their finances outperform less forward-looking companies. Yet few corporate chiefs invest enough in developing the bosses of tomorrow.

A new study by Bain & Co of 23 high-growth companies reveals that only a small minority – less than 15% – systematically tries to develop leaders by advancing the right people through the right jobs. Those few averaged shareholder returns of more than 10% a year above their cost of capital over a ten-year period. But the one in four firms that placed little emphasis on cultivating leaders averaged returns of less than 1% a year (see chart 1).

Top managers are all too aware that leadership is critical to their company's performance. A separate Bain survey of 163 senior executives found that 94% of respondents linked corporate performance to having top management talent in the right jobs (see chart 2). However, 54% thought that the quality and depth of their management talent pool was no better – and in some cases worse – than their competitors'. Yet the standard approach to managing leadership talent falls well short of the rigour, determination and strategic thinking typically applied to managing a company's finances. Companies can reap huge benefits by embracing a rigorous system that develops and allocates leadership capital to create long-term value. To maximise their returns on leadership they need to do four things:

With a clear picture of leadership supply and demand, companies can allocate their talent resources more strategically

Model future leadership needs

When they are deciding how to allocate financial resources, managers evaluate business plans and strategies carefully. Equally, you cannot recruit, develop, retain or deploy leaders if you don't know what you are aiming to achieve. Most firms should focus on the top tier of management, the 100-500 most senior executives. That is where placing successful individuals in the right roles can have the greatest impact on company performance.

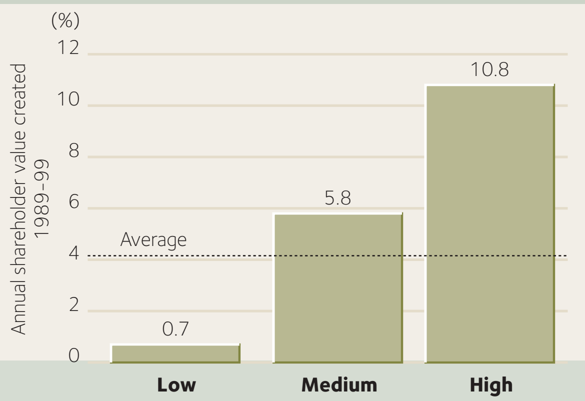
Companies should start by trying to predict where and when they will need leaders in the future. They need to plot likely trajectories for their businesses and key employees, as well as the probable rates of attrition, recruitment and career progression. By adopting a rigorous, fact-based approach, companies can determine the kinds of capabilities that they will need under different growth scenarios: where they may fall short and where they may have too much talent.

When a large mining company modelled its leadership needs and potential last year, it discovered that, without radical change, it would face a shortage of more than 150 managers over the next five years. At the same time, there would be no headroom to promote more than 50 top managers who would be ready for promotion during that period.

Many companies wrestle with this mismatch between supply and demand. But most lack the discipline and the analytical approach to address the problem before it becomes a drag on company performance. The mining firm has taken steps to improve its pipeline of leaders and fill mission-critical positions more effectively. It aims to halve the attrition rate of its top performers by analysing their future needs, measuring performance rigorously and adopting a merit-based pay scale. They now differentiate more between top and under-performers, thanks to a more disciplined approach to performance evaluation, which ensures that performance ratings fit a targeted distribution. Recruitment and training are also becoming more closely tied to future leadership requirements. Thus, the mining company aims to boost its bottom line by 2-5%.

Such tangible measures of success are essential to building an effective business case for leadership. →

Chart 1
Effective leadership supply generates value for shareholders



Source: Bain & Co

Charts by bounford.com

The authors, who are all leaders in Bain & Company's organisation practice, include **Robin Buchanan**, senior partner in London; **Dean Donovan**, a director in South Africa; **Alan Bird**, managing partner in South Africa; **Steve Ellis**, managing director in San Francisco; **Marcia Blenko**, a partner in London and **Paul Rogers**, a director in London.

→ Companies must focus on the value created from leadership capital, not the processes for managing talent. Adopting a value-driven perspective helps prepare executives to make tough decisions.

Deploy leadership capital where it earns the highest returns
With a clear picture of leadership supply and demand, firms can allocate their talent resources more strategically. Top talent must be regarded as a strategic resource and leaders should be deployed to where they generate the highest returns across an entire group or division.

Most chief executives attribute the lack of good leaders to a shortage of good candidates. But many fail to develop the talent they have already attracted

This may require a change in executive thinking. Our survey shows that 51% of managers think their senior executives are unsure which leadership roles are most critical for corporate success (see chart 3). Companies have a better chance of avoiding such confusion if they design roles effectively and identify those which are "mission-critical". Putting top performers in those jobs adds the most differential value. Yet many companies fail to recognise this. For instance, although purchasing is strategically important for large retailers, responsibility for it often lies with relatively junior staff.

Leaders also need to be deployed within mission-critical roles long enough to make an impact. Companies often rotate their most capable people through a series of jobs in short succession in order to broaden their exposure to the entire business. But keeping them in the same job for a longer period of time can sometimes create more value. When a company's leadership strategy is aligned with its business strategy, top performers know that they will not be penalised for staying longer in certain key roles and that they will have just as much opportunity to advance.

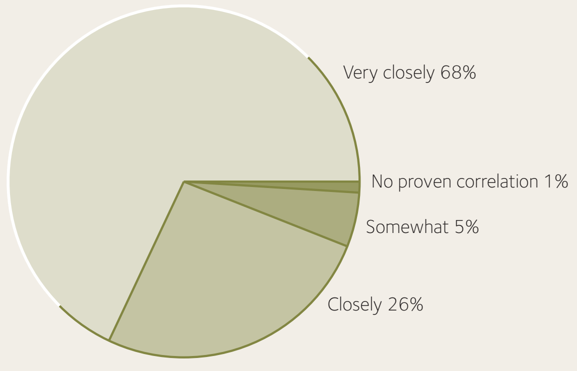
Conversely, the right person for a job today may no longer be so tomorrow if the nature of a role changes rapidly. At a technology company that had grown rapidly by adding new customers through a series of global deals, senior managers became masters at anticipating where to position the company to grab market share and at structuring deals to build competitive advantage. But when the technology markets became saturated, the company needed a new set of leadership skills. It quickly had to figure out how to retain customers and offer global products at a lower cost. Deal-making prowess became less important than the ability to forge a common culture and encourage global teamwork. The team that did the old job well had to be refocused and augmented with new talent and skills from outside.

Lead managers to their full potential
Most chief executives attribute the lack of good leaders to a shortage of good candidates. But many fail to develop the talent that they have already attracted. Nearly 60% of executives in the Bain survey admitted that they were not cultivating enough talent to sustain their business models or innovate for growth.

Encouraging managers to reach their full potential requires setting targets, aligned to strategic goals, that stretch each of them. Companies that are focused on getting the highest returns on leadership, such as General Electric or Johnson & Johnson, achieve this by conducting rigorous performance evaluations. Regular reviews are not enough; companies need to measure an array of critical attributes, such as results, skills, attitude and potential, accurately and systematically – and managers need to be able to act on the results.

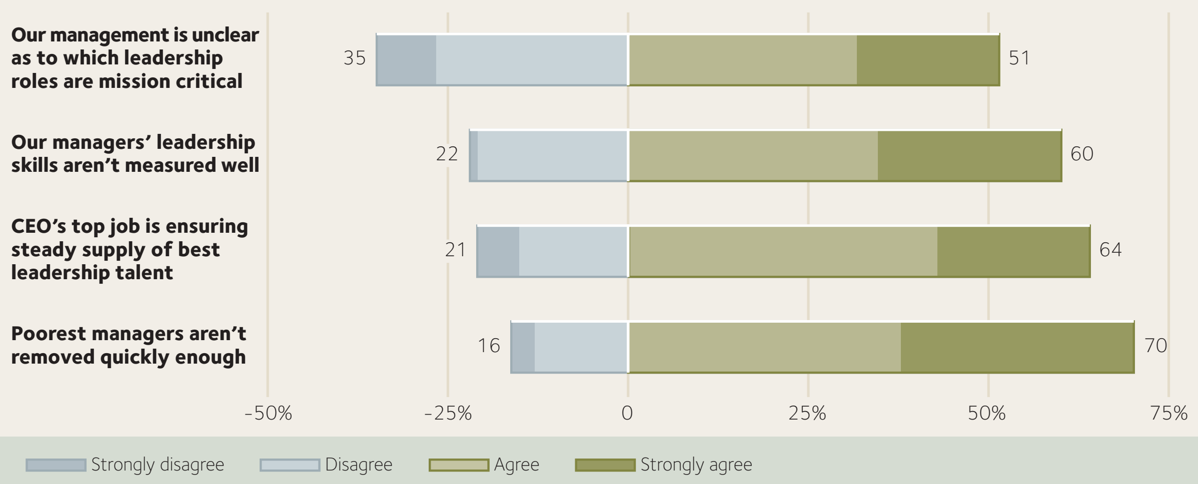
Companies need to invest more in their top performers. Pay should be linked to measures of true value creation and top performers rewarded with

Chart 2
How closely do you link strong corporate performance to having top management talent in the right positions all the time?



Source: Bain & Company Corporate Leadership Survey, May 2002

Chart 3
How strongly do you agree with following statements about leadership supply?



Source: Bain & Company Corporate Leadership Survey, May 2002

salaries 40% above average. Training and career-development opportunities should also be targeted at high-flyers. Yet many companies offer fewer such opportunities to managers as they rise higher in the organisation.

The most effective firms reward talent-building as well as delivering business results. Line managers can be encouraged to build the supply of leaders by making the development of other leaders a criterion for their promotion. Such an approach makes it clear that this is a top priority for senior managers. Once this is instilled in the line organisation, it becomes self-perpetuating.

Motorola embraced this integrated approach after its previous system for developing leaders had failed, dragging down its performance and hindering its ability to adapt. As part of a comeback strategy, Motorola designed a leadership supply and deployment programme. Two years ago, it undertook an ambitious initiative to rate, rank and cross-calibrate their management-level employees, starting with its top 500 executives. The rankings create three tiers of leaders: the top 15%, who receive improved pay and investment; the bottom 15%, who are fired; and the remaining 70%, in whom the company invests normally. "If people first live the principles and then perform, we keep developing them," says Christopher Galvin, Motorola's chairman and chief executive. "If they don't, they need to step aside and give someone else a chance."

Strengthen your leadership balance sheet

Motorola's poor financial performance forced it to act decisively to replace second-rate people and bring in and develop new talent – steps that are critical to any effective leadership-supply system. Roughly half (49%) of executives believe that inferior career-development opportunities for top-calibre employees hurt their ability to field more top-quality leaders. And 43% think their company suffers from poor recruitment procedures for assessing potential leaders.

The key is to plan future leaders' progression, rather than current ones' succession. Succession planning is largely a top-down exercise: senior managers are expected to fill certain jobs, including, eventually, their own. This kicks off a hunt for talent inside and outside the company. Progression planning, though, encourages senior executives to reverse their points of view. Rather than focusing on positions to be filled, they look at the entire pool of talent they can tap, both internally and externally, and start building career progressions that convey talented managers to positions of leadership. Opportunities for accelerated development have to be created, thereby increasing retention rates among top talent who may be at risk of leaving.

Sun Microsystems knows the value of this approach. In the space of six weeks this spring, four of the computer-systems company's most senior executives, including Ed Zander, its president and chief operating officer, announced their departure. In an industry where company-hopping is the norm, most computer companies still look for talent externally. But Sun embraces progression planning. Scott G McNealy, its chairman and chief executive, has made it a top priority, having seen its positive effects first-hand at General Electric, where he has been a director since 1999.

Although it would have preferred to spread out the departures, Sun quickly regained its balance. Three of the vacancies have been filled by seasoned managers within the company; Mr McNealy assumed Mr Zander's duties. The company's commitment to talent is visible also in Mr Zander's continued involvement with younger executives at the recently established Sun Leadership Institute.

Building effective talent systems forces companies to take a long-term view. They need to commit to clear principles and strong disciplines that outlast individual leaders so that managers can achieve their full potential and ensure a pool of competent future leaders. Such an approach can increase any company's leadership capital and maximise its returns.