Your Highest-Yielding (Under-Capitalized) Asset: The ROI of Leadership

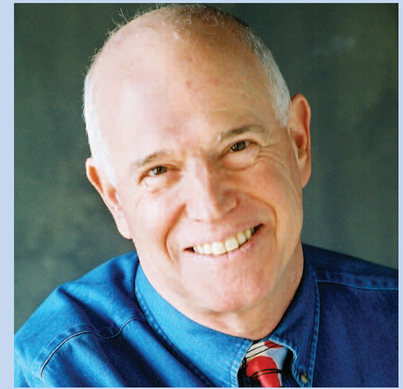
By Michael Shenkman and Bonnie Gorbaty

Your "return on investment " (ROI) measures the health of your company. The purpose of the ROI figure, no matter what the nuances of its calculation, is to measure the intrinsic value that a company gains from its investments – the resources it envisions as being productive. We believe that the greatest ROI is found in the differences that leaders – and only leaders – can bring to a company or organization, but there is not yet a hard-and-fast formula for quantifying it.

The business world is quite proficient at measuring ROI in the easily quantifiable functions of manufacturing, purchasing, capital investment and sales. At budget time, these functions can mount clear and measurable rationales for their stabilization, growth or downsizing. The less easily quantifiable, more subjectively evaluated functions include marketing, research, training, management and leadership development. Accordingly, they have less visible and easily measured returns and so the managers of these functions see their budgets inexplicably surge during the good times, and deeply cut when things turn sour.

Topping the list of factors for which it's tough to develop a number against which to benchmark a quantifiable return, and one that drives many other returns on investment, is the value of leaders and the difference their leadership brings to an organization. What is the value of a Steve Jobs versus that of his predecessor Gil Amelio in terms of Apple Computer's viability? It's easy to say "infinite;" and, in terms of stock price ($74 under Jobs versus $7 when Amelio left), there is clear evidence of Jobs' contribution. But we can only make that calculation in retrospect. Investments and their return, however, are made in anticipation of gaining. What could we anticipate in terms of ROI of his leadership at that meeting when Jobs took over? Apple Computer was in such bad shape when Jobs took over that on his return, Michael Dell, the founder of Dell Computer, and poster boy of measurable ROI, quipped that Jobs ought to pack the company up.

How can we quantify the return on the investment made in developing a deep bench of leader talent that can sustain a company's changing growth strategies? In his best-selling book *Good to Great*, Jim Collins captured a glimpse of what is possible with the eleven companies his research identified as making the leap from good results to great results and sustaining those results for at least fifteen years. Those eleven companies averaged cumulative stock returns greater than 6.9 times the general market during that fifteen-year transition period.



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Collins noted that a mutual fund investment in these eleven good to great companies during those fifteen years would have multiplied 471 times, compared to a 56-fold increase in the broader market.

Still, there is no magic bullet for determining a leader's value on an ROI basis. The result is completely

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contradictory attitudes when it comes to investing in developing an organization's leaders and potential leaders. On the one hand, ROI criteria seem to get thrown out the window in determining top executive pay. The recent spotlight on the incredible sums paid to CEOs, for instance, highlights this manic, undisciplined tendency. On the other hand, and this is the legacy that concerns us, ROI gets elevated to the status of a holy writ when it comes to investing in potential leaders who toil more or less invisibly at lower levels in the organization. The imbalance has repercussions far beyond the dangerous disparity in salary levels; it goes to the heart of the ability of our companies and organizations to drive innovation – the traditional lifeblood of American business.

You can see how this happens. Prone to being risk-averse, top managers, especially those who interact directly with shareholders, want a sure thing. In terms of assessing personnel in terms of how well they can drive targeted ROI, companies generally choose people with a proven track record for "getting things done," "moving fast," and being a "hard driver" in achieving short-term outcomes. Developing leaders is a decidedly long-term proposition; and even those who seem most likely to succeed in leader development programs often do not succeed. They do not manage the transition between management and leading.

As we see it, the problem here is not in how we measure ROI. The problem is how spending hard cash (investing) on such intangibles as developing leaders can be justified within the quarterly reporting requirement. For managers who are wedded to the idea of a limited, short-term notion of ROI (as the quarterly reporting mania dictates for them), developing leaders is safely relegated to the status of being a "nice to have," "important not urgent," discretionary expense. "Maybe next year," the thinking goes. How do you explain to impatient shareholders why you have to include high rates of investment in leader development activities that may or may not produce reliable returns to the bottom line within the quarterly reporting period? Every company, public or private, that must invest in innovation and lead significant change deals with these questions.

We have good news, however, for the leader executive who is looking for a way to present the case for developing leaders who drive innovation and change in a way that contributes to the bottom line. We have found ways to calibrate the value of the leadership difference within an organization. This article will highlight three of these factors and the costs and benefits associated with them.

While we cannot precisely measure each contribution that a person's leadership makes, down to the last penny, we can point to direct contributions to the bottom line that only leaders make. We can then actually calibrate the difference between the costs and the returns of developing high-potential leaders in an organization. Since ROI is clearly an aggregated number, these "leader differences" can more than justify an investment in developing effecting leaders.

Building Your Leader Bench Through Mentoring

One of the most important leadership factors contributing to high ROI has to do with building your leader bench. One of the measures that subtracts from ROI is executive turnover. It is natural that executives will move on to another company and oftentimes to a competitor. But if you must consistently rely on outside hiring for key positions, the hard costs in search fees alone are tremendous. Add to that the softer costs incurred during the months of downtime it takes to get new people up to speed. Then factor in a premium on these costs for the risk that the new hires won't fill the bill.

A constant, reliable, professionally guided leader mentoring process greatly mitigates this cost. Executives are ready, in-house, fully knowledgeable and chomping at the bit to step into leader roles. Take this example from our own experience. One of our CEO clients, faced with a turnaround situation in a highly competitive and rapidly changing industry, brought in professional mentors with the express purpose of identifying and developing a deep leader bench. The professional mentors worked with twelve carefully selected executives, meeting one-on-one to concentrate on developing "skills of character" that leaders call upon every day. The budget for this eight-month leader development program was equivalent to one mid-level executive salary at this company.

Over a three-year period, three of the twelve mentored executives were promoted into vacancies left by departing executives; two mentored executives left the company; the remainder were all promoted or lateral-moved into even more critical roles. What's the ROI of that leader development? Start by calculating the executive search fees NOT incurred. Then add in the benefit of being able to promote from within to new and critical positions. Not a day, not an hour was lost in the process. The new executives were known, they had proven themselves, and they were already respected by peers and associates alike.

For our client, the benefit of this extensive, long-term mentoring process also showed up in its ability to absorb major industry and technological changes, and generate internal innovations in response to market pressures without skipping a beat.

The value of such smooth transitions is hard to measure. Still, the ROI can be estimated. I suggest this: take the day that the transitional reorganization was announced as Day One. Project the company's growth in its pre-transition configuration over a three-year period from that date. This is not an exceptional exercise, as growth is predicted all the time in order to project headcount, facility costs and other costs of doing business.

Then project the growth predicted by the reorganization. By contrasting the new rate of return with what the new team is projected to be able to do, minus the growth of the company under the old regime, minus the equivalent of one executive salary to pay for professional mentoring services, you can get to an approximate ROI figure against which you can measure success

The same math applies to succession planning. What was it worth to GE that Jack Welch had mentored his successor prospects and was able to select from among them? What was the ROI on the fact that Jeff Immelt was able to step into that role without skipping a beat? To this ROI, we can add the value a deep leader bench brings to sustaining leader development for long-term sustainable ROI across the company.

The ROI on New Ideas

Another difference leaders make to a company is that they capture and implement new ideas. When leaders are available throughout an organization, they are willing to step into new projects and learn completely new things, work with new people, and are even willing to fail. But leaders also have the wherewithal to drive a new project to success, even against the odds. What is the ROI of having someone in-house, ready to take up a challenge?

For example, a client was undergoing a massive introduction of a new technical product line that was on the cutting edge in its industry. It purchased a small company that worked in the new technology, but operated on a much smaller scale than did our client. The integration with the old team in place was just short of catastrophic. The company turned to other executives, ones who also had been mentored, to replace the old guard and to take up completely new operations the company had never had before. The turnaround was dramatic. These leaders, products of developing a deep bench, took up the challenge with gusto and insight. Aside from a few technicians from the acquired company, all the leaders for this turnaround came from the inside. No search fees; no downtime. Just results.

Positioning

Leaders also know the value of differentiating their companies from the rest of the industry pack. Leaders tend to think more clearly about the company's brand and position, and they are not "me too" types. We don't have any research on this, but in our own experience, companies that are successful in moving into new strategic areas, via an acquisition or internal innovation or a combination of both, have leaders at the decision table.

In one company I work with, the battle between the leaders and the managers was constant, and often bitter. The leaders pushed the company into very challenging innovations that stretched and stressed every part of the company. The managers were irate. Their processes were being disrupted, their authority was undermined by new promotions and lateral moves; the costs were definitely scary.

The managers weren't wrong, mind you. The company had to take on huge cost-cutting moves in areas not strategically related to the change. Morale sank precipitously for a time. The advocates for change did, in fact, hurt the old company, in the short term. Its stock sank to historic lows. Layoffs and offshoring were made necessary. All as the managers predicted.

But, in terms of longer-term ROI, the company's leaders saw this as a process of "creative destruction" that they were willing to undertake. Our point is the managers' solution was to stay put, cut costs and pretty up the bottom line, increase the short term, risk-free ROI, for the sake of the sale. While the success of the change is hardly certain, and the managers' predictions may still come to pass, there are signs that the leaders' gamble was worth it. The company's stock has doubled since the decision was made, its whole infrastructure has been upgraded, its costs are completely aligned with its new capabilities, and it is attracting huge investments from potential customers and partners. The company has carved out a unique market position that adds significant multiples to its value.

What about the value of leaders in capturing innovation? The company's leaders scanned the market for what was to be a challenging but viable course for the company to take. The leaders sold the change to the board. These leaders then toughed it out through all the pain and uncertainty the change entailed. And, all of this was done without one single new hire in the executive leader ranks (other than the technical leaders that came over with a small acquisition involved in the transition).

There is no change that this leader group is daunted by. Several of the reluctant managers left the company. The excitement and sense of accomplishment is palpable at this company. This company has a bright future. That ROI can be calculated by measuring zero (the firm's value after sale) against the current and future growth of the company.

These are a few examples of what we call ROI-contributing factors that only leading offers. Our ***Leadership Difference Snapshot*** (on our website at www.archofleadership.com) provides a more complete listing of other points of impact that aggregate into an impressive number of ROI calculations. Take the snapshot to see how well your leadership is making the difference today.

Not Everyone is a Leader

So far, we've focused on success stories. What about all those people that don't succeed at leading? How is that factored into the cost of developing leaders? Doesn't it raise that cost precipitously?

Good questions. One of the reasons the whole idea is so fraught with risk is that while managing the mix of processes, numbers, and machines is complex, it can be taught and learned eventually. Managers can be trained. They can go to B-schools and learn their trade. They can attend a seminar with hundreds of others (at a relatively low cost), read a book and pick up a valuable skill they can take back and implement.

No so with leadership. Leaders, even those who are "naturals," are mentored into excellence. There is no cookie-cutter, formulaic way to develop leaders. And, mentoring takes time because it is a slow process of developing trust, gaining in-depth knowledge of a person's life, not just an evaluation of certain production skills. The mentor helps leaders develop a deep understanding of themselves and the special relationships leaders need to create with people so they will trust the leaders enough to follow them through the traumas of change and personal challenge. The insights that a developing leader must learn happen as a result of a guided process of self-discovery that includes astute questioning, deep listening and journal writing.

Why do leaders need this kind of mentoring? Because *leading is a matter of knowing yourself and what you offer people.* If the leader is to bring people of varied talents and personalities together, he or she must have the ability to project to a larger stage the core values and vision of what the world can be. The leader needs to have a sense of self-trust, an ability to accept what he or she offers, and then boldly put it out there for people to test. In that way, the leader engenders the kind of trust that makes people willing to take the kinds of risks that make for great vision, great effort and collaboration, and great companies. The mentor guides the leader in discovering how their self-trust defines how they lead. We call this the "Leader Brand."

The cost of developing leaders can seem exorbitant or too time-consuming for a business under competitive pressures to survive. But, professional mentors offer a clear and reasonable way to consider leader development within the context of ROI. Professional mentoring has a definite cost associated with it, and operates within specific time and resource parameters. This differs from executive coaching, because such coaching can go on indefinitely. Coaching is geared to specific performance-related issues, matters of personality and individual style that may or may not be "fixable."

People who are chosen for mentoring, in contrast, are those who have already demonstrated budding leadership ability. This increases the likelihood (but far from certainty) of their making a real contribution to ROI following the mentoring process. Professional mentors concentrate their conversations on factors that have been identified as directly contributing to a person's ability to lead, as opposed to being able to manage. Since there is strict confidentiality, the work takes place at great depth, having immediate and significant impact. Mentoring thus transforms the potential leader's self-perspective and self-trust so that risks, new situations, inspirations and the drive to meet seemingly impossible goals become desirable, not obstacles of paralyzing fear.

Additional benefits flow from the mentoring process. People in a mentoring program rarely leave the company during the eight-month process. They want the attention and value it. We have mentored more than 300 people in the last five years, and only two have left the companies that sponsored their mentoring during the process. After the mentoring process, some left the company and actually went on to pursue other kinds of endeavors, finding that leading was not the best fit for them after all. And remember, these people were already selected as the best leader prospects, people the company want to have around.

When a company invests in leader mentoring for several years, a philosophy about leading sets in. A sense of adventure and high expectation for change and dedication to the mission infuses the organization. Leaders have a common vocabulary and talk to each other, multiplying the high demands leaders make, spreading those expectations throughout the company. The company becomes a challenging, lively place to work. The culture then self-selects for the best people in the industry, again accelerating and deepening the

company's ability to innovate. This, I believe is what happened at Apple upon Jobs' return. It is definitely confirmed in Collins' book on the good to great companies that getting the right people on the bus is the first thing you do in order to drive the bus to someplace great.

Conclusion

What is the ROI for all this? For mentoring 12 people over an eight-month period, figure the equivalent of one executive salary. Deduct that cost from increased stock price, continuing marginal growth rates, cash available for reinvestment or bonuses, reduced fees for executive search, and reduced opportunity costs from executive turnover.

Admittedly, that number may not be sufficiently fixed to pass Sarbanes-Oxley muster, but it makes for a viable presentation and explanation for the narrative that accompanies the quarterly report. And more than that, it makes for the kind of story that demonstrates a company's strength in the face of adversity, displaying the values that investors can translate into their own sense of adventure. It opens on to territory where the ROI measures not only costs against revenues, but the company's real *value* to all its stakeholders.