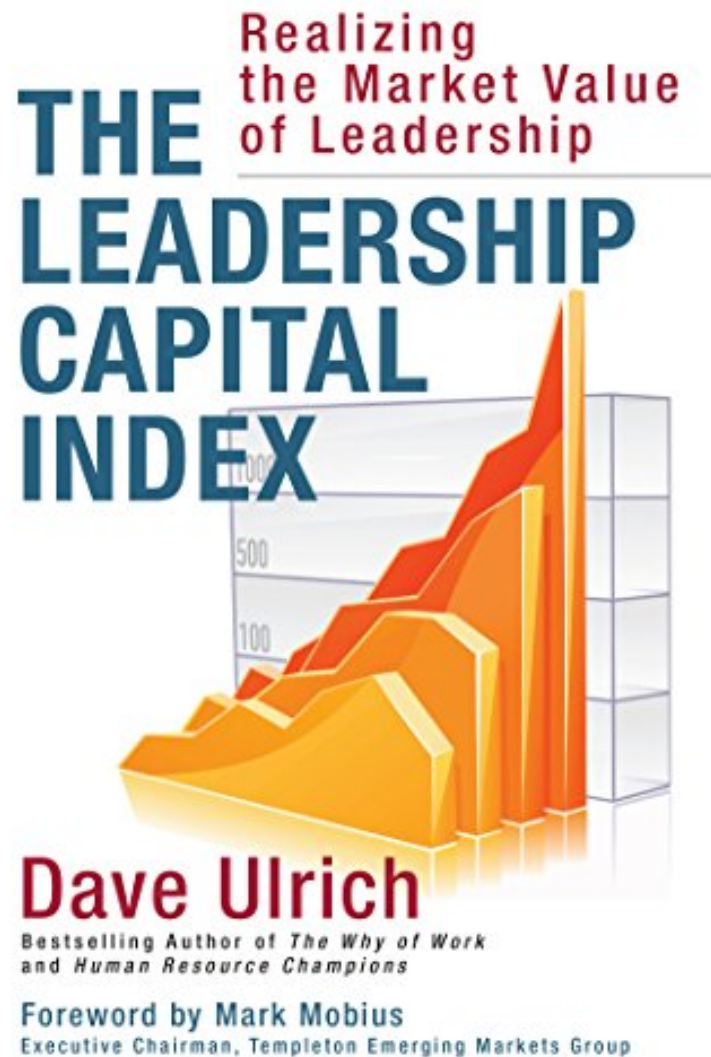


The Leadership Capital Index: Realizing the Market Value of Leadership

Dave Ulrich

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Dave Ulrich : The Leadership Capital Index: Realizing the Market Value of Leadership before purchasing it in order to gauge whether or not it would be worth my time, and all praised *The Leadership Capital Index: Realizing the Market Value of Leadership*:

4 of 4 people found the following review helpful. A Comprehensive Prospectus on your next CEO! By Geraldine S. Lake After two decades of leadership books all of which promise 7 paths to leadership ecstasy, it is refreshing to find a treatise that tries to identify empirical dimensions which can be used to: (1) assess current leaders and/or (2) potential

leaders. Ulrich has done a comprehensive review of many of the previous books on leadership which may have identified two or three important leadership dimensions which worked in their situations, but in this book insights are drawn in a comprehensive picture of what to look for in a prospective CEO. Congratulations are in order for Ulrich and the system he articulates. 0 of 0 people found the following review helpful. Dave took leadership to the next level of value generation. By Marcos Malaga I guess we always knew that leadership and building a sustainable leadership pipeline both bring value to the business, it's just that we never knew how much value until this book. 0 of 0 people found the following review helpful. Five Stars By Paul Ayisu Another masterpiece. Thankful to the seller.

When it comes to evaluating a firm, leadership matters. We know that financial outcomes can predict about 50 percent of a firm's market value. Intangibles like strategy, brand, talent, RD, innovation, risk, and so on account for the rest. But leadership underlies them all. And despite how important we know it is, we've been forced to rely on subjective and unreliable ways to measure its impact; until now. In this landmark book, leadership scholar, author, and consultant Dave Ulrich proposes a "leadership capital index" - a Moody's or Standard and Poor's rating for leadership. Drawing on research from investors and business leaders, and synthesizing the work of dozens of consulting firms and leadership experts, Ulrich analyzes two broad domains, each comprising five factors. The individual domain includes personal qualities, strategic prowess, execution proficiency, interpersonal skills, and fit between the leader's style and the organization's market promises. The organizational domain encompasses a leader's ability to create customer-focused cultures, manage talent, demand accountability, use information to gain competitive advantage, and set up work processes to deal with change. Ulrich details rigorous metrics and methods for evaluating leaders on each of these factors. The result is a groundbreaking book that will be of vital interest not only to equity and debt investors but also to boards of directors, executive teams, human resource and leadership development professionals, government and ratings agencies; and of course to leaders themselves.

"Ulrich isn't just reeling off ideas. He backs them with the sharpest thinking from the Big Four and beyond. And he suggests how entire organisations, including HR, can support leaders in creating and propagating cultures that encourage the right behaviours." - Robert Jeffrey in People Management "No one is born a CEO. There's a full skillset that must be learned over time. Drawing on extensive research, Dave's approach to measuring this special brand of leadership enables investors and executives alike to evaluate and understand the qualities of those who determine a company's culture and ultimate success." -- Stephen A. Schwarzman, Chairman, CEO Cofounder, Blackstone "It is a delight to read Ulrich's take on leadership. His deep thinking, insights, and analytical ideas have brought much-needed rigor to the practice and processes of leadership. With this book he has begun the crucial journey of more deeply understanding leadership as a vital organizational asset." - Lynda Gratton, Professor of Management Practice, London Business School, and author of The Key "In today's digital world with sophisticated metrics, going with your gut on key talent acquisitions can be very hazardous. Ulrich has now introduced some needed rigor into evaluating organizational leadership." - William Conaty, Advisory Partner, Clayton, Dubilier Rice, and coauthor of The Talent Masters "This is a valuable and practical guide for investors to evaluate the leadership of companies before they invest. For those interested in the discipline of leadership, it is a comprehensive framework to look at leaders; their style and values; and evaluate how they perform. And this is also like version 1 of a useful manual for corporate leaders on how to run their businesses successfully." - Dr. Tan Chin Nam, Chairman, Temasek Management Services, and senior corporate adviser "Leadership was once something you had to have faith in. Dave Ulrich has introduced some science into the mix. It takes some of the guesswork out of figuring out what great leadership really is." - Keith R. Read, Senior Managing Director, Cerberus Capital Management, LP, and Cerberus Business Finance, LLC "Investors who study Ulrich's approach; and employ it; will give themselves an advantage in the ever-tougher challenge of performing in today's markets. The book provides a genuine edge in answering the question, How do we find the better companies? Answer: by finding the better leadership teams." - Jim Ware, CFA, founder of the Focus Consulting Group and coauthor of High Performing Investment Teams About the Author Dave Ulrich is the Rensis Likert Collegiate Professor of Business Administration at the Ross School of Business, University of Michigan, and a partner at the RBL Group consulting firm. He is the author or coauthor of over thirty books, including The Why of Work, Leadership Brand, and HR from the Outside In. He has received a Lifetime Achievement Award from ASTD (now ATD), has repeatedly been named to the Thinkers50 list of thought leaders, and has been designated the #1 most influential international HR thought leader by HR Magazine. Excerpt. copy; Reprinted by permission. All rights reserved. CHAPTER 1 When Leadership Matters to Investors, It Matters More "How much is that doggie in the window?" asked Patti Page in a 1952 novelty song. Investment analysts and others have asked essentially that same question since companies have been publicly traded: "How much is this company?" (With a strong subtext of "How much is this company worth to me?") A dog's value comes from its recognizable traits (breed, age, health, temperament), but also from its personal value to the owner (relationship, history, companionship). Similarly, a company's value comes from its tangible assets like products, receivables, technology, and

facilities—the assets that show up on the balance sheet and are as easy to see as the surface of a dog. Company value also includes intangibles such as strategy, brand, intellectual property, and reputation, which are more subjective and less likely to show up on the balance sheet but have been recognized as being just as essential to determining a company's desirability as an investment. Underlying the intangibles, each organization has a level of leadership capital—an established pattern of both individual leader characteristics and organization and human capital processes—that can and should be included in determining firm value. Investors often have a strong feeling about the importance of a particular leadership trait, but their opinions tend to be superficial because they don't recognize or have ways to fully evaluate all the elements that underlie effective leadership. They make judgments with only one or two pieces of a leadership puzzle, not the entire puzzle. The leadership capital index in this book will help investors and others improve their approach to firm valuation. When leadership capital becomes a factor in investor judgments, it will naturally receive more emphasis in day-to-day corporate life, to the benefit of many.

Audiences for Leadership Capital Insights The insights from this book should prove useful for stakeholders committed to understanding leadership and value: investors, rating firms, proxy advisory firms, boards of directors, senior executives, and HR and leadership specialists.

INVESTORS The primary audience for this book is investors looking to value the quality of a company's leadership. Interested investors include equity and debt investors, long-term and short-term investors, and relational and transactional investors. Investors who value and assess the quality of leadership will make more informed decisions about the future value of a company. Most thoughtful investors recognize that leadership matters, but they are not clear on how to rigorously assess leadership. A major private equity group held an annual conference for the CEOs of companies it had acquired, where it would share advice on what these independent CEOs should focus on in the next year. In 2009, soon after the market collapse, this conference focused for two days on leadership. The group executives had discovered that it often took five to seven years to turn around a distressed company—and that in 60% to 70% of the cases, the biggest challenge was the quality of leadership. Often the leaders who'd gotten the company into a position where it was purchased by the private equity group were not able to make the bold changes needed to turn around and transform their company to prepare it to be repositioned in the marketplace. The group leaders felt that if they could prepare acquired-firm leaders to be more capable, they could turn the companies faster. The group decided to hire a talent czar, someone who could assess leadership talent in companies likely to be acquired and then develop leadership in acquired companies to be better able to transform their company and prepare it to be resold. These private equity investors recognized that leadership mattered—and that they were not in a position to perform thoughtful or thorough assessments of leadership. So they retained a specialist to do so. As this private equity group recognized, valuing leadership comes from and extends the work on intangibles. Two firms in the same industry with the same financial results may have dramatically different market valuation. This differentiated market valuation is often attributed to intangibles, which show up in business by boosting—or undercutting—investors' confidence in a firm's performance. Leaders architect intangible value. When investors accurately assess leadership, they are indirectly but accurately assessing the future intangible value of a firm. Thus investing in leadership capital may result in a leadership premium or discount, depending on the outcome of the assessment.

RATING FIRMS Standard Poor's (SP), Moody's, and Fitch issue about 95% of the creditworthiness ratings based on their view of a company's ability to pay back its debt. Credit rating has been a staple of measuring firm financial performance since the early 1900s, and a firm's credit rating influences both its cost of capital and its ability to access capital. While critics sometimes challenge the details of risk assessments, these ratings continue to have great influence. Just as credit ratings reflect the likelihood of continued financial effectiveness, a leadership capital rating could be created to reflect the likelihood of leaders' making the right choices to drive firm performance. If universally accepted, a leadership capital index would have implications for numerous stakeholders. For example, in 2011, SP very publicly downgraded U.S. securities from AAA to AA because of the budget deficit and rising debt burden. This downgrade influenced borrowing costs for the U.S. government, companies, and consumers. However, the underlying reason for this downgrade was not just the debt burden itself but the inability of leaders in Congress to collaborate well enough to face and solve the deficit problem. A leadership capital index that assesses the quality of leadership would complement a report on the symptom (debt burden and ability to repay), but go beyond it to assess the underlying problem (quality of leadership). Likewise, in the 2008–2010 recession, many Western banks were “bailed out” by government support. The problem with this metaphor is that bailing water out of a boat only relieves the symptom. If the hole in the boat is not fixed, water will keep leaking in. The “hole in the boat” may be defined as poor leadership. Unless and until leaders behave differently, similar results will occur. Even after financial bailouts, leaders who spent excessively at executive retreats or on executive compensation continued to place their firms at risk. To avoid future bank risks, regulators formed bank stress tests that focused on risky assets, balance sheet quality, and the amount of capital on hold. Unfortunately, none of the bank stress tests in the United States (by the Federal Reserve Board), Asia (by the International Monetary Fund), or Europe (by the European Banking Authority) include an assessment of leadership. Perhaps this is why financial stress tests are somewhat discounted and do not receive the confidence they were intended to inspire.

PROXY ADVISORY FIRMS Proxy advisory firms, including Institutional Shareholder Services (ISS), Egan-Jones Proxy Services, Glass, Lewis Co., and Institutional Investor

Advisory Services (IIAS) in India offer shareholders advice on how to vote their shares. These firms issue reports on how a firm's governance practices relate to firm performance based on public financial data. For example, ISS reports four pillars of governance practices: board structure, executive compensation, shareholder rights, and audit-related activities. While all are related to leadership, none of these four pillars rates leadership capital directly. They report the alignment of total shareholder return over one, three, and five years with CEO pay and compare this to an industry peer group to measure pay for performance, but they do not offer further insights on leadership. Including more refined indicators of leadership would enable these proxy firms to offer more thorough recommendations.

BOARDS OF DIRECTORS

As trustees of a firm's assets and shareholder interests, boards of directors have fiduciary responsibility for its performance. To fulfill this responsibility, boards review strategic plans, financial performance, firm policies, and operating choices. A primary task of a board is to select a CEO who can make astute decisions to lead the firm. In addition, the board determines compensation for the CEO and other key executives. Through these actions, boards recognize the importance of leadership capital for firm success—especially in settings like government agencies, not-for-profits, privately held companies, or countries where market value may not be a dominant logic. A leadership capital index could help the board manage succession against a set of criteria that informs and bolsters confidence from investors and others. Executive succession is not just about the person who moves into a key position—it is about how the individual qualities instill confidence in others, particularly investors. In addition, boards sometimes invite in financial advisers to help determine how to increase total shareholder return. Often these advisers examine industry trends (to see if the firm has a strategic advantage) and financial performance (to see if it meets financial expectations). Less often do boards invite in leadership advisers to examine intangible value to see if their firm trades at a premium or discount to the industry. Boards might use the leadership risk assessments proposed in this book to review their firm's quality of leadership, which in turn would give investors more confidence.

THE C-SUITE

C-suite executives and senior leaders want to demonstrate excellent leadership skills. Often leadership excellence is defined by the personal characteristics of the leader (authenticity, charisma, communicator, and so forth). But unless these personal leadership characteristics build confidence with investors, they are not contributing all they could to sustainable value. CEOs are also committed to building future human capital—their number one priority, according to a recent survey.² Having a leadership capital index would help senior leaders know what to expect of themselves and other leaders so that investors would be more likely to invest in the company because of what leaders know and do.

HR AND LEADERSHIP SPECIALISTS

HR and leadership development specialists who design and deliver leadership improvement efforts could also be well served by a leadership capital index. Recently, my colleagues and I were in a consortium of leading companies, most of which had teams or HR professionals in attendance. One question we asked these groups to consider was, "What would you like investors to know about your quality of leadership that would increase their confidence in your future earnings and market value?" Almost none of these senior HR professionals had considered this question, even as they worked to improve leadership in their company. Indeed, one of the consortium teams happened to be investors from one of the large global sovereign wealth funds, and these investor participants talked about what they look for in leadership when they make significant investment choices. But as they were presenting their list of desired leadership attributes, I noticed that none of the HR participants in the workshop were paying much attention. I stopped the discussion at that point. "Do you realize what you are hearing?" I asked. "Guys from one of the largest investors in the world are sharing what they are looking for in leadership in your companies—or your rivals in the investment market. No one is taking notes. What you should be doing is rigorously writing down what they say, then sharing this with your CEO and chief investment officer so that they can communicate these messages in conference calls and investor discussions. And you should be rethinking leadership investments to ensure that you have or develop these traits." With some embarrassment, these HR professionals started taking notes! And some later told me they could now engage in more business-oriented discussions with their business leaders. Using a leadership capital index that focuses on how investors view leadership can help sharpen leadership improvement efforts. If nothing else, it will bring the concept to the table and allow it to be considered.

Logic of Leadership Capital Index

A leadership index differs from a leadership standard. Standards define what is expected; indices rate how well an activity performs. For example, consider the Economist's Big Mac index, which measures the cost of a Big Mac in various countries in terms of its difference from the average Big Mac price in the United States. The index doesn't try to tell you how much a Big Mac should cost—rather, it is a crude but useful assessment of the cost of living around the world. An index guides investors to make more informed choices. When a rating agency like Moody's or SP downgrades a company, it is not saying the company did or did not meet financial reporting requirements. It is offering an opinion about the firm's ability to repay loans in the future. Likewise, a leadership capital index would inform investors and others about the readiness of the firm's leadership to meet business challenges. I am not proposing some sort of leadership equivalent of generally accepted accounting principles (GAAP)—this is not an attempt to codify all leaders in the same way. Developing such a leadership standard would be nearly impossible because leadership is inevitably both personally subjective and contingent on the unique needs of the company. Defining a leadership standard would be like defining the perfect basketball player. Both Michael Jordan and Bill Russell were enormously successful, but they

had very different skills, played in different eras, and had different roles on their teams. Likewise, it is silly to ask who was or is the best leader—Bill Gates, Richard Branson, Indra Nooyi, Ratan Tata, Carlos Ghosn, Warren Buffett, Zhang Ruixin, Steve Jobs, Larry Page, Oprah Winfrey, or Jack Welch? In fact, each was very successful using unique skills appropriate for the circumstance. In the near future, no uniform standard of leadership is at all likely, but an investor who recognized the quality of leadership in each of these leaders and thus invested in them early on would have been well served. A leadership capital index can give investors and other interested parties a set of guidelines to assess leadership. When my colleagues and I share our aspiration to develop a leadership capital index, almost everyone agrees that this would be a marvelous resource. Some call it the holy grail for both firm valuation and leadership development, but most are skeptical that it can happen. However, the timing is now right, because both firm valuation and leadership improvement efforts have evolved to a stage where such an index can actually be created. My current proposal for a leadership capital index follows the logic of the minimum viable product for innovation in high-tech.³ According to this logic, web applications and lean start-ups continually experiment to learn how to improve. The product is not wholly defined in advance; it develops as it is tested, used, and improved. In valuation and leadership, a number of initial efforts have been made to establish an investor view of leadership. By combining these separate but thoughtful initiatives, we can now create a more rigorous and holistic leadership capital index. Leadership capital index 1.0 is to build the case for the index and establish a framework and baseline for the index, which is the purpose of this book.

Valuation Evolution: From Financial to Intangible to Leadership

The definition of an organization's value has changed over the years, and I believe it is still changing. Once it was mainly the physical stuff that could be removed and sold; then it expanded to include the intangible assets that made it a going concern. Leadership looks like the next step. It's worth tracing the development in more detail. Historically, the accounting profession received a major challenge after the stock market crash of 1929. Many argued that stock prices misrepresented firm value because the public information available to investors did not accurately reflect the extent of a firm's assets. In 1934 the Securities and Exchange Commission was formed to create standards and regulate how public companies report their financial performance to investors. The large accounting and audit firms at the time (called the "Big Eight": Price Waterhouse Co.; Haskins Sells; Ernst Ernst; Peat, Marwick, Mitchell Co.; Arthur Young Co.; Lybrand, Ross Bros. Montgomery; Touche, Niven Co.; and Arthur Andersen Co.) established a set of standards and principles through the Financial Accounting Standards Board (FASB). The rules define uniform standards in an effort to communicate accurate information to investors so they can better measure firm value (generally accepted accounting principles—GAAP—in the United States, or international accounting standards—IAS—outside the United States). The intent of these accounting standards is to offer investors comparable, public, and transparent data that will enable them to make accurate valuation decisions. The ingredients, or financial data, from the accounting standards can then be combined to define a firm's value. An entire industry has been created and evolved to define approaches to the increasingly complex task of measuring a firm's value.⁴ Income approaches to valuation focus on capitalization of current net income or cash flows and discounting of future cash flows. Cost approaches to valuation emphasize the cost of replacement of an asset to determine its value. Market approaches value assets because of their current value based on competitive pricing. Again, each of these broad approaches to valuation combines the ingredients from the accounting standards data to determine a value of the firm.

IMPORTANCE OF INTANGIBLES FOR VALUATION

In recent years, due to changes and uncertainty in markets, information, and globalization—and despite the constant attention reported in the preceding section—the financial data publicly reported by firms has not reflected their value accurately.⁵ Earnings reported in a variety of forms (net income, operating earnings, core earnings, and more) have become ever more suspect.⁶ As a result, efforts at firm valuation have turned from financial results toward a deeper understanding of the intangibles that influence these results. Baruch Lev, an accounting professor who is a thought leader of the intangibles movement, has shown the importance of intangibles as indicated through market to book value—suggesting that for every \$6 of market value, only \$1 occurs on the balance sheet.⁷ This means that the balance-sheet number—which is what traditional accounting measures—represents only 10% to 15% of the value of these companies.⁸ This data shows that the value of many firms comes as much from perceived value as from hard assets. Firms like Coca-Cola and Gilead have high market value from brands and patents. Technology-based firms like Google have high market value with relatively little in the way of cash flow, earnings, hard assets, or patents. And even traditional companies like 3M and IBM are increasing market value by focusing on brands, leveraging the Web, and restructuring. Professor Lev further recommends that managers learn to win investors over by finding ways to more clearly communicate intangibles with them.⁹ Harvard professor Robert Eccles and his colleagues at Pricewaterhouse Coopers (PwC) call for a "value reporting revolution" by changing financial reports to include more intangible information. They find that only 19% of investors and 27% of analysts "found financial reports very useful in communicating the true value of companies." They argue for changing the performance measurement game to better allocate capital and assess the true value of firms. In identifying better measures of firm performance, they focus on "key performance measures—both financial and non-financial, and how they relate to each other, that they are measured and reported on, and that they create real value."¹⁰ They propose a model they call "Value

Reporting Disclosure; with enhanced business reporting where firms report information on business landscape (industry, technology trends, the political and regulatory environment, social, and environmental trends), strategy (mission, vision, goals, objectives, portfolio, governance), resources and processes (physical, social, organizational capital and key processes), as well as GAAP-based performance.¹¹ By reporting these more intangible factors, they give investors better information for determining a firm's true value. Analysts perceive the benefits of better disclosure when they help long-term investors have greater confidence in future earnings. Accenture's finance and performance management group also reports that intangibles are an increasingly important part of a firm's value.¹² Its classification of assets still includes monetary and financial assets, but also intangible assets of relationships, organization process, and human resources, and it proposes measures to track these intangible assets. Ernst Young's Center for Business Innovation has also attempted to find out how investors use non-financial information in valuing firms.¹³ It concludes that non-financial criteria constitute, on average, 35% of an investor's decision. Sell-side analysts use non-financial data, and the more non-financial measures analysts use, the more accurate their earnings forecasts prove to be. Because of studies like those just cited,¹⁴ in recent years intangibles have received more attention as a source of value.¹⁵ Generally intangibles have been listed as intellectual capital or knowledge as evidenced in patents, trademarks, customer information, software codes, databases, business or strategy models, home-grown processes, and employee expertise.¹⁶ Investors have worked to classify lists of intangibles that include intellectual capital but are more expansive. Baruch Lev categorizes intangibles into RD efforts (such as trademarks, patents, copyrights), brand value (such as image, reputation), structural assets (such as business systems, processes, and executive compensation, human resources), and monopoly position.¹⁷ In our earlier work, Norm Smallwood and I synthesized the work on intangible value into four domains called the architecture for intangibles (see Figure 1.1). We found that intangibles could be clustered into four broad categories—making and keeping promises, having a clear strategy for growth, managing core competencies, and building organization capabilities—all of which depend heavily on the behavior of leaders.¹⁸ In this current work, I emphasize the point that leadership is a key underlying factor in an organization's ability to keep promises, set clear and compelling strategies, align core competencies, and build organization capabilities. When leaders at all levels of a firm guide these four domains, they create sustainable intangible value. Therefore investors who assess leadership will be more able to fully value a firm's intangible assets and overall market value. As I've said, this is the right time for this book. Nearly every interested investor has access to publicly reported data, so essentially, each investor knows what every other investor knows about a firm's financial position and, increasingly, about its intangibles. Investors need to dig deeper to find new insights, and this is not easy to do. For example, the New York State Attorney General recently required BlackRock (the world's largest asset management company) to stop surveying Wall Street analysts to find out their collective views on a company's financial performance and likelihood of being taken over.¹⁹ The argument was that financial data should be public, transparent, standardized, and shared so all investors have the same access to it. When financial data is widely shared, however, investors have to find other information, such as leadership, to inform and differentiate their investment choices.

LEADERSHIP: THE NEXT STEP When New York University researchers administered a questionnaire to a hundred venture capitalists, exploring the criteria for fundability of new ventures, they found that the most important factor is the quality of the entrepreneur or management.²⁰ Similarly, when Boris Groysberg and his colleagues at Harvard surveyed analysts to find out what they valued in making their investment decisions, they found that quality of management was among the top factors.²¹ However, they also found that analysts lack consistency in rating this dimension. Research among joint ventures and venture capital firms has also found that information that has not traditionally been incorporated in the due diligence process, such as the quality of management and culture, can be critical to the future success or failure of the acquisition. The success of many companies can be traced to a few prominent managers who provided the required leadership. Without auditing intangible assets such as management, it is not possible to conduct a correct valuation of a potential investment.²² These studies show that work on valuation is moving toward an assessment of the quality of leadership—the leadership capital—that underlies and creates intangibles and leads to financial results. Figure 1.2 traces the s-curves in the history of valuation, showing how intangibles move beyond financial information and proceed almost inevitably to the inclusion of leadership. These days investors are creating metrics for intangibles (like brand recognition, strategic clarity, innovation index). Investors who do a better job of assessing leadership will create information asymmetry for themselves and make better investment decisions. However, management practices and leadership vary enormously across firms and countries.²³ Financial valuation sets the accepted baseline that levels the playing field, but leadership valuation differentiates how investors can determine long-term firm value.

Leadership Evolution: From Personal Style to Organization Impact to Investor Value What makes effective leadership? That is the dominant question when it comes to the study of leadership, and its exploration has filled countless books, many thicker than this one. Nonetheless, it is useful to review the overall development of the idea. The answer to what makes effective leadership has evolved over time, each new stage building at least in part on its predecessors.²⁴ Some firms have celebrity leaders or an individual leader who gains notoriety. While these charismatic individuals become important to a firm's success, more often it is the depth of leadership talent throughout the organization that builds long-term success. When my colleagues and I

talk of leadership, we mean the collective group of leaders throughout a company, not just the CEO or another individual senior executive. Thus, while individual leaders matter, increasingly the entire cadre of leaders, the leadership, matters more.²⁵ Assessments of effective leadership have moved from a stance of believing that leaders excelled by first leading themselves, then being the sort of people others follow. Later assessments examined how leaders looked to others by leading in the organization, and the more modern view has them looking outside by creating value for external stakeholders.

WHO YOU ARE Early leadership theorists tried to identify a core set of demographic traits that characterized an effective leader: height, gender, heritage, speaking style. They also tried to identify personality traits and backgrounds that made leaders more effective. All to no avail. It turned out that successful leaders could come from a variety of backgrounds and display a variety of physical and personality traits. The only trait that seemed to consistently differentiate better leaders was being somewhat (not too much) smarter than their followers.²⁶ Traits eventually combined to form a leadership style, often a trade-off between people and task. Generally, leaders exhibited a preferred style, but the best leaders could be both soft and hard, caring about people and managing tasks. Defining effective leadership by looking inside a leader is still an active field, with some useful observations to offer. The focus is now on the core competencies—the knowledge, skills, and values—of successful leaders.²⁷ My colleagues and I have synthesized this competency-based work into what we call the leadership code, suggesting that leaders master five competency domains to be effective (strategy, execution, talent, human capital, and personal proficiency).²⁸ I discuss these domains in more detail in Chapter 2 and throughout the book. While many leadership theorists and advisers emphasize one competence area (for example, authenticity, emotional intelligence, strategy, execution, talent management, or human capital development), my colleagues and I have found that effective leaders master all five competency domains to be effective. Personal approaches to leadership primarily focus on helping leaders become more attuned to who they are and who they can become to be effective.

WHAT YOU DO FOR OTHERS IN YOUR FIRM Leadership theorists eventually recognized that looking inside the leader was not enough to define effective leadership. Leaders also had to deliver results according to the task at hand. Part of this effort was to determine which leadership approaches worked in which situations. In this view, effective leadership depends on the requirements of the situation. Situations may vary by maturity of team members, complexity of the tasks at hand, time horizon for doing the work, or uncertainty in predicting outcomes of the work. Any individual leadership style will work better in some situations than in others, and truly effective leaders can tailor their style to the needs of the moment.²⁹ The other part of looking to others means that leadership effectiveness is less about a personality trait and more about how leaders help make organizations more effective. Leaders can drive organization effectiveness through employees, organization cultures, or financial performance.³⁰ The impact of leadership on employee performance has been studied extensively.³¹ Leaders' actions shape employee sentiment at work, a phenomenon that may show up as satisfaction, commitment, and engagement—or the reverse. Thousands of studies have shown that leaders drive employee response to work.³² Leaders also create strategies that differentiate their firms for long-term success.³³ In addition, leaders shape an organization's culture or identity. Culture has often been represented as the values, norms, beliefs, and unwritten rules of an organization, and it tends to take on the personality of the leader.³⁴ Leaders create culture through managing people, performance, information, and work practices.³⁵ Culture in turn drives financial performance.³⁶ Leaders also drive financial performance within a firm. Many studies have shown that leadership has about a 12% to 14% impact on firm performance.³⁷ In one study, extraordinary leaders doubled company profits.³⁸ Strategic leaders help make choices that help position their organizations for success.³⁹ For example, in her research, Alison Mackey wanted to find out how much CEOs affected firm performance. She looked at fifty-one firms over ten years w