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MANAGING ORGANIZATIONS

Turning Potential into Success: The Missing Link in Leadership Development

by Claudio Fernández-Aráoz, Andrew Roscoe, and Kentaro Aramaki

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Organizations around the world are failing on one key metric of success: leadership development. According to research from the Corporate Executive Board (CEB), 66% of companies invest in programs that aim to identify high-potential employees and help them advance, but only 24% of senior executives at those firms consider the programs to be a success. A mere 13% have

confidence in the rising leaders at their firms, down from an already-low 17% just three years ago. And at the world's largest corporations—which each employ thousands of executives—a full 30% of new CEOs are hired from the outside.

The problem isn't a lack of internal talent. At Egon Zehnder we've been measuring executive potential for more than 30 years, and we've identified the predictors that correlate strongly with competence at the top. The first is *the right motivation.* This generally means a fierce commitment to excel in the pursuit of big, collective goals but, to a great extent, is contextual. For example, the leaders of a large charity and of an investment bank will need different kinds of motivation. This predictor can't easily be rated or compared meaningfully across individuals. However, the other predictors—*curiosity, insight, engagement,* and *determination*—can be measured and compared. And when we look at how managers in our global database (who come from thousands of companies in all sectors and are mostly in the top three levels of the hierarchy) score on those four key hallmarks, we find that 72% of them demonstrate the potential to grow into C-suite roles. In addition, 9% have what it takes to become competent CEOs.

Unfortunately, many organizations haven't figured out how to fully develop their prospective leaders. That limits these people's advancement and eventually their engagement and, ultimately, leads to turnover. Recent research from Gallup shows that 51% of U.S. managers feel disconnected from their jobs and companies, while 55% are looking for outside opportunities. And the problem cascades down: According to two comprehensive studies from Indeed.com, the most popular U.S. job-search website, 71% of employees are either actively hunting for or open to a new job, while 58% review postings at least monthly. The average rate of employee turnover (of which about three-quarters is voluntary) has been growing steadily for the past six years. In 2016 it hit a new high of 20.3% in the United States, and it's much higher in the most attractive sectors. The stats in other countries are comparable.

Low engagement and high turnover are extremely costly for organizations, especially if the people jumping ship are high potentials in whom much has already been invested. How can companies prevent this massive waste of talent and create more-effective development programs?

- First, by determining the most important competencies for leadership roles at their organizations. In our leadership advisory services at Egon Zehnder, we've identified seven that we believe are crucial for most executive positions at large companies: *results orientation, strategic orientation, collaboration and influence, team leadership, developing organizational capabilities, change leadership,* and *market understanding.* In addition, many leading companies are finding that an eighth—*inclusiveness*—is essential to executive performance.
- Second, by rigorously assessing the potential of aspiring managers: checking their motivational fit and carefully rating them on the four key hallmarks—curiosity, insight, engagement, and determination. (See the June 2014 HBR article "21st-Century Talent Spotting" for a primer on this.)
- Third, by creating a growth map showing how a person's strengths in each of the hallmarks aligns with the competencies required in various roles.
- Fourth, by giving high potentials the right development opportunities—including job rotations and promotions they might not seem completely qualified for but that fit their growth maps—as well as targeted coaching and support.

Companies like Japan Tobacco and Prudential PLC, the British multinational life insurance and financial services group, have used this approach to enhance their talent development programs and boost their internal leadership pipelines. Following it requires deep commitment from senior executives and some investment in the human resources function. But the cost of inaction is greater: As competition for smart and able managers heats up around the world, organizations can't keep ignoring and demoralizing internal talent while filling their C-suites with expensive external hires. They must learn to grow their own leaders.

Getting a Read on Needs and Skills

Before an organization can begin mapping managers' potential to required competencies, it must determine what exactly it needs. That will vary from business to business. A company recently acquired by a private equity firm would probably want to make results orientation a priority, while the management of an old-fashioned bank trying to stay relevant in a digital age might need keen market understanding and a strategic orientation.

Requirements will vary from role to role within firms as well. Let's consider the competencies that the board of one pharmaceutical company we worked with projected that its CEO, CFO (who was also the chief strategy officer), and business unit heads would need three years down the road, given its midterm strategy. Like all chief executives, the CEO had to have strong strategic and results orientations. But this particular company was trying to adapt to the digital era and to become more diverse in its people and more flexible in its way of working, so the board also highlighted inclusiveness and team and change leadership as priorities. For the CFO—who would be tasked with overseeing the implementation of the new strategies—collaboration and influence, change leadership, and strategic orientation were deemed must-haves. And for the unit heads, who would be on the front lines of strategic and cultural change and also responsible for hitting demanding budgets, the key competencies were results orientation, developing organizational capabilities, team leadership, and inclusiveness.

Your organization should similarly aim to identify the competencies that are most crucial for its top roles in light of its own challenges and goals. We suggest rating the level of proficiency needed in each competency for each role on a scale from 1 to 7. (For a more detailed explanation of how to translate skill levels into numerical scores,

see the exhibit “Levels of Competence.”) C-level positions typically require a rating of at least 4 in the competencies critical for those roles, and CEO positions, a rating of at least 5.

Levels of Competence

We evaluate executives on their mastery of eight leadership competencies (listed in the far left column), assessing where they fall on a spectrum from 1 (baseline) to 7 (extraordinary). We have found that four traits—curiosity, insight, engagement, and determination—predict how far managers will progress. Below each competency are the traits linked to strength in it.

COMPETENCY PREDICTED BY: C Curiosity D Determination E Engagement I Insight

	LEVEL 1	LEVEL 2	LEVEL 3	LEVEL 4	LEVEL 5	LEVEL 6	LEVEL 7
RESULTS ORIENTATION C D	Completes assignments	Works to make things better	Achieves goals	Exceeds goals	Improves firm’s practices and performance	Redesigns practices for breakthrough results	Transforms business model
STRATEGIC ORIENTATION C I	Understands immediate issues	Defines plan within larger strategy	Sets multiyear priorities	Defines multiyear strategy for own area	Changes business strategy in multiple areas	Creates high-impact corporate strategy	Develops breakthrough corporate strategy
COLLABORATION AND INFLUENCE C D E	Responds to requests	Supports colleagues	Actively engages with colleagues	Motivates others to work with self	Facilitates cross-group collaboration	Establishes collaborative culture	Forges transformational partnerships
TEAM LEADERSHIP C E	Directs work	Explains what to do and why	Gets input from team	Inspires team commitment	Empowers teams to work independently	Motivates diverse teams to perform	Builds high-perfomance culture
DEVELOPING ORGANIZATIONAL CAPABILITIES C E I	Supports development	Encourages others to	Actively supports team	Systematically builds team’s	Aids development	Builds organizational	Instills culture focused

efforts	develop	members' growth	capability	outside team	capability	on talent management
CHANGE LEADERSHIP C D E I						
Accepts change	Supports change	Points out need for change	Makes compelling case for change	Mobilizes others to initiate change	Drives firmwide momentum for change	Embeds culture of change
MARKET UNDERSTANDING C ◯ ◯ I						
Knows immediate context	Knows general marketplace basics	Investigates market and customer dynamics	Deeply understands market	Generates insights about market's future	Identifies emerging business opportunities	Sees how to transform industry
INCLUSIVENESS C ◯ E I						
Accepts different views	Understands diverse views	Integrates other points of view	Functions well across diverse groups	Facilitates engagement between factions	Strategically increases employee diversity	Creates inclusive culture

SOURCE EGON ZEHNDER
FROM "TURNING POTENTIAL INTO SUCCESS: THE MISSING LINK IN LEADERSHIP DEVELOPMENT," NOVEMBER–DECEMBER 2017, BY CLAUDIO FERNÁNDEZ-ARÁOZ, ANDREW ROSCOE, AND KENTARO ARAMAKI

You should cascade this process down through the ranks so that you have a clearer idea of the key skills needed to do lower-tier managerial jobs, too. With all positions, however, you must resist the temptation to demand high levels of all competencies, because you'll never find leaders who are perfect. In a study of more than 5,000 executives at 47 companies we conducted with McKinsey, we found that only 1% had an average proficiency score of 6 or better, and just 11% had an average score of 5. So even for the most senior positions, you should seek above-par scores in most competencies and stand-out scores in just two or three.

The next step is to comprehensively assess future leaders' current competencies and their potential for growth. You can do this through a deep review of their work experience; direct questioning; and conversations with their bosses, peers, and direct reports. To get the best information out of people and their colleagues, pose open-ended questions and probe. For instance, to get a read on how much determination

managers have, ask about a time something went badly for them and how they responded. To assess their competence at developing organizational capabilities, press for details about the people they've mentored. You should score each person on each hallmark of potential; at Egon Zehnder we use a scale of 1 (emerging) to 4 (extraordinary) for this. You should also score each person on his or her current level of each core competency (using the 1-to-7 scale), creating a snapshot of where he or she stands.

> Resist the temptation to demand high levels in all competencies.

With this information, you can now take the critical third step: predicting where each executive is likely to succeed. Having compared our 30 years' worth of executives' baseline scores with information about their eventual career growth, we can tell you that there are patterns in how individual hallmarks translate to the eventual mastery of leadership competencies. Curiosity is significantly correlated with all eight, so strong scores in it are a prerequisite for anyone being considered for development and promotion. However, the three other hallmarks are each correlated with different competencies and can therefore help us project how leaders will develop. For example, and perhaps not surprisingly, insight is a good predictor of the ability to develop a strategic orientation and market understanding. On a more granular level, we estimate that someone with a score of at least 3 (out of 4) on that hallmark (and on curiosity) should be able to achieve, with the right support, a level 5 competency (out of 7) in strategic orientation. We've also found that people with high determination scores can build the strongest results orientation and change leadership competencies, while those with high engagement scores are likely to be strongest in team leadership, collaboration and influence, and developing organizational capabilities.

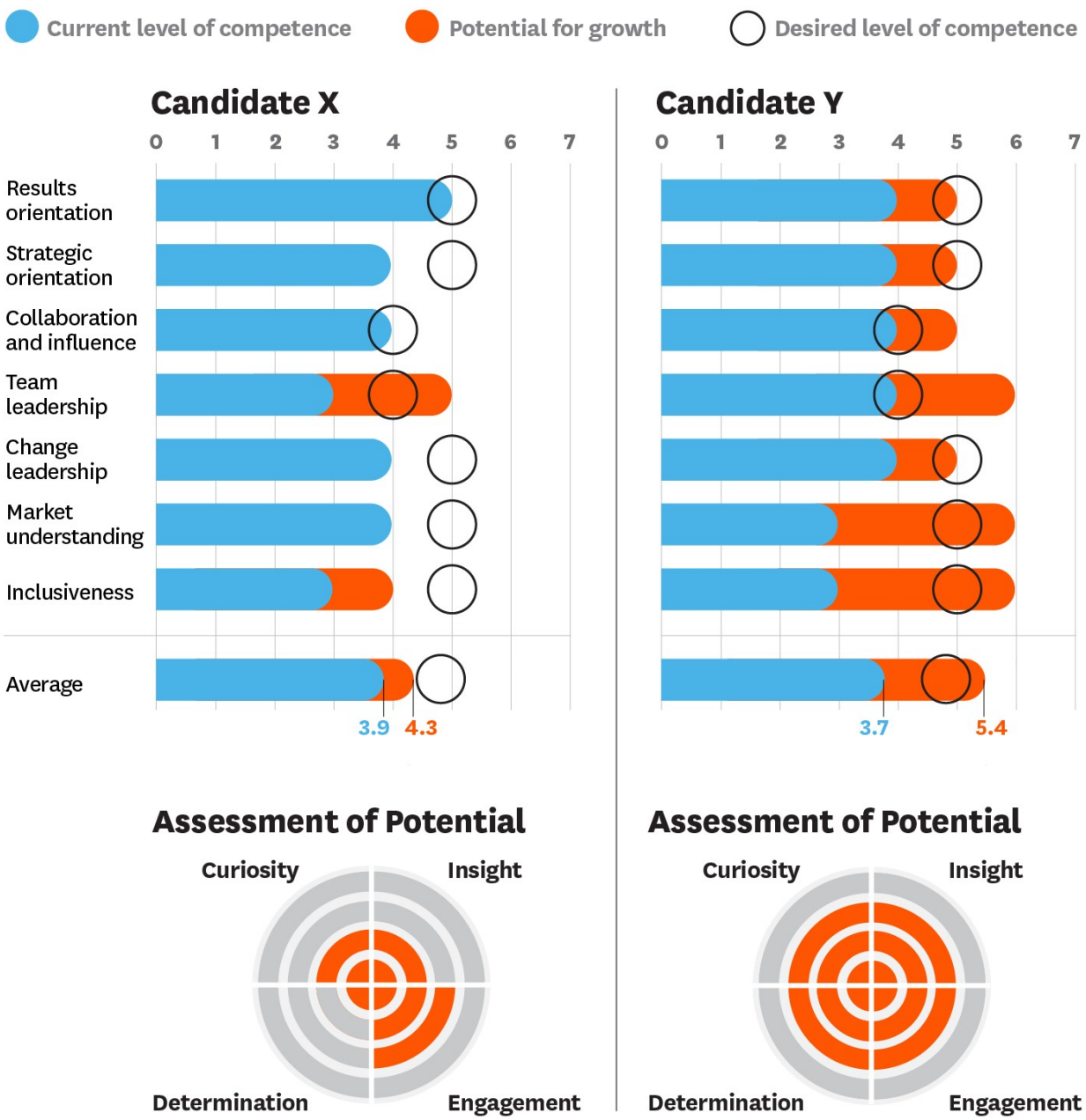
Armed with assessments of your emerging leaders' current competencies and potential for growth in each area, you will be in a much better position to make development and succession plans throughout your organization. And that will help you ensure that you have a strong pipeline of people to fill C-suite roles in the future.

The experiences of a major global manufacturer we advised illustrate how this works. The company's CEO was due to retire in a year, and the board was trying to decide who should replace him. When we appraised two internal candidates, X and Y, we found that they had comparable strengths but very different profiles. At the time X, a veteran operator in the company's core business, had a higher level of two competencies critical to the CEO job—results orientation and market understanding. But his lower scores on determination, insight, and curiosity revealed that his potential for growth was more limited. Y, who had come up through the ranks in an emerging business, was by contrast slightly weaker on current competencies but, with strong scores on all the hallmarks, showed significantly more potential to perform well as a CEO.

Comparing Two Candidates

When X and Y are evaluated on their current levels of the competencies needed for the CEO position at a global manufacturer, X looks like the better candidate. He is closer to the company's targets for the role.

But when potential is measured, Y begins to shine. His assessment indicates that he could develop his skills beyond X's.



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When the board reviewed these findings, a heated discussion ensued. One senior director argued adamantly for the appointment of X, who had slightly stronger competencies and had deep exposure to the core business. Another director strongly favored Y because of his higher potential. A third director favored an external search given the need for a fully qualified, competitive CEO in just one year. Eventually, the group landed on a creative solution: Ask the current chief executive to stay an extra year, during which he and the board could offer customized development programs to both internal candidates and then monitor their growth.

This is the fourth key step in turning high potentials—at all levels—into leaders: Give them the opportunities, coaching, and support they need to close the gap between their potential and their current competencies. For example, a highly curious, insightful person might be assigned to strategic-planning and innovation projects. Highly determined people should be involved in business-unit turnarounds and cultural-change efforts. Employees with high levels of engagement should be asked to manage small teams and work with key clients.

Well-planned job rotations are also crucial. A survey of 823 highly successful senior executives conducted by Egon Zehnder revealed that the vast majority of them consider stretch assignments and job rotations to be the most important way to accelerate a career. Yet according to a yearly survey of 500 companies by HBS professor Boris Groysberg, these talent practices are actually ones that organizations are the worst at.

The most effective rotations are tailored to individuals' development needs. To strengthen results orientation, for instance, you should move managers through jobs where they'll have P&L responsibility, oversee a start-up initiative, or help implement

a restructuring. If the goal is to strengthen someone's inclusiveness competency, rotations through regional businesses and corporatewide functions are a good approach. (For more on how to use assignments to build specific competencies, see the exhibit "Matching the Hi-Po to the Job.")

Matching the Hi-Po to the Job

Specific kinds of stretch assignments help executives build individual leadership competencies. To strengthen their results orientation, for instance, you can put them in jobs where they'll manage a P&L, run a start-up, or oversee a restructuring.

	Leading a large organization	Managing a P&L	Leading multiple regions or businesses	Managing a corporate-wide function	Running a start-up operation	Overseeing a restructuring
Results orientation		•			•	•
Strategic orientation				•	•	
Collaboration and influence			•	•		
Team leadership	•	•				•
Developing organizational capabilities	•				•	
Change leadership				•		•
Market understanding		•	•		•	
Inclusiveness			•	•		

SOURCE EGON ZEHNDER

To help your high potentials build their strengths and make the most of opportunities, you can provide individual coaching and group interventions (which might, say, help their teams create a better sense of identity and purpose). At the global manufacturer that was preparing to replace its CEO, candidate X was given coaching to help him build people-related competencies, while candidate Y was tasked with leading P&L improvements in multiple regions to increase his market understanding and his inclusiveness, which were significantly below the level the firm thought a "fully qualified" CEO should have. A year later the executives were assessed again, and while both had improved, Y's growth well outpaced that of X, to the point where their competencies were nearly equal. The board decided to offer the CEO job to Y, who went on to successfully implement major change programs and growth initiatives, including mergers and acquisitions. He quadrupled the company's operating income while increasing return on equity from 3% to 11%.

An example of how targeted development works at lower levels comes from an Asia-based global manufacturer, whose CEO was concerned about the slow progress of a diversity initiative. One of its goals was to propel women up the ranks, but none had so far been identified as high potentials by their bosses. The CEO decided to launch a pilot program that involved assessing 10 female managers selected by the head of HR for both potential and competence. The results were striking: The assessments showed that most of them had the attributes necessary to succeed in senior executive roles down the road.

Z, a 30-something corporate planning officer, was one of the women selected. Because of her strong curiosity and engagement, her average potential competency was a high 4.7, but her average current competency score was a low 2.6. And in a

couple of areas—strategic orientation and the development of organizational capabilities—she fell well under the target levels for her next possible role and far short of those needed for more-senior jobs.

Capturing the Female Advantage

Women are still underrepresented in the top echelons of corporations today. In an effort to learn why, we dug into our global database of ratings of executives' potential and competence, to see how the women compared with their male counterparts. The results were telling:

On average, women's scores trail men's on five of the seven key competencies of leaders. While all the differences are statistically significant, they're large in only two areas: strategic orientation and market understanding.

However, women score higher than men on three of the four hallmarks of potential—curiosity, engagement, and determination—while men have a slightly stronger level of insight. Again, the differences are statistically significant but not too large, except in the case of determination, where the female executives we've assessed scored much higher than their male peers.

However, further research showed that the company had failed to help her build those skills. She'd never been asked to manage her own team or lead strategy projects. Her bosses worried about "burdening" someone so "junior" with such big assignments, and Z herself admitted that she lacked confidence.

But the assessment results helped change those attitudes. As the person with the strongest potential scores among all her peers in her department, Z started to get—and embrace—more challenging work. The CEO soon appointed her to head up strategy at a large U.S. subsidiary and supported her by enrolling her in an executive business program and asking the chief human resources officer to serve as her mentor. Z spent a year and a half overseeing multinational projects and proved to be an excellent team builder and strategist. The CEO then asked her to return to headquarters and promoted her

How can we reconcile these findings? Why do women have higher potential but less competence than men? We believe it's because women are typically not given the roles and responsibilities they need to hone critical competencies. How can you develop team leadership if you're not given the chance to manage a team, or strengthen your strategic orientation if you never participate in any planning discussions or strategic projects?

to head of alliance management, where she is now effectively leading a sizable group.

Organizations must make trade-offs between current competence and potential.

The stories of Z and X and Y highlight the fact that for most executive appointments, and especially successions at the top, organizations must make trade-offs between current competence and development potential. A sound estimate of how far each of your top leaders can go will allow you to do that in a less risky, more effective way.

Real Results in Practice

When companies take this approach to leadership development—focusing on potential and figuring out how to help people build the competencies they need for various roles—they see results.

Shortly after Japan Tobacco's privatization, in 1985, the company decided to globalize and to diversify into various businesses, including food and pharmaceuticals. Because of this it needed a new class of leaders. But in Japan hiring executives from the outside has long been highly unusual. In addition, most companies still tend to favor tenure over competence or potential in promotions. Japan Tobacco decided to stick with the first tradition but abandon the second. It

began to rigorously assess current leaders' potential and accelerate their development through frequent rotations and focused training. Since then, the company's high potentials have been "owned" by HR and "leased" to key departments under an initiative, currently labeled New Leadership Program, that is constantly tweaked with an eye toward future business scenarios. This approach to leadership development, together with sound strategic decisions, has produced impressive corporate results: After acquiring the British company Gallaher, in 2007, Japan Tobacco became the third-largest global player in the cigarette sector, and thanks to its profitable diversification across geographies and industries, it became the sixth-largest Japanese company in corporate value across all sectors.

Four years ago, Prudential PLC also decided to redesign its leadership development practices to match its global ambitions. At the time, management acknowledged that the existing talent-review process was "assessment-heavy but insight-light" and too focused on current capabilities. Senior leaders set out to revamp it by emphasizing rigorous succession planning across all divisions and regions. Though this change was led by the executive committee and board, development now cascades up rather than down and starts with conversations between HR leaders and line managers, who have been trained to spot future stars. Team managers openly discuss business imperatives, critical roles, and successors, all through the lens of potential, and unit leaders report back up to the group's CHRO and CEO, Tim Rolfe and Mike Wells, sharing details about why people were deemed high potentials and how over time they can grow into different roles across the organization. What have the results been? In 2016, Prudential had 19 openings in its top 100 global roles, including five at the executive committee level, and all but one were filled through internal promotions. The new approach has helped the firm find great leaders even for its most quantitative and analytical businesses, such as asset management, and allowed it to put unexpected people in highly critical roles. For example, Prudential recently

announced that it would move Raghu Hariharan, the director of strategy and capital market relations in the group head office, into a position as CFO of the firm's Asia business.

More organizations should follow these models. A scientific approach to talent development—focused on spotting high potentials, understanding their capacity for growth in key competencies, and giving them the experience and support they need to succeed—will be an extraordinary source of competitive advantage in the coming decades. And it will help many more managers transform themselves into the great leaders they were always meant to be.

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