The High Cost of Doing Nothing:

Quantifying the impact of leadership on the bottom line

Most executives instinctively know that strong leadership is essential for overall organizational success. However, in most organizations, there is a lack of urgency to improve leadership skills driven by a belief that an organization's current leadership capacity—and subsequent performance—is good enough. But is it? Analysis by The Ken Blanchard Companies® shows that the average organization is forfeiting over $1 million per year in untapped potential because of less-than-optimal leadership practices.*

In a recent article titled, "How Extraordinary Leaders Double Profits," authors Jack Zenger, Joe Folkman, and Scott K. Edinger make the extraordinary claim that there is enormous potential for organizations to improve their bottom lines by developing leaders who, for example, inspire people to perform at higher levels and who can recognize and remove obstacles to employee productivity. In fact, their research shows that good leaders can double profits.[1]

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Similarly, Laurie Bassi, cofounder of McBassi & Company and a former professor of economics at Georgetown University, has shown that organizations whose leaders eliminate barriers, provide feedback, inspire confidence, share information, and welcome new ideas outperform those that don't. In comparing the average three-year compound annual growth rate in income for high versus low sales offices in a major business, Bassi found that the growth rate for the higher-scoring offices ranged from 60% to 130% higher than the growth rate for offices with low human capital management scores.[2]

Strong leadership is not only important to the overall success of an organization; anything less has significant financial implications. In this white paper we will explore the impact that leadership has on employee productivity, employee turnover, and customer satisfaction. By looking at the effect that leadership has in each of these three areas, we believe it is possible for executives to begin to recognize and quantify the impact of average versus best-practice leadership in their organizations.

EMPLOYEE PRODUCTIVITY

The connection between leadership practices and employee productivity is well documented and presents the largest opportunity for most organizations today. In a 1995 study of nearly 1,000 firms, Mark Huselid of Rutgers University found a statistically significant correlation between high-performance work practices and intermediate employee outcomes such as turnover, productivity, and overall corporate financial performance. The factors that impact employee productivity include selection, performance management and appraisal processes, as well as development strategies that include training, coaching, and mentoring.[3]

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* *Based on initial results of participants using Blanchard's Cost of Doing Nothing Calculator (www.costofdoingnothing.com)*

Providing employees with the tools, resources, direction, and support they need to perform at their best are just some of the factors that lead to a high-performance work environment. In addition, leaders need to consider systemic organizational obstacles that might be present in the work environment. When any of these factors are left to default instead of design, the result is generally less than optimal productivity. In fact, in discussing these barriers to employee development and their subsequent impact on productivity with senior executives around the world, most senior executives have assessed that their workforce is operating at only 60% to 65% of their potential.[4]

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As surprisingly low as this may sound, it is very similar to the results of a large survey of 1,300 private-sector companies conducted by Proudfoot Consulting in 2002. In that survey, conducted with companies from seven of the world's leading economies, Proudfoot found that, on average, only 59% of work time is productive.[5] What gets in the way of higher employee productivity? According to Proudfoot, there are three major causes:

- Insufficient planning and control (43%)
- Inadequate management (23%)
- Poor working morale (12%)

As Tor Dahl, former president of the World Confederation of Productivity Science and a member of the Board of Directors for the American Productivity and Quality Center, explains, "Although most people are working very hard these days, we have found that each individual in an organization can still increase productivity by at least 30%. How can that be? The answer lies in the fact that most workers, often of no fault of their own, are not working on the right things in the right way. The culprits are a variety of organizational 'ills,' including lack of clear directions and goals, sub-optimized processes, excessive paperwork and reporting requirements, unproductive meetings, inappropriate systems and tools, etc."[6]

What's Possible with Better Leadership?

Research published by The Ken Blanchard Companies in 2006 identified strategic leadership and operational leadership as two of the factors that most impact employee passion, and subsequently, overall organizational vitality.[7]

From a strategic perspective, this means that leaders need to set the tone and direction for their organizations by creating a strong vision, an empowering culture, and a strong set of strategic imperatives. From an operational leadership standpoint this means that leaders need to provide people with the day-to-day direction and support they need to do their best. The maximum benefit occurs when both strategic leadership and organizational management practices are aligned.

While it is unrealistic to expect workers to be 100% productive through every working day, Blanchard believes that most organizations are operating with a 5% to 10% productivity loss that better leadership practices could eliminate. Using data from a Situational Leadership® II implementation involving 300 managers and 1,200 direct reports at a large financial services firm, this study showed that the organization achieved a 5%-12% increase in productivity among direct reports of managers who attended the leadership development training and became better leaders using the new skills they had learned.[8]

EMPLOYEE TURNOVER

Retaining skilled, motivated, and experienced employees is a continual challenge for most organizations. While economic cycles can temporarily increase or decrease the number of available applicants in the job market, it is always in a company's best interests to keep skilled and experienced employees after they have joined the firm's workforce. This is due to the fact that there are several different costs associated with replacing an experienced employee, including:

- The cost of covering the position while vacant
- The cost of finding a replacement
- The cost of getting a new person up to speed

These costs directly impact a company's financial performance. As Seymour Burchman, a principal at the global management consulting firm Sibson & Company, points out, "Employee turnover has a significant effect on companies' top lines by inhibiting their ability to keep current customers, acquire new ones, increase productivity and quality, and pursue growth opportunities." According to Sibson, this can result in a 16%–50% cost as a percent of industry earnings.[9]

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Additionally, according to Saratoga Institute, a leading authority on turnover and retention, between 9% and 32% of that cost is directly attributable to poor management practices. In research conducted through anonymous exit interviews with 19,000 people leaving organizations, Saratoga Institute found that people leave organizations for a variety of reasons closely related to leadership competencies including[10]:

- Lack of respect from or support by supervisor (13%)
- Supervisor's lack of leadership skills (9%)
- Poor employee relations with a supervisor (4%)
- Lack of recognition (4%)
- Supervisor incompetence (2%)

In a typical organization, the cost of poor leadership and subsequent employee turnover can run well into the hundreds of thousands of dollars, depending on an organization's current turnover rate and the specific positions being lost. While there are many models for calculating the cost of turnover in an organization, a conservative estimate is 30% of annual salary to replace a lower-skilled, entry-level employee, to as much as 250% of annual salary to replace a highly specialized or difficult-to-replace position. For organizations looking for a general benchmark to cover employees of all types, Saratoga Institute uses a 100% replacement cost for its calculations.

Employee Retention Benchmark

While it may not be possible to retain 100% of the skilled and experienced people your organization would like to keep, Blanchard believes that the average organization could reduce turnover by approximately 9% by improving the levels of respect, recognition, direction, and support supervisors and managers provide to direct reports.

For organizations that are unsure of benchmark retention rates for their industries, we recommend the Web site for the U.S. Department of Labor's Bureau of Labor Statistics at www.bls.gov. For industries that are not listed, a good minimum standard would be to improve upon the U.S. national rate of 20%.[11]

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CUSTOMER SATISFACTION

Improving leadership practices can likewise improve customer satisfaction scores and thus reduce the resulting negative financial impact that lower scores cause. Best-in-class service providers typically achieve customer satisfaction ratings of approximately 85%, according to the American Customer Satisfaction Index, while average providers score closer to 75%.[12]

For the typical organization, this gap between average and exceptional satisfaction levels translates into a 3.8% reduction in revenue growth, resulting in hundreds of thousands of dollars of potential revenue loss for any organization generating $10 million or more in annual revenue.[13]

Anthony Rucci, Steven Kirn, and Richard Quinn first quantified this connection in the late 1990's when they identified that every 1.3% increase in customer satisfaction scores corresponded with a subsequent 0.5% increase in revenue growth. In an article originally published in the Harvard Business Review titled "The Employee-Customer-Profit Chain at Sears," the authors concluded that leadership practices which lead to higher employee satisfaction scores translated into higher customer satisfaction scores, and subsequently into bottom-line impact.[13]

Additional research by The Ken Blanchard Companies in 2006 confirmed the connections between leadership effectiveness, employee passion, customer devotion, and overall organizational vitality by identifying that[14]:

- Effective operational leadership directly predicts positive employee passion.
- Positive employee passion directly predicts customer devotion.
- Customer devotion directly predicts organizational vitality.

In looking at the specific, quantifiable impact that good management practices can have on improving customer satisfaction scores, The Ken Blanchard Companies believes that better leadership can generate a 3-4% improvement in customer satisfaction scores and a corresponding 1.5% increase in revenue growth. This is based on the results of an impact study evaluating the results of a Situational Leadership® II initiative with over 700 managers of a major retailer. The managers were trained and later evaluated by follow-up associate opinion surveys conducted with over 10,000 direct reports. The retailer also conducted customer satisfaction surveys after the implementation to evaluate the initiative's impact on the customer experience.

As predicted, direct reports perceived leadership skill improvements in all areas including their manager's ability to delegate, provide feedback, provide support, and provide directive behavior. Most importantly, the customer satisfaction survey showed a 3.8% improvement in overall customer satisfaction.[15]

Leadership Impacts the Bottom Line

In any economic cycle, the basics still apply—you have to have a good business plan, you have to take care of your customers, and you have to take care of your people. Leaders are an important part of that process. After all, it is leaders who help employees set goals; make sure that those goals are in alignment with overall corporate strategy: and who are also responsible for providing the direction and support that employees need to succeed at work on a daily basis.

Even though change—like a leadership development initiative—can be disruptive, difficult, and financially challenging, taking no action is often the most expensive option of all. In this white paper we have quantified the cost of doing nothing by looking at the impact that less-than-optimal leadership practices have on an organization. In our estimation, the average organization is leaving hundreds of thousands, and in most cases, millions of dollars on the table each year in three key areas—employee productivity, employee turnover, and less than satisfactory customer satisfaction scores.

One challenge that all organizations must address is the invisible drag on performance known as maintaining the status quo—the belief that conditions are good enough just as they presently stand. This is a serious deception that causes otherwise good companies to settle for less-than-optimal performance.

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In any economy, organizations need to make sure that they are getting the best out of their people by providing strong, consistent, and inspiring leadership. Today, the need to satisfy customers, create new innovative solutions, and get the most out of every dollar is even more important. By evaluating and improving leadership practices throughout their organization, executives can remove a persistent drain on financial performance that allows their organization to grow and thrive.

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