

# The Hefty Underestimated Costs of Average and Poor Leadership and the Four Keys to Performance Break-Thru



Research shows 80% of leadership performance is well below the waterline and the cost is much higher than you imagine

(The Pareto Distribution)

[www.onirik.com.au](http://www.onirik.com.au)

**Author:** Geoff Wade, Principal Consultant, Onirik.

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## Executive Summary

Most organisations know that strong leadership is critical for overall success. And in most organisations this is accompanied by a lack of urgency to improve leadership skills. It appears to be driven by a belief that current leadership skills are good enough. But when we assess leadership the analytics consistently show that around 40% of critical (i.e. directly impacting results) leadership abilities are sub-optimal. Leadership ability is well short of good enough and this represents a significant untapped profit potential that is being forfeited.

In this paper I first review the evidence for the assumption that leaders directly impact performance. The case is compelling. Bad managers are bad for business, and they're even worse for their employees. Developing effective leaders is a critical business lever for success.

Then I draw upon academic and commercial research findings about leadership performance spreads and poor leadership costs make some realistic and conservative estimates for the cost of poor and average leadership. My calculations suggest the commonly referenced guideline that the cost of one poor leader, over one year, is around \$125K is overly conservative. A more realistic annual cost for one poor performing front-line or middle manager is \$400K. In some roles, like sales, it is over \$1M. In addition while the assumption is that only 15% of managers are poor performing the reality is that 80% of leadership is performing well below the waterline.

It's clear that leadership performance improvement is urgent, important and valuable for organisations. In my experience effective leadership performance improvement is one of the highest return on investment allocations (typically 400%) for limited company capital resources.

But, many companies give leadership development low priority and less than 10% of executives believe their organisations build leadership skills very effectively. Too many adopt the one-off training event approach to leadership development and this is guaranteed to fail.

So I conclude by talking about the four critical keys of leadership performance improvement that ensure your investment delivers measurable leadership behaviour change and commercial benefits. They are:

1. Start with a business purpose / commercial outcome in mind. Then identify the few skills required.
2. Start with and address mind-sets. Mind-sets are the foundation of effective action and process.
3. Treat leadership development as a process integrated into the rhythm of the business.
4. Measure the mind-set, behaviour and financial changes from your leadership interventions.

## Leaders Are the Primary Driver of Team Performance

Over the past century, developed countries have witnessed significant transformations; the industrial economy (making tangible goods) has largely been superseded by the service economy (delivering knowledge solutions). In Australia over 73 percent of the workforce is employed in knowledge intensive services (Boedker, Binney, and Guthrie, 2007). When people and their knowledge, rather than machines, are your “production engine” then effective leadership is critical.

Poor leadership is the primary cause of low team performance (Society for Human Resource Management, 2005). Effective leadership delivers 25% higher productivity and 65% higher returns on capital (Bloom Lemos, Sadun, Scur, and Van Reenin 2014). Your managers hold the key to unlocking the rapid performance improvements you want. In fact, your managers are the ones who are directly responsible for the state of sales, operations, safety or service you’ve got right now. It’s not your frontline staff who are at fault.

Sales teams being led by world class leaders generate six times more than teams with the worst managers (Folkman, Sherwin, Steel, and Zenger, 2012), and almost double that of teams with average managers (Bassi, L. and McMurrer, D, 2007; Edinger, Folkman, and Zenger, 2009; Weinberg, 2015). Turning your managers into world class leaders is the way increase growth rate and to rapidly more than double profits.

For service delivery, poor managers lead to low service levels (Edmonds SC. 2012; Wilson, Bitner, Gremler, and Zeithaml 2012; Cheng, Chiu, Hui, Tse, and Yu, 2007). When discussing barriers to performance most senior executives concede that their workforce is operating at only 60% to 65% of their potential (Blanchard, K 2004 and 2009). Turn your managers into world class leaders and you’ll rapidly increase productivity, service delivery, and net promoter scores.

Managers are responsible for at least 70% of the variance in employee engagement scores across business units (Gallup, 2015 and Huselid, 1995). Hence the famous quote, “People join organisations and leave their managers.” (Buckingham M and Coffman C, 1999). When your managers become world class, engagement will quickly increase too.

### *Bad managers are bad for business, and they’re even worse for their staff.*

I’ve only referenced a modest number of sources but in my research there is consistent and overwhelming evidence that poor leadership correlates directly with low team performance and a high opportunity cost. These findings have led my peers and I to establish a habit of asking senior leaders the following three questions. I invite you to answer them for yourself.

The first is, “Do you have the right leadership team to realise your vision, strategy and goals?” Over the decades that we’ve asked this question of thousands of senior executives the majority have answered “No.”

This naturally leads to our second question, “What is that costing you?” The answer varies depending upon the size of the organisation. But every time it is an unacceptable cost, usually estimated in millions of dollars, even for small organisations.

Our third question, “So, what are you doing to up-skill or replace your poor performing leaders?” is all too often answered with an embarrassed silence or the justification, “Nothing; because past development and training produced no measurable and lasting improvement.”

I agree that stand alone leadership training is of little value and it is surprising to me that so many executives have done nothing or given up. In my experience the leadership performance improvement problem is soluble and delivers an extra-ordinary payback on the investment required. There are four keys to leadership improvement, that we have tested and proven across more than 10,000 managers among our client base. These are provided after analysis of the misunderstood and underestimated high costs of poor leadership.

## Why the Economic Cost of Poor Leadership Underestimated

While there is a unacceptable human cost to poor leadership, this paper will not address it. Wellbeing, including workplace stress and anxiety, collectively cost the Australian economy \$190 billion annually, equal to 12% of GDP (Boedker, Binney, and Guthrie, 2007). It causes the loss of nine million working days every year. According to the South Australian Health and Medical Research Institute (SAHMRI), human wellbeing is the single most important issue for our population, economy and way of life.

I'll also exclude discussion of senior managers because the group is small; and in these roles one delayed decision, or wrong decision, usually costs millions, or tens of millions. No one disputes the cost of poor senior leadership - it can break the company.

I will bring your attention to, and make some calculations for, leaders in front-line through middle manager roles. These front-line management levels account for more than 80% of leadership and directly impact a similar percentage of the organisation's staff. Their 'poor performance cost,' as a group, is worth exploring.

I will focus primarily upon productivity and turnover costs. These are well researched, published, quantified and more tangible than the cost of poor workplace wellbeing, dissension or poor decisions.

First I'll talk briefly about statistics. I'll keep it simple. And for the non-mathematically inclined I assure you it's necessary to dispel a common misconception about the scope of low and average leader performance.

### Leadership Performance Follows a Paretian Distribution

The 'Bell Curve,' in the image below, represents what statisticians call a 'Normal Distribution' or 'Gaussian Distribution.'

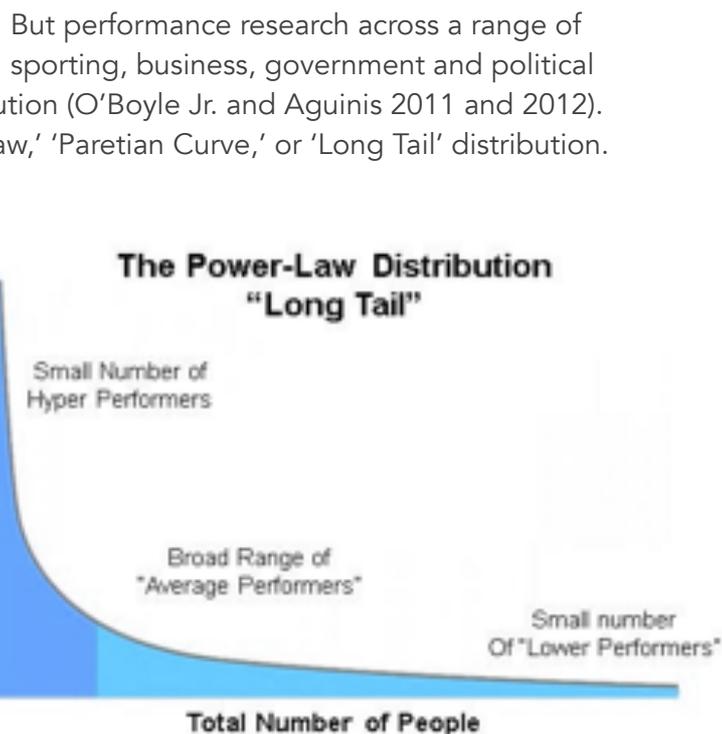


A normal distribution is a sample with an arithmetic average and an equal or symmetric distribution above and below average. This model assumes that there are groups of people one standard deviation above and below the mean. We call these low or high performing and each group makes up around 16% of the population. There will also be a very small number of people two standard deviations above the average. Typically we call these 'hyper performing' and they make up between two and three percent of the sample population.

But performance research across a range of sporting, business, government and political professions shows 94% do not follow a normal distribution (O'Boyle Jr. and Aguinis 2011 and 2012). Rather these groups fall into what is called a 'Power Law,' 'Paretian Curve,' or 'Long Tail' distribution.

We've found the same in our work modelling experts and expertise. As roles and competencies shift towards greater levels of complexity and information density - like leadership - the result is a shift towards Paretian performance distributions. I've seen national and global leader performance distributions published as bell curves (Bloom, Lemos, Sadun, Scur, and Van Reenin 2014), but in my experience, and that of O'Boyle and Aguinis, the leadership distribution mostly does not fit this mathematical model.

In the Paretian Curve statistical model there are a small number of people who are 'hyper performing,' a broad swath of people who are



'average performing' and a smaller number of people who are 'low performing.' It has very different characteristics from the Bell Curve. It essentially accounts for a much wider variation in performance among the population. In the Power Curve most people fall below the mean. Roughly 10% of the population are far, i.e. more than two standard deviations, above the average, a large population are below average, and a small group are far below average. So the concept of 'average' becomes meaningless and the familiar Pareto 80:20 rule gives us the long tail image.

Think about how people perform in creative, service, and intellectual property businesses. There are superstars in every group. Some software engineers are 10 times more productive than the average; some sales people deliver two to three times their peers' sales; certain athletes far outperform their peers; musicians, artists, and leaders are the same. The 'hyper performing leaders' are often gifted in a combination of skill, passion, drive, and energy and they actually do drive orders of magnitude more value than many of their peers.

## The Paretian Curve Implications for the Enterprise Cost of Poor Leadership

Nobel Laureate P. W. Anderson, in 1997, said, "*Much of the real world is controlled as much by the 'long tails' of distributions as means or averages: by the exceptional, not the commonplace. We need to free ourselves from 'average' thinking.*" The recognition that around 95% of leadership performance follows a Pareto distribution appears to be a much deeper insight than you might realise. There are two components to this. One is the step size of the potential performance improvement. Two is that the bulk of the population can improve. Paretian performance distribution is significant concept.

The Bell Curve performance distribution sets expectations that moving from average to high leadership performance delivers one standard deviation improvement. Likewise moving from poor to high leadership performance delivers two standard deviations in performance improvement. But our experience with clients has mostly been the Paretian Curve prediction. Namely a shift from average to high leadership performance results in two to three standard deviations improvement. While moving from poor to high leadership performance yields between four and ten standard deviations of performance improvement.

I'll share the research that quantifies the value of a standard deviation improvement in performance later in this document. For now, I invite you to begin to perceive that there is the potential for leadership performance improvement to deliver far more significant business outcomes than the expectations you'd have if you've been using the prevailing Bell curve belief set. Effective leadership performance improvement project ROI's can run well into the triple digit digit percentages.

*Whatever the cost per individual leader, the Paretian distribution increases the total organisation cost by six times that of a Normal (Bell) performance distribution.*

By definition low performance is two standard deviations or more below high performance. With a Bell Curve spread of leadership performance you'd normally expect around 16% of managers to be low performing. With a Paretian Curve performance spread the difference between the hyper performers and average performers is more than two standard deviations. So, even the average performers are low performing. With a Paretian distribution you expect 80% managers to be poor performing relative to the hyper performers.

The Paretian spread of leadership performance has profound enterprise implications. Whatever the cost per leader, the Paretian distribution potentially increases the total organisational cost by a multiple of six times.

## Assessing a Realistic Total Cost of Poor Leadership

Development Dimensions International (DDI), a reputable researcher, suggest the annual cost of one poor leader is more than \$126K. They attribute this to low team productivity, high turnover and dissension in

the leader's team. Lighthouse, a leadership blog website, show calculations to support a claim the cost of a bad manager is \$192K per annum (Evanish, 2015).

I've estimated the cost of three consequences of poor leadership; low productivity, high turnover, and lost revenue. My calculations show these numbers are overly conservative and a more realistic annual cost of one poor leader is around \$350K. And in key sales / production / service roles the cost of poor leadership can easily exceed \$1M per leader per year.

## Employment Related Costs of Poor Leaders

### Organisational Productivity Cost

I'd like to start by looking at productivity, from an organisation wide perspective. What are the likely gains from moving from poor leadership to world class leadership, or from average leadership to world class?

Multiple research sources give consistent data on this:

1. Gallup (2013) the global average productivity difference between top and bottom quartiles organisations is 21%.
2. The Australian Industry Group (2015) the productivity difference between average and top quartile is 21%.
3. Ernst and Young (2013) Australian workers could be, on average, 21% more productive every day if they could change just one of two things. 'Poor management' and 'lack of motivation' were cited as the top two obstacles to productivity improvement.

You can see the expectation is fairly consistently around 20%. And if we conservatively assume a normal bell curve performance distribution:

- We know the average (the centre of the bell curve) is 21%, and the upper limit of the potential productivity improvement range is 42%; and
- We can assume the minimum productivity improvement potential is 0% for world class teams (by definition it can't be negative); and
- We can assume the range is the normal three standard deviations (which is conservative - our real world experience shows it is usually wider), and
- Then we can calculate that one standard deviation is  $(21/3)$  i.e. 7%, and
- For the 16% of the population, that are low performing leaders, when moved to high performing, they would realise gains in the range 35% to 42% for productivity.

And, if we use a Paretian Curve for leader performance distribution, then the spread of performance between the low performing and high performing leaders becomes much wider. We would expect, in moving low and average performance to hyper performance gains of six to 10 standard deviations. In other words in the range 42% to 70%.

*Australian workers could be, on average, 21% more productive every day.*

I trust that now you can begin to see how the extra-ordinary performance costs of poor leaders can be much higher than you have imagined. I have worked with organisations where the performance spread of teams and leaders was as wide as the Paretian expectations. And I've seen levels of improvement they found hard to believe. You can imagine the outcomes and the value of good leadership in these contexts.

### Specific Role Productivity Cost

Next I'd like to look at productivity from an individual perspective to see if it is consistent with the enterprise view. Much research has been published on the Economic Value Add (EVA) of competent performance in leadership and front-line roles. The researchers have determined the percentage of increased productivity attributable to competency vs. independent variables (Bloom, Sadun, and Van Reenen, 2010; Spencer, Berger and Berger, 2003; Hunter, Schmidt, and Judiesch 1990).

Researchers found that depending on the complexity of the job role, performance one standard deviation above the mean is worth between 19% and 120% productivity increase.

Job Complexity	Average Increased Productivity One Standard Deviation
Low	+19%
Moderate	+32%
High	+48%
Sales	+48% to +120%

These percentages are actual productivity or measured EVA ‘performance distribution’ figures; not merely ‘global estimation’ survey guesstimates by employees, managers, or human resource staff. The individual productivity cost of 19%, for simple roles, is consistent with the 21% cost from the organisational perspective productivity quoted in the section above. Albeit the individual perspective suggests much higher opportunity costs, 32% to 120%, resulting from poor leadership and poor performance for more complex roles. Numbers consistent with Paretian expectations.

### Putting a Value on Lost Productivity

It is relatively easy to assign an employment cost or salary value to lost productivity. I can use the average industry labour costs and compare with research data to make assessments for front-line roles.

First I’ll make some calculations for the salary / labour economic value of 21% lost productivity that results primarily from poor leadership. If I assume:

- The average span of control (i.e. team size) is nine (9) people (Neilson and Wulf, 2012).
- A 160 hour working month (which falls between a 35 hour and 40 hour working week).
- A direct productive labour cost of \$46 per hour; based on the Australian average salary of \$82K per annum (ABS, 2016; Living in Australia, 2016 - see the table opposite) and 11 working months or 1,760 productive hours per year.

Then a 21% increase in productivity recovers  $9 \times 21\% \times 1,760 = 3,330$  hours of lost productivity per year. And the increase in productivity is worth \$153K per annum per leader. You can easily make specific calculations for your enterprise.

### Turnover Cost

There are two components to turnover cost calculations. First is the employment cost. There are two parts to this - (a) the avoidable volume of turnover and (b) the cost per replacement. The employment cost is the product of the (a) and (b). The second component is the non employment related costs like slower growth rate and lower revenue. These are discussed in a separate section below. The total turnover cost of poor leadership is the sum of both.

The Deloitte Human Capital Trends report (Schwartz, Collins,, Stockton, Wagner, and Walsh, 2017) says 78% of business leaders rate employee engagement and retention as one of their top concerns. And leaders make or break retention. Employees of managers that respect their work are 32% less likely to look for a new job (Likavec and Troyani, 2016). A Gallup survey confirmed the number one reason people quit their jobs is a bad boss (Gallup 2013). And in 2015 an Approved Index survey of UK employees suggested 42% left a job because of a bad boss.

Average Australian Wages by Industry

Business Sector	Average Annual Wages
Accommodation, Cafes And Restaurants	\$56,113
Retail Trade	\$58,640
Other Services	\$64,704
Administration And Support Services	\$67,642
Manufacturing	\$72,332
Rental, Hiring And Real Estate Services	\$72,394
Arts And Recreation Services	\$73,148
Wholesale Trade	\$77,241
Construction	\$78,957
Transport, Postal And Warehousing	\$82,805
Health Care And Social Assistance	\$84,183
Public Administration And Safety	\$85,202
Education And Training	\$89,950
Professional, Scientific And Technical Services	\$92,482
Electricity, Gas, Water And Waste Services	\$94,396
Information Media And Telecommunications	\$96,652
Financial And Insurance Services	\$97,235
Mining	\$139,303

The Saratoga Institute, a leading authority on turnover and retention, in research conducted through anonymous exit interviews with 19,000 people, found that people leave organisations for a variety of reasons closely related to leadership competencies (Branham, 2005). Saratoga Institute say that around 32% of turnover cost is directly attributable to poor leadership practices (Branham, 2005).

So, we can accept managers have a direct impact on turnover and bad managers have higher turnover rates. How much higher?

Gallup reported that the difference between turnover for poor leaders and the best was 25% in high turnover organisations and 65% low turnover organisations (Gallup 2013). The average staff turnover for all industries in Australia is 16% (Begley, Hardwick-Slack, 2015). So, for a poor leader this means the turnover could be between 20% and 26% depending upon whether your industry is high turnover or low turnover respectively.

## Turnover Volume

You can look at turnover volume from the perspective of benchmarks - the best practice and the average for your industry, compared to the actuals for your organisation and for each leader. Poor performing leaders usually have higher turnover than benchmark. And it is the delta between high turnover rate and the best practice that is the real cost.

In one organisation we work with the industry best practice turnover rate is 8%, their industry average is 24%, their company average is 33% and their worst performing leaders have 40% turnover. The conservative delta cost is 16%, the difference between 40% and the 24% industry average (in other words a 40% reduction in turnover). Some would say it's 25%, the difference between 33% and the 8% (in other words a 76% reduction in turnover).

If you'd like to do some calculations for your company, the table above (ABS, 2016; Living in Australia, 2016) provides staff turnover rates by industry and you'll have the actual statistics for your company.

## Replacement Cost

The Centre for American Progress (Boushey and Glynn, 2012) estimates that the direct costs of replacing an employee with salary of \$30,000 to \$50,000 a year costs 20% of that salary. And the process takes 52 days on average.

Average Turnover Cost

Job Type / Category	Average Turnover Cost (as a % of salary)
Entry Level - Hourly, Non Skilled	30% - 50%
Skilled Hourly	70% - 100%
Technical	100% - 150%
Engineers	200% - 300%
Specialists	200% - 400%
Supervisors / Team Leaders	100% - 150%
Middle Managers	125% - 200%

Staff Turnover Rates by Industry

Industry	Years in Job Before Change	Turnover Rate %
Accounting	6	17%
Administration	3.5	29%
Advertising, Arts, Media	3	33%
Aviation	2.5	40%
Construction	3.75	27%
Design & Architecture	4	25%
Education	5.5	18%
Engineering	4	25%
Government & Defence	3.75	27%
Healthcare	3.5	29%
Hospitality & Tourism	2	50%
Insurance & Superannuation	4	25%
IT	3.5	29%
Management	3	33%
Manufacturing	2.5	40%
Mining	9.5	11%
Other	6	17%
Real Estate	4.5	22%
Retail	2.75	36%
Sales & Marketing	5.5	18%
Trades & Services	7.5	13%

But when you add in the indirect costs, the total cost sits in the range 1.5 and 2 times the person's salary (Phillips, 2009). Most replacement cost estimates address only out-of-pocket cost and exclude:

- Exit costs involved in the process of terminating the employee.
- Overtime costs that are incurred as remaining staff work extra time to compensate for the resource loss.
- The internal screening and interview costs.
- The cost of training the new recruit and their ramp up time.
- Intangible costs like loss of business opportunity.

The table on the above shows some average replacement costs estimates, as a percentage of salary, for a range of jobs (Phillips, 2009).

## Putting a Value on the Turnover Cost of Poor Leadership

I'll work with an example in an industry that employs skilled hourly labour. If we assume:

1. The average labour cost of \$82K per annum (ABS, 2016; Living in Australia, 2016).
2. The replacement cost of 70% of salary (Phillips, 2009).
3. The example I referenced above where the conservative delta cost was 9%, i.e. the difference between the average turnover at 33% and the industry average of 24%.
4. We will also compare the delta cost of 32%, the difference between the worst case 40% turnover and the industry best practice at 8%.

The conservative cost of turnover for one leader of 9 people becomes  $9 \times 9\% \times \$82K \times 70\% = \$46.5K$  per annum. If we use the 32% delta the cost is  $9 \times 32\% \times \$82K \times 70\% = \$165K$  per annum.

I can do similar calculations using the Gallup's finding that good leadership reduces turnover by 25% and 65% for high turnover or low turnover industries respectively. The results is a consistent cost of turnover, within the leader's team of direct reports. For the 25% case  $25\% \times 9 \times 40\% \times \$82K \times 70\% = \$52K$  and for the second case  $65\% \times 9 \times 40\% \times \$82K \times 70\% = \$134K$ .

Various factors drive the turnover differential between actual and best practice and not all can be attributed to leadership. The researchers like Saratoga and Gallup say that between 32% and 70% can be laid at the door of leaders. So, to be conservative, I can discount my numbers by 68%, assuming only 32% of the delta is ascribed to leadership. One could also argue that as I'm only working with the delta between leader actual and industry averages an allowance for non-leader causes has already been made.

Even when discounted turnover cost is added to my productivity cost, you are now looking at a result that is double the DDI calculation. And we haven't yet considered the lost revenue growth or the impact on revenue and margin of high value jobs like sales and production.

## Other Opportunity Costs Related to Poor Leadership

Salary appears to be the basis for the DDI estimates for the cost of poor leadership. The Lighthouse calculations were detailed in the source and clearly based on salary alone. What the research shows is that most leaders and employees in key roles with direct impact on business results (i.e. valuable jobs like sales, production, service delivery) can leverage economic benefits that are vastly greater than the salary or employment costs alone because they impact production volumes and revenue.

*Poor leaders in roles with direct impact on sales or production cost much more.*

Special considerations apply for job leader roles that have a direct impact on key results. Sales managers, production / manufacturing managers, field service managers, and customer service managers fit this category. I'd invite you to consider two specific leader roles - the sales manager and the manufacturing manager.

## Enterprise Revenue Growth Opportunity Cost

Through employee engagement and employee turnover leadership has a significant effect on revenue. It does so by inhibiting the ability to keep current customers, acquire new ones, increase sales productivity, improve quality, and pursue growth opportunities. This can result in a 60% to 130% lower growth-rate (Burchman, 2000; Bassi, and McMurrer. 2007).

Poor leadership impacts customer satisfaction and researchers say that every 1.3% increase in customer satisfaction scores corresponds with a subsequent 0.5% increase in revenue growth (Rucci, Kirn, and Quinn, 1998). Best-in-class service providers typically achieve customer satisfaction ratings of above 85%, while average providers score around 75% (American Customer Satisfaction Index). For the typical average performing organisation, this translates into a 7.7% reduction in revenue growth. But in my experience, in my corporate career and with our clients, the impact is non-linear above a 90% customer satisfaction index

where each 1% improvement in customer satisfaction scores can translate to around 5% revenue growth; a finding that correlates with the Burchman and Bassi research referenced above.

*The total annual cost of each average and poor performing leaders is more than \$420K per leader per year.*

Smaller companies average just under \$200K revenue per employee, while Fortune 500 average just over \$300K revenue per employee ([www.hoovers.com](http://www.hoovers.com)). You calculate this number for your own organisation. So, if we assume a team of 9 and conservatively work with \$200K per employee then the team should be contributing around \$1,800K per annum and the growth opportunity cost is  $\$1,800K * 0.077 = \$140K$  per leader per year. Add this to previous calculations and the total cost, at over \$400K, is more than three times the DDI estimate.

### **The Lost Revenue Cost of a Poor Sales Manager**

Average salespeople earning about \$82K in direct salary sell on average \$3.0 million worth of goods or services (Sloan and Spencer, 1991; Martin, 2013, ABS, 2016; Living in Australia, 2016). And superior salespeople, who are one standard deviation above the mean, sell 120% (\$3.6M) more; i.e. they sell goods and services worth \$6.6 million (Sloan and Spencer, 1991; Hunter, Schmidt, and Judiesch 1990). This 120% difference between superior and average salespeople is at the top end of the 48% to 120% range found by Hunter Schmidt, and Judiesch. And its is also consistent with our experience in modelling top sales performers where we've found the productivity difference is typically well above 100%.

I propose to be conservative and only work with the value of one standard deviation - when I know the Pareto performance spread implies I should be using at least two times this number. I also propose to be more conservative and only consider economic value add from additional margin (vs. revenue) to calculate the cost of poor sales leadership. I'll assume 25% gross margin on sales. The value add is still an amazing \$925K for one sales person. Multiply this calculation across a team of 9 sales people and the average annual cost of poor sales leadership in one team can be near \$8M (adding lost margin and lost productivity and turnover costs.)

### **The Lost Production Cost of a Poor Manufacturing Manager**

In (Hunter, Schmidt, and Judiesch 1990) there is a worked manufacturing example where a 30% increase in production productivity for a manufacturing team of four people equates to an economic value add of \$9.8M in revenue. Again I will assume a 25% gross margin on the additional production and only look at the economic value add of the gross margin. The result is a conservative cost for poor leadership of a manufacturing team of 9 people can be near \$5M.

## **How to Get Effective Leadership Performance Improvement**

The links between leadership, engagement, discretionary effort, productivity and profitability are well established, with best employers delivering on average 22% more profit per employee and double the revenue growth of other organisations (Gallup 2013). Despite evidence that organisations that achieve sustainable leadership improvement perform better than those that don't, only 31% of Australian and New Zealand organisations are improving employee engagement levels and business performance. This supports executive beliefs that the majority of the leadership development programs are not delivering leadership improvement or team performance improvement.

The average spend on leadership development for first-line through middle managers ranges between \$2.5K and \$4.7K, respectively (Schwartz, Bersin, and Pelster, 2014). This suggest investing an effective leadership development that actually produces leader on-the-job behaviour change and improved business results should deliver an attractive ROI. How? Assume a \$4.7K leadership development investment. Add another \$4.5K in implementation costs (e.g. made up from \$1K for follow-up leadership analytics, \$1.5K for the leader's time in the classroom, and \$2K for coaching support from internal and external sources.) Assume

*When done right leadership development delivers better than 400% ROI.*

the development is effective and reduces the conservative \$126K DDI cost of poor leadership by only 33%. The ROI is a minimum 300%. The payback period is less than 4 months. If my estimate for the cost of poor leadership applies then the ROI is going to be at least 3 times that number - i.e. 900%.

There is general consensus that good leaders make a difference and that effectively upgrading leader capabilities is a worthy investment. Three quarters of CEOs and senior executives believe that it is important to develop the knowledge and skills of their leaders (Ashbridge, 2008). Yet the track record of leadership development is disappointing - the same survey reported 7% of executives believed leadership development in their organisations was effective.

There is no shortage of published material on leadership development. An Amazon search lists over 60,000 books on the topic. A Google search lists over 33 million links. There is plenty of content and there are numerous suppliers and training options. The problem is that organisations struggle to link their leadership development efforts to clear business goals, focus them on the core set of leadership qualities that build enduring high performing teams, integrate them with broader management processes and measure all dimensions of outcomes.

## Single Event Training Has a Poor track Record

Have you asked yourself, "What's the return on the money and management time invested in my existing leadership training programs, and how can I improve it?" Too often organisations default to off-the-shelf leadership training with little relevance to their business goals. A much more systematic approach is needed, integrating learning with the company's strategy, management processes, real-world performance improvement projects and performance measurement systems.

Leadership development is a process. One that starts with the required performance improvement, then the capabilities required to deliver it.

*87% of skills learned in single classroom event training are lost within 1 month.*

The traditional model of leadership development focuses on training as a one-off or tick-in-the-box event, not a process. It is well documented that adults retain only 10% of what they have heard in lecture-based training sessions (Rackham, 1979; Equation Research, 2004). Another study by the American Society for Training and Development (ASTD, 2010) reported that only 13% of participants applied the learning in the

workplace and 3% of training led to an impact on the organisation. Such results contribute to failed training investments and the astute sceptical senior executives I referenced earlier in this paper.

Some argue that when it comes to leadership, the training industry has been broken for years because you don't train leaders you develop them – an important distinction lost on many. The terms training and development have somehow become synonymous (like management and leadership) when in both cases they are not. One leadership development practitioner says "Leadership training is alive and well, but it should have died long, long ago." (Myatt, 2012)

Leadership training is often a rote, one directional, one dimensional, one size fits all, authoritarian process that imposes static, possibly irrelevant, information on attendees. The majority of training takes place within a monologue (lecture/presentation) rather than a dialog. Researchers (Kolb 1984; Boyatzis and Kolb 1991) showed that adults can't learn merely by listening to instructions; they must also absorb the new information, use it experimentally, and integrate it with their existing knowledge. When people learn by doing (e.g. role plays, simulations, on-the-job application), 65% of the learning is retained. And when they practice what they have learnt in the workplace for some weeks, together with real time observation and coaching from their manager or a coach, and with frequent performance analytics assessing their behaviour changes and providing feedback, almost all of the learning is retained (Rackham, 1979; Whitmore, 2009).

## The Four Keys to Successful Leadership Performance Improvement

For some time my team has helped clients with leadership development in a slightly different way; one that plugs the gaps in traditional leadership development methods. Our approach has helped our clients to consistently achieve leadership and business performance success. The results have been so consistent that we offer a guarantee with our methodology. We note that some other respected leadership development vendors are now advocating a similar approach.

There are four keys to deploying successful leadership development programs that reduce the cost of poor leadership and deliver rapid performance break-thru.

- 1. A clear business outcome.*
- 2. Address mind-sets & skills.*
- 3. Integrate the process in BAU.*
- 4. Report changes and results.*

### 1 Build Leaders for a Clear Business Purpose



Define an 'Intention' and 'Outcome.' Clearly define, "What is the program for?" and, "What is the measure for success?" Context matters. If it is for growth, then leaders that can nurture and build sales talent are required. When you focus on the outcome and the context it inevitably means focussing on a small number of competencies; perhaps one to two that will drive the desired performance. Competencies are high level clusters of capabilities. A competency like 'coaching skills' will include five to seven capabilities like 'questioning' and 'listening.' So, when the outcome is

productivity improvement, the critical subset of leadership competencies may just be seven habits.

It is critical to couple classroom 'thinking' and 'experiential learning' with 'real work.' Tie leadership development to real on-the-job projects that have a business impact and where the application will improve the learning. Business-outcome-focused programs produce more sustainable impact than off-the-shelf, academic leadership training programs. When we work with clients they usually name the program something like 'Service Break-Thru' or 'Productivity Break-Thru' or 'Sales Break-Thru' to underscore the operational outcome orientation and of the project. Although it's leadership development, it fits within a wider 'Performance Break-Thru' framework. McKinsey (Ewenstein, Gurdjian, Lane, and Webb, 2010) talk of one client who named a leadership development program as 'Strategy Implementation', banning reference to the words 'leadership' or 'training', to emphasise the business performance and delivery intention of the work.

Leaders, no matter how talented, often struggle to transfer even their most useful off-site learning experiences into changed behaviour on-the-job. Companies can make each business project a leadership-development opportunity as well, and to integrate leadership-development components (e.g. change management) into the projects themselves.

Using leaders' real work issues as material for application and practice (rather than abstract examples) generates immediate tangible results for the business and provides more sustainable learning. McKinsey describe this approach as 'forum' and 'field.' (Ewenstein, Gurdjian, Lane, and Webb, 2010) Managers learn in group settings and practice challenging scenarios with one another. They leave the forum with an action plan, shared with the broader group, and their immediate manager, to apply their learning in the field around team performance improvement. Application in the field, with coaching support from their immediate supervisor, their peers, and expert coaches, is where the bulk of learning takes place.

### 2 Make Allowance for Mind-Sets

Strengthen 'who leaders are,' not just 'what they do.' Becoming a more effective leader often requires changing behaviour which is best accomplished by adjusting underlying mind-sets. Identifying some of the deep, 'below the surface' thoughts, feelings, assumptions, and beliefs is usually a precondition of lasting behavioural change; one too often shirked in development programs.

For example, delegation will not succeed with a 'controlling' mind-set like "I can't lose my grip on the business. I'm personally accountable and only I should make the decisions." Staff development will be compromised when you have a 'fixed mind-set' perspective regarding team member's abilities vs. a 'growth mind-set' (Dweck CS, 2006 and Briceno, 2012). People can change the way they see the world and their values; it requires a combination of experiential learning and 'limiting belief' change processes. Teaching performance management processes will fail if leaders do not also develop the emotional resilience needed for tough feedback conversations.

I often talk about leadership development as a sequential process of Be, Do and Have:

1. Be (being self-aware and being aligned with your values), and
2. Do (set goals and act using effective situational relevant leadership practices), and
3. Have (achieving successful outcomes).



The 'Be' foundation includes mind-set elements like self-awareness, self alignment, intrinsic motivation, and resilience. Without these the 'Do' or implementation falters. Too many leadership programs skip these personal aspects in favour of 'Do' practical content and process learning. Include the important 'Be' starting point to help your leaders to understand how their behaviour is experienced by their teams and peers with profiling and analytics tools. And use tools that give you actionable insight. Often we've heard clients complain about the data they already have saying, "I have so much detail I don't know where to begin." or, "The information is so high level that I don't know what action to take."

Help your leaders to perceive their underlying values, limiting beliefs, needs and fears that often unconsciously drive their behaviours. In this way, they can understand the source of behaviour patterns they want and need to change and make lasting shifts in the way the work, rather than making superficial changes that will not stick. It is simpler to identify and clean up limiting belief sets, within the boundaries of effective leadership, and to help leaders to anchor resourceful mind-sets for situational leadership than you might think. And leaders often talk to us about the relative ease and speed they experience in changing habits when we help them to make second order (mind-set) or third order (belief) changes as part of the development process.

### 3 Deploy Leadership Development as a Process

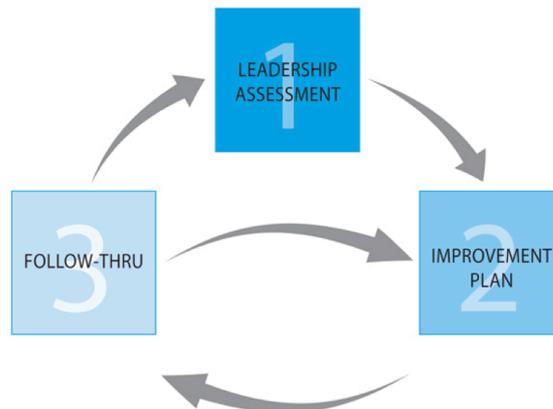
Take action to aid managers to apply what they already know, as well as to help them learn on the job, not just through formal training. Some companies talk about a 70:20:10 (McCall, Yost McHenry, O'Connor, and Plunkett, 2014) rule of thumb approach to training and development. The intention is 10% of learning through formal training, 20% from others and 70% on-the-job. According to the Conference Board and DDI (Sinar, Wellins, Ray, Abel, and Neal, 2015) leadership development occurs at a ratio more like 52:27:21. To make it simple to remember, they say 55:25:20 - although the point is this represents double the classroom learning.

One might argue that 'learning from others' occurs on-the-job so the ratio is confusing. And for some people the ratios can have the effect of emphasising the separation of the different types of learning rather than seeing them as synergistic and ideally integrated. Remember, the 'numbers' and ratios are not some type of target. That said less than 5% (Bower, 2014) of organisations have put in place the processes that manage this mix of leadership development for their managers. If you expect managers to improve their on-job leadership performance you need robust processes in place to ensure they do actually learn on-the-job and through others. Without these processes, and measures of each, learning doesn't occur, or it happens in a black hole, and on-job leadership performance doesn't improve.

Another problem here is that if your organisation is like most, while you might provide formal leadership training, you're unlikely to have in place robust processes to help managers apply what they know back on the job, to measure this, or continue leadership development outside the classroom. Build a

'leadership performance improvement engine,' not just a series of stand-alone in-house or out-sourced workshops. Entwine leadership development within the talent and performance management processes.

This means a paradigm flip is required. Traditionally leadership development is seen as the realm of the Human Resources (HR) or Learning and Development (LD) function. An integrated leadership engine requires the leadership development process be the responsibility of the organisation's leaders with support from HR or LD. Intuitively this makes sense. Because who else, other than your immediate manager, has the self-interest and the authority to establish agreed performance contracts with you, coach and mentor you, then demand transparency and accountability for your leadership performance improvement?



The best companies make leadership development a part of what all leaders do. They still draw on a network of internal and external resources (including corporate universities, external faculty, industry experts, consultancies, and coaches). They also mandate that internal leaders play active roles in leadership programs and the leadership performance improvement system - of course with HR support.

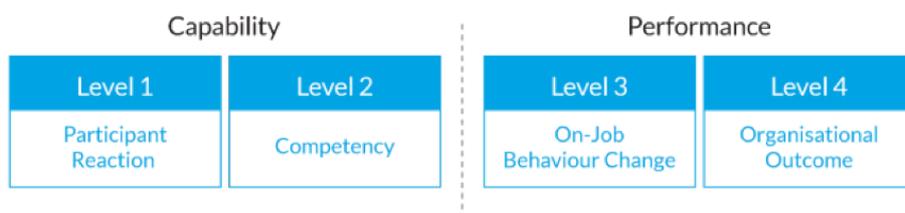
#### 4 Measure Results

Corporations and executives spend a lot of time managing the balance sheet. Currently the global supply of capital is high and the real cost of borrowing (allowing for tax breaks and inflation) for many companies is close to zero. Today, financial capital is relatively abundant and cheap. In contrast, little time is invested managing human capital. Human capital - the time, talent and energy of your workforce - is today's scarcest resource. Time is finite. Difference-making hyper performer talent is scarce. Inspired engaged employees are rare and are reported to be 3 times more productive than dissatisfied employees.

Financial capital is plentiful and cheap and carefully managed; human capital is scarce but not carefully managed. Why? In part, it's because we value and reward good management of financial capital. And we measure it. How can we manage human capital better? Start with measuring it. You can't manage what you can't measure.

It's critical to track both observable shifts in leadership behaviours and the consequential business results. In my experience, most organisations do a poor job measuring mind-set and leadership behaviour - things they describe as 'soft' or 'fuzzy.' When businesses fail to track and measure changes in leadership performance over time, they increase the odds that improvement initiatives won't be taken seriously. Further, when evaluation of leadership development begins and ends with training participant feedback and classroom competency (Kirkpatrick Levels 1 and 2 in the image below); the danger is that trainers learn to play the system and deliver a syllabus that is more pleasing than challenging to participants. The best leadership programs tailor a 'from present ability to desired ability' program for each participant using some form of leadership analytics.

### LEADERSHIP TRAINING EVALUATION



One approach is to assess the extent of behavioural change, through a 180 degree or 360 degree feedback assessment. Assess at the beginning of a leadership program and again after four months and thereafter at four to six months intervals. You can use this approach to integrate your leadership performance improvement process with the 90 day rhythm of the business. Mind-set analytics and behaviour analytics are useful for tracking the baseline, measuring, establishing transparency and accountability.

It is important to sustain the measurement of impact long after the program ends. I've seen clients let the leadership behaviour measurement lapse, only to see an almost immediate lapse in business metrics, and then fast recovery when they reinstated the leadership analytics.

Finally, measure the business impact, especially when training is tied to business performance improvement projects. ERP systems usually make measurement simple. And there are well documented and robust methods for doing this and quantifying project impact when many factors drive KPI (e.g. Impact Measurement Framework, Bersin, 2006 and 2008; ROI Framework, Phillips and Phillips, 2007, 2009, 2010, 2011). Companies must measure behaviour change and business results to show evidence to quantify the value of their investment. Doing so will build greater support among senior executives for the investment. In my experience it is the norm to see effective leadership development programs deliver margin improvements that are more than four times the investment - this needs to be reported.

### Examples of Client Results Using the Four Keys

A water utility client attributes an 85% reduction in overtime, a drop in cost per job of more than 15%, a 31% increase in job first fix rate, a 12% increase in productivity, clearing of their significant jobs backlog and retiring of external support contractors, increased and consistent customer satisfaction rating, and consistently coming in under costs budget to the leadership development we provided through our Productivity Break-Thru system.

A large residential security services provider attributes a rapid improvement in employee engagement, tripling of sales productivity and 22% improvement in operational productivity to the models of sales expertise and leadership development we provided through our Productivity Break-Thru system.

A mining company attributes a 22.4% increase in mining crew productivity, at an open-cut mine, to the models of operator expertise, truck driver expertise, leadership development and the Productivity Break-Thru system we provided.

### A Change Management Framework

While it's easy for me to list the four keys to effective leadership performance improvement, it unlikely to be so simple for you to go and implement them in a non-disruptive way, unless you've done something like it before. Get help, if you need it. As you'd expect there are detailed complete change management frameworks, effective methodologies, products, and tools that address all the elements of the four keys. And the changes are such that they can be integrated with 'business as usual.' With the high ROI you can anticipate it is usually possible to get senior executive support for the investment in help.

And organisations like mine also offer results guarantees. We partner with clients in several ways ranging from 'teach your in-house resources to employ our methodology and relevant support tools' through to 'we co-deliver and support you every step of the way.'

### Conclusion

The case that leaders impact employee engagement and business performance is compelling.

Sources estimating the cost of one poor leader, over one year, at between \$125K and \$200K are overly conservative.

The prevailing cost of poor leadership estimates are low for three primary reasons:

1. They assume a Gaussian performance distribution curve. But the evidence is that leadership and front-line performance follows a Paretian curve 94% of the time. As a result the difference in performance between poor and average leaders, and their teams, and hyper performing leaders

and their teams, is more than two standard deviations. In addition at least 80% of leaders are defined as low performing.

2. They assume the front-line leaders and their teams do not have significant impact on enterprise performance, when the counter intuitive opposite is true. Special considerations apply for front-line leader roles that have a direct impact on key results. These include sales managers, production / manufacturing managers, field service managers, and customer service managers. The revenue leverage they have from sales and productive output extends well beyond the salary cost of low productivity and turnover.
3. The exclusion of leadership impact on employee wellbeing; because historically it has been difficult to measure and assign costs. It is now possible to measure. A person's relationship with their immediate supervisor is a key driver of that individual's wellbeing. And human wellbeing may be the single most important issue for our population, economy and way of life.

As a consequence the predominant assumptions about the relatively low cost of poor front-line and middle manager leadership are flawed. This is important because it leads to flawed corporate decision making, assigning a low priority and budget to the imperative to improve leadership performance. When the allocation of scarce corporate capital to projects is based on bad data and inaccurate assumptions then lower returns are realised. It's clear that effective leadership performance improvement is urgent, immensely important and highly valuable.

In addition, for the organisations stuck with poor and average managers, other programs a company institutes to increase employee engagement and performance (e.g. rewards, career paths, stimulating work environments and benefits) will be at best compromised and at worst wasted investments.

There are four critical elements of leadership development that can rapidly improve leadership performance. All four are only rarely addressed by corporations. All four must be addressed systematically and consistently to realise the full latent potential within leadership performance improvement. They are:

1. Start with a business purpose / commercial outcome in mind. Then identify the skills required.
2. Start with and address leader mind-sets. Leaders must be internally congruent before they can master situational leadership.
3. Treat leadership development as a non-disruptive process integrated into the rhythm of the business. It is not a series of stand-alone training events.
4. Measure the results of your leadership development interventions. Measure the baseline, the classroom experience, the classroom competence level, the mind-set shifts, the on-the-job behaviour changes, employee engagement and business results improvements.

Address these four keys and leadership improvement will quickly deliver one of highest ROI's through significant measurable commercial benefits.

As you'd expect we offer comprehensive change management frameworks, effective methodologies, measurement products and tools that address all the elements I discuss in the four keys. Contact us if you'd like to know more.

## About the Author and Onirik

*Geoffrey (Geoff) Wade (BSc, BE, GCNLP, MBA) is the Founder of Onirik.*

*Onirik helps clients accelerate people performance for profit improvement. Using the technologies of neuroscience, modelling expertise, and change management - practical and non-disruptive programs have been developed for fast and lasting commercial results.*

*For more information you can email the author using the link <http://www.onirik.com.au/contact-us/>*

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