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Leadership

The five new foundational qualities of effective leadership

CEO succession planning has never been harder. But there are questions leaders can ask today to help better prepare for tomorrow.

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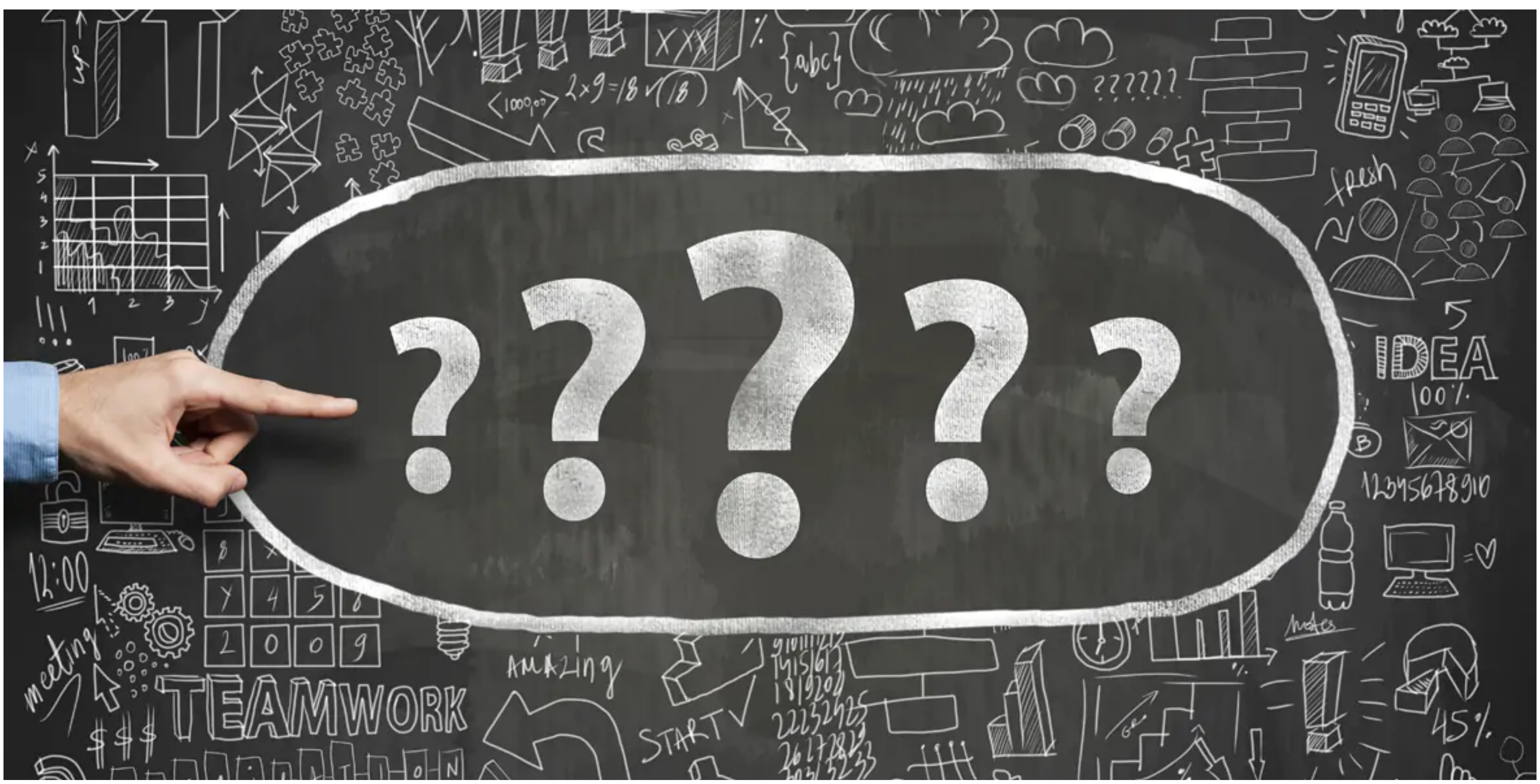

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From the start of the postwar era to March 2020, boards judged business leaders' effectiveness primarily by their ability to maximize efficiency and deliver steady performance. Financial outcomes and shareholder value were the key metrics, and an important measure of a CEO's impact was their ability to meet earnings guidance to the penny. Manufacturing systems and physical assets accounted for the majority of a company's value. That turned the pursuit of efficiency into a discipline, like a martial art, with leaders aspiring to earn black belts. For most of this era, governments worldwide worked to make it easier for capital to follow cheap labor. Globalism gave CEOs and boards a generally stable platform for driving long-term growth, punctuated by the ups and downs of economic cycles and a few financial crises.

The last few years have brought real change. Balance sheets today have significantly more nontangible assets—intellectual property and digital capability, for example—than ever before. And a series of tsunamis have buffeted the ship of capitalism: stakeholder activism, geopolitical tension, technological breakthroughs, and macroeconomic shifts. In this new landscape, definitions of "good" leadership are continually being rewritten. Issues that were seen as lesser priorities even a few years ago—environmental, social, and governance (ESG) and diversity and inclusion—are now front and center. CEOs are expected to be fluent in addressing this ever-expanding set of concerns. "The external pull is becoming so great—to manage issues and pressures and activism—that to be the CEO in our traditional sense is becoming impossible," a board member at a Fortune 50 company told us. "We have to rethink the role."

Our work with boards, CEOs, and C-suite teams across many industries brings us into daily discussions on this topic: how must we define effective leadership when the starting assumption is that the environment is unstable and assets are largely intangible? There's been a shift from quantifying leadership through metrics, which are meant to lend a scientific air to executive assessement, to understanding the qualitative attributes that lead to success. It's about how leaders behave, how they build teams and develop talent, and who they are—not just the numbers they produce. From all these wide-ranging, highly contextual discussions, consistent patterns are emerging. These patterns cast doubt on the effectiveness of the traditional focus on "competencies" and CEO psychometrics, and instead bring a rigor and realism to conversations.

One example of how fast-moving this shift has been: numerous leaders who were at the top of the CEO succession list in 2019 are no longer deemed fit-for-purpose by company directors. Instead, boards are looking a layer or two deeper for leaders with less attachment to hierarchy or predictability. In the 10 to 15% of organizations we have worked with in which the 2019 top successor is still viewed as the best choice, those executives have often made significant, overt shifts in their leadership approaches.

Here are five key questions to ask of tomorrow's leaders that define the foundational qualities required for success.

1. Can they lead with a compass when there's no map? Strategy documents laying out detailed, multiyear road maps are no longer realistic. Today's leaders have to be able to establish a compelling destination and then navigate through the fog with a compass. "You have to be ready to make a decision today, realizing that you may get new data tomorrow that means you have to reverse the decision you just made," a veteran CEO of a Fortune 25 company told us. "You have to have the courage to follow that new information. The job's always been ambiguous. But the environment has never been this fluid."

Boards and CEOs expect succession candidates to be adept at providing direction and key performance indicators that will signal whether course adjustments are necessary. "We're living in an age with many more discontinuities than we had a generation or two ago," said Mark Thompson, former CEO of the New York Times Company and now board chairman of Ancestry. "It's not about trying to find the perfect strategies. It's more about helping organizations to be more open, flexible, and adaptable to change."

This shift demands a more dynamic, individual leadership approach, as well as a reimagining of basic organizational processes. Siemens, the multinational industrial conglomerate headquartered in Germany, did away with tracking employee performance against annual targets, a long-established practice that Barbara Humpton, the CEO of Siemens USA, called "performance-management theater." Instead, Siemens developed a framework for leaders around four company-wide priorities—customer impact, technology with purpose, growth mindset, and empowerment—and encouraged employees to embrace disruption. Leaders were expected to be in constant communication with their direct reports about progress against those goals.

"We also had this industrial-age idea that there was a perfect image of a leader, based on, say, ten characteristics that you would rate on a scale of one to ten," Humpton said. "Are you a 100-point leader, or are you somewhere in between zero and 100 and you need to develop? We abolished that model completely." Though many factors go into driving performance, the approach certainly hasn't hurt the company, which grew 8.2% in its last fiscal year.

2. Have they embraced uncertainty as a team sport? Comfort with ambiguity—a long-standing fixture in the field of leadership assessment—is no longer a useful measure, given that ambiguity defines the role today. The more pertinent metric is whether a leader can instill *adaptability* as a core skill across the enterprise. This requires leaders to create a shared narrative to drive home the organization's comfort with uncertainty. In effect, the message to the organization becomes: "The future is uncertain, but we are built for that."

When Sasan Goodarzi, an 18-year veteran of US software company Intuit, was named chief executive in 2019, he wanted to refocus the culture more on what could go right rather than what could go wrong. Goodarzi intentionally referred to his team's five enterprise priorities as bets. "We use the word *bet* to convey that it's a new chapter [and we] have the courage to take big swings, and to know that we are going to take additional risks," he said. "We will fail, we will miss, but we will get more right than we will get wrong." So far, results have beat market expectations.

3. Do they walk their talk? With the rise of stakeholder capitalism, leaders face scrutiny from a broad array of constituents, including shareholders and employees. When a gap appears between what leaders say they'll prioritize and what they actually do, they will be called out.

At a large technology company, for example, the CEO rallied employees and investors with a compelling vision for how the company could reshape the future of work by the way it operated for the long term. But day-to-day, employees only heard managers focus on quarterly performance. In our dozens of interviews with senior and middle managers at the company, they questioned whether a vision for the future still existed. "We have a financial strategy, not a business strategy," one VP said.

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The leadership team was shocked with the feedback but recognized that the business reviews and town halls emphasized quarterly financials. "We've failed to role model how to orient the company toward a long-range destination. We have to change that," said one EVP. Over the next nine months, the senior team traveled the globe reminding employees of the vision, emphasizing that near-term metrics served only as milestones. Engagement and clarity improved, and the company is outperforming its peers today.

Board members and CEOs evaluating C-suite candidates are increasingly applying a simple test early in the vetting process: have the candidates' stated goals in running their business matched the way they have allocated capital, talent, and other resources? "If you say something is important, does your budget *show* that it's important?" said Bob Brennan, a board director whose long career has included four CEO roles. "If a [leader] were to say to me, 'Let me tell you about my strategy and the prioritization,' I would say to them, 'Show me your operating expenses, and I'll read you back your strategy.'"

Gaps between a leader's actions and words, particularly at the CEO level, create reputational and performance risks for the enterprise. Boards want to see candidates with a track record of minimizing such gaps.

4. Have they demonstrated mastery of the matrix? After decades of designing organizations primarily for efficiency and to deliver predictable outcomes, operating structures now need to adapt to respond to greater complexity. Modern matrix structures make a company more responsive to customer or client needs. But a matrix presents a leadership gauntlet. Its intricacy can mire executives in endless meetings and unclear decision rights, slowing the pace of the entire organization. Effective CEO candidates use the matrix differently, encouraging cross-discipline thinking and ways to unlock innovation—and they teach others to do the same.

"Traditional business school training is silent on how to effectively lead a matrixed organization," the CEO of a US$7 billion technology company told us. "Yet those leaders who embrace its advantages and get skilled in matrixed leadership end up harnessing the full capabilities of their teams." He learned this lesson after his company's efficient but centralized operating model caused it to lose a step to more nimble competitors. So it shifted to a slightly more complex structure that moved R&D closer to customers, improving response time but requiring more collaboration. "The results show up in financial, customer-satisfaction, and employee-engagement terms," the CEO said.

To be effective, colleagues have to invest time and energy to build trusting relationships across matrixes. Without a shared sense of team, people can default to seeing their own business unit as "us" and their peers as "them." Boards and CEOs are on the lookout for leaders who take deliberate steps to work with colleagues in pursuit of shared goals. This requires leaders who can define what winning means within a matrix.

"The first thing is the concept of shared success and understanding the metrics that people get measured on in the matrix," said Sowmyanarayan Sampath, CEO of Verizon Consumer Group. Leaders can fall into the trap of having a want-it-all list of priorities that sends mixed signals and sets up their organization for internal conflict as teams fight over resources and priorities. "If somebody in supply chain wants to take out cost, and somebody else is focused on driving revenue, there is no amount of conversation and coaching that can fix that misalignment. So you have to have clear metrics," Sampath said. And those measures should reflect hard choices, he added: "If you are able to prioritize easily, it probably means [your choices] don't carry any trade-offs, which means the priorities are kind of bogus."

5. Are they really who they say they are? Directors are emphasizing a new threshold question about candidates: who are they as people? In a world where *everyone* is a stakeholder and any internal communication is likely to circulate publicly, boards want to understand the values that C-suite candidates bring to the table, how those values guide their decision-making in the face of uncertainty, and whether their self-awareness is high or low.

Getting this wrong can wipe out billions in valuation. An example: Steve Easterbrook was fired as CEO of McDonald's when it was revealed in 2019 that he had violated company policy by having a relationship with a colleague. The company's share price dropped as much as 3%, erasing US$4 billion in value.

The question about values—aside from coming up in reference checks—is not accounted for within traditional competency modeling, psychometric tests, and succession protocols. The leadership industry's primary focus has been to compare a candidate's scoring on competencies (such as strategic thinking, comfort with ambiguity, and executive presence) against those of other executives in their datasets. The binders produced for each candidate are presented as if they were scientific findings to show board members whose profile is the safest bet. "I think companies too often overengineer succession in pursuit of an unachievable sense of certainty," said Matt Breitfelder, global head of human capital at Apollo Global Management. "All candidates are a mix of strengths and weaknesses that are pretty easy to sum up. The more interesting question is, are they leaders people want to follow?"

Character, of course, is not a science, but a question of lived values. And values do not lend themselves to clinical deconstruction that approaches CEO selection as if it were a "clean room" exercise in building an ideal executive. There is no single, abstract set of "right" values. Rather, there are the values of actual candidates, weighed against the organization's strategic and operating realities, and set against a backdrop of external stakeholders and macroeconomics. Character demands a nuanced conversation, and clarifying each candidate's demonstrated values should set up the right succession discussion, rather than seeking to provide simplistic answers.

From our boardroom experience, we have developed two simple frameworks—an authenticity index and a self-awareness index—to better inform those conversations. To gauge authenticity, we ask an executive to choose ten from a long list of values that they hold dearest. We then ask 20 to 30 people who work with the executive to select from the same list the top ten values that best describe the leader. Comparing the candidate's top ten to their assessors' top ten starkly illustrates whether the leader shows up in the world in the way they intend. Having little to no overlap in the two lists is a red flag, but so are high-contrast misalignments. If the leader cites "accessible" or "approachable" as a key value, for instance, but assessors select "political" or "information-hoarding" instead, boards can factor such disconnects into their decision-making.

The self-awareness test starts without any lists—just open questions. A leader is asked to identify their top strengths and development areas. Then the same questions are posed about that leader in detailed interviews with ten to 15 people who work closely with them. The results provide fodder for two distinct board discussions. First, if the leader's self-described areas of strength or areas for improvement bear little overlap with those cited by assessors, the board can decide: how much does self-awareness matter in our next CEO? Second, if there is strong correlation between how others view the leader and how the leader views themselves, how do those strengths and development areas align to the needs of the company's strategy?

This nuanced approach does not offer false certainty, but it does reflect the complexities of modern leadership and the challenges inherent in top jobs. These new foundational principles, taken together, require a departure from longstanding traditions that developed during a much more stable era when "good" leadership had the luxury of a much narrower focus. That boards and CEOs alike are calling for such changes is a recognition that the systems and structures built to deliver smooth and steady growth in a much more predictable world no longer work—that they have become, to borrow Barbara Humpton's phrase, "performance-management theater."

With uncertainty as today's primary certainty, definitions of effective leadership must match the macroenvironment *and* the organization's specific culture and context. The five questions above help boards have better conversations, drive higher quality decisions, and build more sustainable foundations for their organizations.

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